BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Avista Corporation's) Petition for Recovery of Expenditures) Related to Electric Deferral Mechanism) ______________________________________)	**DOCKET NO. UE-010395**

BRIEF OF COMMISSION STAFF ON AVISTA'S REQUEST FOR EMERGENCY RATE RELIEF

September 17, 2001

TABLE OF CONTENTS

I. OVERVIEW 1

II. THE CONTEXT OF THIS CASE 3

III. SETTLEMENT STIPULATION ISSUES 5

A. The Requirements of the Commission's Orders in **Docket No. UE-000972 Still Apply 5**

B. The Settlement Stipulation Permits Petitions to Alter, Amend or Terminate the Settlement Stipulation 6

C. Avista's Petition is Permitted Since There Has Been Worsening Hydro Conditions, But the Extent to Which Power Cost Deferrals Were Otherwise Due to "Uncontrollable Events" Has Not Been Proven 7

D. Avista Says it Seeks to Alter or Amend the Settlement Stipulation, But in Substance, the Relief Avista Seeks Terminates the Settlement Stipulation 8

IV. THE STANDARDS FOR EVALUATING AVISTA'S REQUEST FOR EMERGENCY RATE RELIEF 10

A. Requests for Emergency Rate Relief Are Evaluated Pursuant to the Standards Established by the Commission in the "PNB Case" 10

B. The Emergency Rate Relief Standards 11

C. Under the Emergency Rate Relief Standards, the Commission Does Not Accept Long Range Forecasts 12

D. The Commission Does Not Approve Emergency Rate Relief for Specific Expenses. Avista's Claim that "No Standards" Apply to its Surcharge Request is as Alarming as it is Misleading 12

V. EVALUATION OF AVISTA'S FINANCIAL CONDITION AND RELATED ISSUES 15

A. Avista Needs New Revenues in Order to Meet Financing Covenants. A 32.6% Increase is Justified 15

B. Avista Needs a Plan to Establish a Level of Credibility With Wall Street That Avista Has Lost Through its Own Actions 18

C. Staff's Plan for Avista is the Only Plan Consistent With Commission Orders and Longstanding Commission Policy 20

D. Avista's and ICNU's Plans Are Not Consistent with the Commission's Orders in Docket No. UE-000972 22

1. Avista's and ICNU's Plans Violate the Commission's Orders in Docket No. UE-000972 by Requiring Premature Resolution of Recoverability Issues. The "Subject to Refund" Feature Is No Cure 23

2. Avista's and ICNU's Plans Also Require Premature Recovery of Deferred Power Cost Balances by Means of the PGE Monetization Credit. That Credit Should Not be Used to Offset Deferrals for Other Reasons as Well 26

E. The Deferred Power Cost Accounting Should Terminate Effective June 30, 2001 27

1. The Issues Surrounding Avista's Accounting and Reporting of Deferred Power Costs 29

2 Background for Avista's Deferred Power Cost Accounting 30

3. Avista's SEC Form 10-K for the Year 2000 (Ex. 505, second document) 32

4. The Importance of FAS 71 33

5. The Relevant Text of FAS 71 33

6. There Has Been No Compliance With FAS 71 Demonstrated With Respect to Avista's Deferred Power Costs. All Available Evidence Was Not Considered, Contrary to the Express Requirements of FAS 71 34

7. Conclusions on the Deferral Accounting Termination Issue 39

F. The Rating Agencies and Lenders 40

VI. ISSUES RELATED TO DEFERRAL AMOUNTS 41

A. Deferral Balances Should Not Be Allowed to Include Return and O&M Costs 41

VII. ACCOUNTING FOR SURCHARGE REVENUES 42

A. Staff's Proposed Accounting for any Revenues Received from Emergency Rates Properly Reflects the Subject to Refund Condition Proposed by All Parties. It Also Reflects the Fact Deferred Power Cost Recovery Issues Have Not Been Decided 42

B. Avista's Proposed Accounting for Any Revenues Received from Emergency Rates Improperly Assumes the Commission Has Made Decisions on Cost Recovery. Those Decisions Are Beyond the Scope of this Hearing 44

C. The Staff's Accounting Proposal Recognizes that Revenues Contribute to Consolidated Cash Flow for Purposes of Avista's Financial Covenants 45

VIII. RATE DESIGN ISSUES 48

A. A Uniform Cents Per kwh Rate Design Should Be Accepted Since it Reflects Cost Causation and is Supported by Longstanding Commission Policy. A Uniform Percent Approach Inappropriately Shifts Costs to the Small Commercial Class and Street Lighting Customers 48

IX. SPECIFIC RECOMMENDATIONS 51

X. CONCLUSIONS 52

I. OVERVIEW

This case is an emergency request by Avista to increase all electric rates 36.9% until the end of 2003. In the history of the Commission, there is no other emergency rate relief request that compares in magnitude or duration. There are major issues in this case regarding the amount and duration of the rate increase requested, whether deferral accounting should be continued, and how and when to address permanent, rather than temporary solutions to the problems facing Avista.

There is significant concern about whether Avista's power purchases were prudent. That issue is not before the Commission at this time. Nor is any other issue regarding whether Avista has met the conditions for recovery established by the Commission. This is clear from the directives of the Commission: "We are not addressing the prudence of these costs in this phase of this proceeding or other issues subsumed under Mr. ffitch's description of the deferred costs issues…". (ALJ Moss, Tr. 97:10-13). And it is confirmed by the Notice of Second Prehearing Conference (August 1, 2001) at 3, ¶¶ 12 and 14, in which the issues in this phase of the case are described. That description excludes recoverability issues, including prudence.

Instead, this phase of the proceeding is to evaluate whether Avista has qualified for emergency rate relief under the Commission's emergency rate relief standards. If so, what rate relief ought to be afforded? The other issue is whether deferral accounting for power costs ought to continue.

Staff's testimony directly addresses all of the issues set forth in the Notice of Second Prehearing Conference and the Second Supplemental Order in this docket. Staff is the only party to enunciate and apply the Commission's emergency rate relief

standards. Staff finds that Avista has a cash flow problem. Staff proposes a plan which provides certainty for Avista, its customers, and its investors, while adhering to the applicable orders and standards established by the Commission:

- Avista would be granted a substantial, 32.6% rate increase for 90 days, subject to refund;
- If necessary, Avista would seek continuation of an emergency rate increase by promptly filing a general rate case and proving it is entitled to interim rate relief;
- The Commission would proceed to a prompt and final determination of what deferred power costs are recoverable, and establish how those costs would be recovered;
- Deferred power cost accounting would terminate effective June 30, 2001 to reflect what the Commission ordered in Docket UE-000972.

As we demonstrate in this brief, Staff's plan is the only plan on this record that a) provides for a prompt and certain determination of which power costs are recoverable; 2) is consistent with the Commission's authority, as implemented by Commission decisions on emergency rate relief; 3) is consistent with the deferral accounting orders in Docket No. UE-000972.

Staff understands that its plan requires cooperation from Avista. Avista would need to promptly file a rate case, and a complete direct case on recoverability issues. Prompt responses to the significant number of data requests that are still outstanding is a must. (Elgin, Tr. 647:5-22). Staff also understands that Avista may not have a strong incentive at this stage to support any plan other than its own. But Avista is asking for an extraordinary amount of money from its ratepayers. In an emergency, it is eminently reasonable that extraordinary efforts be required of Avista to get the issues of recoverability addressed and resolved.

II. THE CONTEXT OF THIS CASE[1]

Avista's 36.9%, 27 month rate increase request is not filed in the isolated context of Avista's financial circumstances. It arises out of the Settlement Stipulation the Commission approved in the instant docket. It arises in the context of the Commission's orders establishing deferral accounting in Docket No. UE-000972. And it arises in the context of an apparent "sea change" in management approach and philosophy. Avista admitted it was "cleaning up … some things that occurred over the last couple of years that not everyone has, well, certainly few people are very proud of…." (Ely, Tr. 209:24 – 210:2).

In quick retreat from the strategy it once vigorously advocated and defended before this Commission, Avista is now attempting to return its focus to its core energy businesses. (Ely, Tr. 158:11-17). Whether this new strategy will succeed without further harm to ratepayers is yet to be seen.

This unfortunate situation was described not just by Avista's current CEO, Mr. Ely, but also by those public witnesses who expressed concern about Avista's alleged poor judgment and poor foresight. These witnesses opposed any attempt to bail out the utility at ratepayer expense. (*See e.g.*, testimony of Mr. Partch, Mr. Yuse, Mr. Post, Mr. Olsen, Mr. Biegler).

Other public witnesses offered that Avista has been the unwitting victim of circumstances beyond its control, and that if the increases are needed to provide a

[1] In this section, reference is made to testimony at the public hearing in Spokane. The transcript of that testimony was not available when this brief was written, so a general reference is made to the witness and his or her testimony. For the same reason, the spelling of some witnesses' names is phonetic, if the witness did not sign the witness sheet.

healthy, locally-owned utility, they would prefer that. (*See e.g.*, testimony of Ms. Ficca, Mr. Marr, Mayor Powers).

But if the public testimony is a fair indication, it is fair to say the overall level of public confidence in Avista has declined substantially. Avista has a lot of work to do in that regard. Proposing a 36.9% increase for 27 months, in the midst of an economic slowdown in the Spokane area, does not help. As Mr. Andresen, President and General Manager of Inland Empire Paper put it: "we have our own crisis." Many of Avista's other business customers are experiencing reduced production. This affects yet more Avista customers both "upstream" (*e.g.,* suppliers) and "downstream." (*E.g.* stores and recipients of recycling materials, for example). (*See e.g.,* testimony of Mr. Moors, Mr. Lampe, Mr. Ewers, Mr. Selfridge).

Another impact of economic slowdown is that workers who are also customers of Avista will have less money to pay large electric rate increases. (*See e.g.,* testimony of Ms. Parks). To some customers, the extent of Avista's proposed increase is the "last straw." (*E.g.* testimony of Mr. Stamper).

Foisting a disproportionate share of the rate increase on the residential or small commercial rate classes, as Avista and ICNU propose, is not the answer. Rate shock exists for these customers, too. It is also apparent that large rate increases can adversely affect the most vulnerable among us: persons with low income, such as students, the elderly, the disabled and others. (*See e.g.,* testimony of Ms. Roberts, Ms. Noel, Mr. Nelson, Ms. Moose, Ms. Yuse, Mr. Beamer, Ms. Horner, Mr. Partch, Rev. Tudor).

Many members of the pubic asked the legitimate question whether the Commission could find a different solution, including whether a more gradual rate impact

could be implemented. (*See e.g.,* testimony of Ms. Horner, Mr. Partch, Rev. Tudor, Mr. Tenold, Mr. Sondren, and Mr. Selfridge). Unfortunately, given the compressed schedule of this case, Commission Staff, for its part, cannot give the Commission or the public assurance that every stone was turned over, and every option thoroughly explored.

Two essential points merit emphasis. First, Avista might not actually receive the revenues it projects by raising rates 36.9%. Second, Avista bears the burden of proof in this case. RCW 80.04.130(2). In view of the very real and adverse impacts of a large rate increase, the Commission should approve only the very minimum increase it determines to be necessary, for the minimum time necessary.

SETTLEMENT STIPULATION ISSUES

There are several legal issues surrounding the Settlement Stipulation that were addressed during the hearings on Avista's emergency rate relief request. We have grouped them together here for analysis.

The Requirements of the Commission's Orders in Docket No. UE-000972 Still Apply

The Commission established the conditions for recovery of deferred power costs in its orders in Docket No. UE-000972. The Commission has ordered that before Avista may recover deferred power costs, it must prove:

That such costs were prudently incurred

That Company-owned resources have been optimized to the benefit of retail customers

That recovery of these costs through a deferral mechanism is appropriate

That the Company make a proposal for cost of capital offsets to recognize the shift in risk from shareholders to ratepayers, and

That the Company have a plan to mitigate the deferred power costs

Ex. 454, p. 2, Order ¶ 3 (August 9, 2000 Order in Docket No. UE-000972) and Ex. 456, p. 2-3, Order ¶ 2 (January 24, 2001 Order in Docket No. UE-000972). This list of conditions will be termed "conditions for recovery" herein.

There was some discussion on the record on the legal issue whether the conditions for recovery imposed on Avista in Docket No. UE-000972 still apply in the Settlement Stipulation environment. (*See e.g.* Tr. 618-19). But it is readily apparent from a reading of the Stipulation that these conditions for recovery still apply. Stipulation ¶ 2 states that "[t]he existing deferral mechanism authorized in Docket No. UE-000972 shall be extended through February 28, 2003, or until the deferral balance becomes zero, whichever comes first." Since recoverability requirements are components of the deferral accounting mechanism that has been approved, ¶ 2 is saying as plain as it can be said: The conditions for recovery in Docket No. UE-000972 still apply.

B. The Settlement Stipulation Permits Petitions to Alter, Amend or Terminate the Settlement Stipulation

On May 15, 2001, the Commission issued its First Supplemental Order in this docket, in which it approved the Settlement Stipulation, which is Ex. 1. According to ¶ 2 on page 3 of that Stipulation, Avista committed to a plan to reduce its power cost deferral balances to zero by February 2003. And deferral accounting "approved in Docket No. UE-000972" was "extended through February 28, 2003" in order to permit that plan to work. *Id.*

Avista's Petition arises under ¶ 4 on page 4 of the Stipulation. Under this paragraph, Avista is permitted to file a petition to "alter, amend or terminate the Settlement Stipulation (or propose other appropriate action) should the deferral balance increase or be reasonably anticipated to increase substantially due to unanticipated or

uncontrollable events, such as an unplanned outage of a large Company-owned thermal unit, or worsening drought conditions." Rate relief can be requested. *Id.* Other parties are not limited in the arguments they may make in response. *Id.*

C. Avista's Petition is Permitted Since There Has Been Worsening Hydro Conditions. But the Extent to Which Power Cost Deferrals Were Otherwise Due to "Uncontrollable Events" Has Not Been Proved

The hydro conditions underlying the Settlement Stipulation assumed hydro conditions to be 135 aMW below "normal." That level has deteriorated to a level of 194 aMW below normal. (Schooley, Ex. 401-T, p. 5:1-8). At the time of the Stipulation, Avista knew hydro could be 172 aMW below normal, and believed it could manage its power cost deferral to zero in that case. (*Id.* and Ex. 108-C, p. 6; Norwood, Tr. 373:12 – Tr. 374:17). However, there is no dispute that there has been a worsening of hydro conditions from what was anticipated. The deferrals continue to grow. So the Petition is permitted.

Whether the Petition is also permitted due to price level changes is less clear, for two basic reasons. First, though market prices are not controllable by Avista, Avista controls the timing of its purchases, the extent to which it hedges against price level changes, and the extent to which Avista is in a net deficit resource position under normal conditions. Avista is indeed a deficit utility, 90 aMW on average, even under normal conditions. (Norwood, Ex. 100-T, p. 9:9-10).

This deficit position has had significant and adverse financial consequences to Avista. Indeed, Avista conceded the obvious: it would not be in the position it is in today if it had more resources. (Ely, Tr. 155:21-23).

No definitive conclusions can be made yet about the extent to which price level changes were or were not beyond the control of Avista, since this issue is inextricably entwined with prudence issues. Those issues are reserved for later hearings.

In sum, it is sufficient to conclude that hydro conditions have worsened, and the result is substantially increased power cost deferrals. Accordingly, a petition to alter, amend, or terminate the Stipulation is permitted.

D. Avista Says it Seeks to Alter or Amend the Settlement Stipulation, But in Substance, the Relief Avista Seeks Terminates the Settlement Stipulation

The Petition Avista filed on July 17, 2001 in this docket seeks a 36.9% increase by September 15, 2001. How the petition is to be characterized is an issue in this case, because the Petition itself does not state whether it is a petition to alter, amend, or terminate the Stipulation. [2]

Avista stated at Tr. 53:16-19, "[t]he Company does not wish to terminate [the Stipulation]. It wishes to, you characterize it as alter or amend the settlement, and I think that would be a fair characterization." But that is not a fair characterization. If Avista's Petition is granted, virtually nothing of substance remains of the Settlement Stipulation. The radical changes now proposed by Avista destroy the integrity of the Stipulation. In effect, the Stipulation has been terminated.

Avista's Petition and direct testimony failed to itemize all the changes to the Stipulation and Orders that Avista seeks. Based on a review of the workpapers, Staff was able to uncover the following fundamental changes proposed by Avista:

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[2] The Petition itself does not state whether it seeks to alter, amend or terminate the Stipulation. The Petition at page 3 does refer to ¶ 4 of the Stipulation. But Avista's "Request for Relief" at page 19 of the Petition does not state what aspect of the Stipulation is being invoked.

- Avista seeks a 36.9% rate increase for 27 months. This requires a substantial ratepayer funding of deferred power costs, instead of Avista managing those costs to zero without increasing rates;

- Avista seeks to recover deferred power costs before proving the conditions for recovery enunciated in Docket No. UE-000972;

- Avista seeks to extend deferred power cost accounting from February 2003 to the end of 2003. This is a nearly 50% extension in time comparing the Stipulation (21 months: May 2001 – February 2003) to Avista's proposal (31 months: May 2001 to December 2003);

- Avista seeks to apply credits from the PGE monetization credit to offset deferred power cost balances, contrary to the amortization allowed in the last general rate case;

- Avista seeks to include operation and maintenance costs, depreciation, and return on investment related to new resources included in the deferral balances.

(Schooley Testimony, Ex. 401-T, p. 7:10-21). Obviously, these proposed changes leave intact little or nothing of the Stipulation. The Petition is more properly characterized as a petition to terminate the Stipulation and to replace it with an entirely different program.

IV. THE STANDARDS FOR EVALUATING AVISTA'S REQUEST FOR EMERGENCY RATE RELIEF

A. Requests for Emergency Rate Relief Are Evaluated Pursuant to the Standards Established by the Commission in the "PNB Case"

The Commission has a long history of evaluating utility requests for emergency rate relief. In *Washington Util. & Transp. Comm'n v. Pacific Northwest Bell Tel. Co.,* Cause No. U-72-30 tr ("PNB Case")(Second Supp. Order, 1972), the Commission established the standards under which it would entertain such requests.

The Commission held that its power for allowing emergency rate relief under these standards was inferred from *State ex rel. Puget Sound Navigation Co. v. Department of Transportation*, 33 Wn.2d 448, 482, 206 P.2d 456 (1949):

> A public utility commission having power to regulate in the public interest may, when it deems it justified, fix a temporary rate to be charged by a utility pending a valuation of the utility's property and the determination of a reasonable rate.

(Second Supp. Order in U-72-30 tr at 5). The Commission also quoted *Puget Sound Navigation* for the proposition that this power, subject to appropriate terms and conditions, was necessarily implied in the Commission's authority to suspend tariff charges. *Id.*

Since the PNB Case in 1972, the Commission has had several occasions to consider requests for emergency rate relief. In each case, it has followed the standards from the PNB case. The orders granting interim rate relief are listed in Mr. Parvinen's testimony, Ex. 551-T, p. 7:7-16. A review of those orders shows that the focus has always been on the overall financial needs of the company in the context of a general rate application, not single-issue cost recovery. In each case, additional revenues were

supplied to handle a specific, demonstrated need for cash flow for the entirety of the utility's operations.

B. The Emergency Rate Relief Standards

The Commission has applied the following six standards when evaluating requests for emergency rate relief:

1) The Commission has authority in proper circumstances to grant interim rate relief to a utility but this should be done only after an opportunity for an adequate hearing.
2) An interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity.
3) *The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient, standing alone, to justify the granting of interim relief.*
4) The Commission should review all financial indices as they concern the applicant, including rate of return, interest coverage, earnings coverage and the growth, stability or deterioration of each, together with the immediate and short term demands for new financing and whether the grant or failure to grant interim relief will have such an effect on financing demands as to substantially affect the public interest.
5) Interim relief is a useful tool in an appropriate case to fend off impending disaster. However, the tool must be used with caution and applied only where not to grant would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders. That is not to say that interim relief should be granted only after disaster has struck or is imminent, but neither should it be granted in any case where full hearing can be had and the general case resolved without clear detriment to the utility.
6) The commission must reach its conclusion with its statutory charge to "Regulate in the public interest" in mind. This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all salient factors.

Washington Util. & Transp. Comm'n v. Pacific Northwest Bell Tel. Co., Cause No. U-72-30 tr (Second Supp. Order at 13)(1972).

C. Under the Emergency Rate Relief Standards, the Commission Does Not Accept Long Range Forecasts

The Commission has previously directed that in evaluating requests for interim rate relief, long range forecasts are inherently unreliable and are to be avoided. Only short term forecasts are to be used:

> In exercising our statutory responsibility to regulate in the public interest we wish to note that the Commission, when considering a petition for interim relief will not consider or give weight to long-range economic projections but will concern itself only with an analysis of existing and actual conditions and short-range projections, which in the main are least subject to volatile economic winds and are more conducive to credible reliability than long range plans.

Washington Util. & Transp. Comm'n v. Washington Natural Gas Co., Cause No. U-80-111 (Second Supp. Order, 1981) at 3.

The wisdom of this policy is no more apparent than in this case. As we demonstrate later, Avista has a dismal record regarding its ability to project deferral balances in both the short and long run. Indeed, no interim rate relief order we could locate has even come close to granting relief for 27 months, as Avista requests.

D. The Commission Does Not Approve Emergency Rate Relief for Specific Expenses. Avista's Claim that "No Standards" Apply to its Surcharge Request is as Alarming as it is Misleading

Avista opined that its Petition "meets previously articulated criteria to be granted an immediate surcharge." (Ely, Ex. 50-T, p. 9:26 – 10:1). Yet neither Avista's Petition nor its witnesses ever stated these criteria or itemized their evidence under these criteria. What we do know is that Avista's testimony here is intended to refer to the standards of the PNB Case. (Ely, Ex. 52; Schooley, Ex. 401-T, p. 10:2-10).

Avista then suggested that despite its opinion that the emergency rate relief standards were satisfied, "[t]here really is [sic] no criteria for a surcharge…" (Tr.

167:15-16 and Tr. 168:6-7). This testimony is alarming, because if Avista is correct that "no standards" govern Avista's request for a rate surcharge, then the ratepayers, investors and the parties have no standards by which to resolve Avista's Petition. This testimony is also misleading, because in the past the Commission has categorically rejected the use of an emergency surcharge as a vehicle to recover specific categories of costs, particularly where no finding of prudence is made.[3] Indeed, if the emergency rate relief standards do not apply, the standard for the surcharge Avista requests is to deny recovery.

It is also significant that the Commission has not entertained requests for emergency rate relief outside a general rate case. As Staff testified, Avista's Petition is a significant departure from accepted practice and policy. This is a principal reason Staff recommends Avista be required to promptly file a general rate case. (Elgin, Ex. 451-T, p. 21:6-14).

Of particular relevance here is the Commission's order in *Washington Util. & Transp. Comm'n v. Washington Natural Gas Co.,* Cause No. U-80-111, *supra*. In that case, the Commission categorically rejected the proposition that emergency surcharges would be used to deal with extraordinary expenses in a piecemeal fashion:

> In our opinion a surcharge is a vehicle to compensate a utility for extraordinary expenses and charges over which the utility has little or no control and the cost thereof is passed on to the consumer on an actual or reasonably known and measurable basis. A surcharge is not intended to be employed, nor will it be considered by the Commission as a stopgap or piecemeal approach to a utility's overall financial requirements.

[3] As the Commission is aware, in the water industry, surcharges are permitted on occasion, where a company has proven the need to install a specific facility. This is done pursuant to specific statutory authority applicable to the water industry. (*See* RCW 80.28.022.)

(Second Supp. Order at 3). The utility's request for surcharge in that case was rejected, but the Commission granted interim rate relief based on an overall evaluation of the company's financial position, in the context of a general rate case.

Another example involved Avista itself, in 1983. In Cause No. U-83-26, the Company requested interim rate relief in the form of a surcharge, in order to begin recovery of its investment and operating costs of the Kettle Falls Project, which was just being placed into service. A rate order in the general rate case was not expected for several months. Despite the Company's allegations that its financial posture would deteriorate absent the surcharge, the Commission rejected any form of emergency rate relief associated with Kettle Falls. The Commission required that the Company demonstrate the prudence of that project in the context of the general rate case. *Washington Utilities & Transp. Comm'n v. Washington Water Power Co.,* Cause No. U-83-26 (Fourth Supp. Order at 4)(1983).

In sum, the Commission has stated as clearly as it can be stated: single issue cost recovery is not a basis for emergency rate relief, particularly when no prudence determination has been made. Avista's "no standards" argument should be dismissed summarily. This underscores the need for Avista to file a general rate case as soon as possible.

V. EVALUATION OF AVISTA'S FINANCIAL CONDITION AND RELATED ISSUES

A. Avista Needs New Revenues in Order to Meet Financing Covenants. A 32.6% Increase is Justified

There is no dispute that Avista is in an apparent cash "crunch." Absent covenant waivers, Avista may soon be in technical default on its $400 million credit line. Avista said it had no access to that line as of the date of hearing. (Eliassen, Ex. 150-T, p. 3:23 – p. 4:1-5; Tr. 249:12-14). Avista is actively seeking waivers of bond covenants. (Eliassen, Tr. 246:24 – 248:12).

It is equally important to recognize that even if Avista's 36.9%, 27 month rate increase proposal is granted, Avista will not be in compliance with its covenants in September 2001, and probably not until next year. (Ely, Tr. 189:24 – Tr. 190:3; Eliassen, Tr. 248:6-12, Peterson, Tr. 290:7-11).

The evidence shows that Avista's liquidity situation is not a long term phenomenon. Avista testified that "next year looks a lot better" regardless of market conditions. (Ely, Tr. 212:10-14). The trends in Ex. 201 show significant improvement over the course of the next 18 months. Additional information presented by Mr. Ely include reductions in overheads, postponement of capital projects, and a dividend totaling $150 million from Avista Energy to Avista Corp. This $150 million is slightly more than the funds Avista Corp. invested in Avista Energy over the past few years. (Eliassen, Tr. 727:22 – Tr. 729:10).

Staff's analysis confirmed that Avista needs cash, though Staff did not consider in its analysis these cost reductions and the dividend from Avista Energy. These matters only became evident during the hearings. (Schooley, Tr. 668:9-12).

Mr. Schooley evaluated the Company's case under the six interim rate relief criteria established by the Commission. (Schooley, Ex. 401-T, pp. 10:2 – 23:6). In the limited time afforded for the analysis, Mr. Schooley was able to evaluate perhaps the most important financial indicator, the times interest coverage test.[4] A fixed charge coverage ratio of 1.25 is required in order for Avista to issue additional debt. (Peterson, Ex. 200-T, p. 2:1-4).

Avista's evidence showed the fixed charge ratio declining from +2.23 at June 2001 to –2.42 by December 2001. (Peterson, Ex. 201, p. 1). The main reason for this is that Avista has been borrowing against the revolving credit line to finance Coyote Springs II. (Schooley, Ex. 401-T, p. 18:9).

The emergency rate relief requested by Avista brings in about $20 million in the fourth quarter of 2001 (Ex. 253), but this alone is insufficient to bring the fixed charge ratio into compliance. (Tr. 189:23 – Tr. 190:3). The surcharge only increases the "likelihood" of Avista completing the financing of Coyote Springs and enhances Avista's ability to issue common stock. (Peterson, Ex. 200, p. 2:9-10).

Staff's approach was to calculate a level of new revenue by adjusting the December 2001 deficit up to the required 1.25 times to meet the covenant. (Ex. 403). Staff offers this revenue amount for the fourth quarter only (90 days), but encourages

[4] Staff explained it did not have time to evaluate whether there were means other than a rate increase to raise the necessary cash. Nor did it have time to evaluate the impact of non-regulated operations on Avista's financial condition. (Schooley, Ex. 401-T, p. 20:17-20 and p. 16:24 - p. 17:1).

Avista to file a general rate case with a request for interim rate relief. By these actions, emergency rate relief may continue beyond the initial 90 days. (Elgin, Ex. 451-T, p. 4:9-16.) Avista testified that it believes it can meet the interim rate relief standards. (Ely, Tr. 167:15-18.) Staff's plan offers Avista the opportunity to present that case in the proper context.

In the end, Staff's analysis shows that a 32.6% increase over current revenues is necessary to give Avista sufficient additional cash to meet its fixed charge ratio of 1.25. (Schooley, Ex. T-401, p. 19:15 – p. 20:7; Ex. 403).

On cross-examination of Mr. Elgin (who did not sponsor Mr. Schooley's exhibits), Avista noted that Mr. Schooley's analysis "assumed" the debt and equity financings projected by the Company. (Tr. 577:19 – Tr. 578:16). What the Company failed to tell the Commission is that Avista itself assumed the same financing activity. As Mr. Peterson testified, "A surcharge would increase the *likelihood* of being able to complete the needed financing." (Ex. 200-T, p. 2:9-10)(emphasis supplied). Avista's projections in Ex. 201, p. 1 show the covenants are met only if Avista finances as assumed.

In sum, given the limited time available to produce the analysis, Staff was able to conclude that Avista has a need for additional revenue in the near future. A 32.6% revenue increase is justified. But this recommendation cannot be considered in isolation. It needs to be accompanied by Avista promptly filing a rate case, and a direct case on recoverability of deferred power costs. Only in that context can the Commission accurately evaluate Avista's financial position, and its need for emergency rate relief on an ongoing basis.

Avista Needs a Plan to Establish a Level of Credibility With Wall Street That Avista Has Lost Through its Own Actions

In a sense, the focus of this case has not been so much about cash, but rather about deferred power cost balances on Avista's balance sheet. Power cost deferral balances now plague Avista's balance sheet. Staff has no significant disagreement with the point that power cost deferrals are a "tremendous burden on Avista's balance sheet." (Eliassen, Tr. 238:25 – Tr. 239:3; *See also* Elgin, Ex. 451-T, p. 12:14-21).

Avista has repeatedly asserted that it needs a plan to provide certainty to investors. Avista has variously stated that investors need "some indication that there is a plan and there is support for the Company going forward." (Ely, Tr. 216:13-15). In part, Avista needs a plan because it has a credibility issue with Wall Street:

> Right now there is somewhat of a credibility issue with the Company on Wall Street because of our previous history over the last two or three years, and they're looking to see, in fact, are we capable of executing on what we say we are going to do.

(Ely, Tr. 190:6-10). Avista's ability to execute on what it has said it is going to do is a crucial issue in this case. The record does not favor Avista even apart from its problems with unregulated subsidiaries.

As Mr. Ely explained, in July 2000, Avista's plan was to implement deferral accounting for power costs. Avista projected a deferral balance at June 30, 2001 of $19.7 million. It proposed a 10 year amortization. (Ely, Tr. 152:8-17).

Five months later, in conjunction with its December 2000 petition in Docket No. UE-000972, Avista told the Commissioners and the Staff that that it planned to manage the deferral balance to zero. Avista projected the June 30, 2001 balance to be $55 million. (Ely, Tr. 152:18 – 153:7).On March 23, 2001, Avista presented a plan to

manage the deferral balance to zero. But Avista projected the June 30, 2001 balance to be $58.3 million. (Ely, Tr. 153:8-15). This plan led to the Settlement Stipulation.

By June 30, 2001, the actual deferral balance had ballooned to $109.4 million. (*See* Petition and Ely, Tr. 153:19-21). On July 17, 2001 Avista proposed yet another plan, this time for a 36.9% rate increase for 27 months. Avista proposes that some $196.6 million in deferred power costs be recovered from ratepayers.[5] There is no plan to manage the deferral balance other than through 100% ratepayer payment. Indeed, Avista has testified that any plan must include full rate recovery of deferral balances. (Eliassen, Tr. 733:12-13). These facts clearly indicate there is no plan to manage deferral balances. The Company has now lost the ability to make even short term projections that are reasonably accurate. Avista projected a deferral balance for the single month of July 2001 of $30 million. The actual balance was $40 million for that month. (Ely, Tr. 153:22 – Tr. 154:3).

These undisputed facts are relevant on several fronts. First, in the face of this evidence, there is certainly no reason to accept Avista's projections for the next 27 months. Second, it is apparent that Avista's credibility problem is largely self-inflicted. Recurring statements from the financial community about Avista's unregulated operations (Ex. 604), and Avista's inability to adhere to previously announced plans, continue to plague the Company. But that is insufficient reason to accept a plan that increases rates 36.9% and makes ratepayers responsible for 100% of all deferred power costs for 27 months.

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[5] Avista's proposed annual amount of $87.387 million times 27 months, divided by 12 equals $196.6 million. (*See* Schooley, Ex.401-T, p. 8:5-8).

C. Staff's Plan for Avista is the Only Plan Consistent With Commission Orders and Longstanding Commission Policy

Staff's goal was to propose a plan that addresses Avista's financial circumstances, and was consistent with the law, past Commission orders and sound policy:

> What Staff tried to do was stay true to your orders and what you had previously done with respect to setting up this deferral. …. But your order says no cost recovery until you demonstrate prudence, and so that's what Staff tried to craft, a remedy to deal with this very complicated case and be true to what you said in your prior orders and be true to the interim relief standards and our overall general rate making policies and principles that we use for general rate applications. That's what we tried to do. We tried to put it all together in a package that fits. This was our best shot.

(Elgin, Tr. 631:6-8, 14-22). Indeed, several important Commission policies are implemented only by Staff's plan.

First, in evaluating emergency rate relief, the Commission focuses on the six interim relief criteria to determine the Company's ability to finance consistent with its financial covenants. (*See* discussion *supra* at pages 10-11). Only Staff's analysis provides analysis in explicit implementation of the six interim rate relief criteria. (*See* discussion *supra* at pages 15-17 and Schooley, Ex. 401-T, p. 10:2 – p. 23:6).

Second, the Commission needs to analyze the need for emergency rate relief in the context of a general rate case. The Commission should again reject the use of long range projections and single issue rate surcharges. (*See* discussion *supra* at page 12). Under Staff's plan, there would be a 90 day rate increase, subject to continuation based on the proper context: a general rate case filed promptly.

Admittedly, this element of Staff's plan falls short of the Commission's consistent treatment of emergency rate relief in the context of a general rate case.[6] But in conjunction with Staff's recommendation that a rate case be filed promptly, it is a measured, rational accommodation of regulatory precedent. And it does satisfy the Commission's policy directive that long range projections be rejected (such as the projections over 27 months advanced by Avista). (*See* discussion *supra* at page 12).

Third, Staff recommends that deferred power costs not be recovered with revenues from emergency rates until the conditions for recovery have been met. (*E.g.* Schooley, Ex. 401-T, p. 23:8-13). This satisfies the Commission's directive that emergency rate relief is not to be used for single issue cost recovery. (*See* discussion *supra* at pages 12-14).

Fourth, in creating the deferral accounting in Docket No. UE-000972, the available evidence indicates the Commission intended to create a tracking mechanism. Staff's plan to terminate the deferral accounting on June 30, 2001 honors the actual intent of the Commission in establishing deferral accounting. *(E.g., see* discussion *infra* at pages 30-33).

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[6] No Commission decision of which we are aware applied the emergency rate relief standards outside of a general rate case. *See Washington Util. & Transp. Comm'n v. Pacific Northwest Bell Tel. Co.,* Cause No. U-72-30 tr (Second Supp. Order)(1972); *Washington Util. & Transp. Comm'n v. Puget Sound Power & Light Co.,* Cause No. U-73-57 (Second Supp. Order)(1974); *Washington Util. & Transp. Comm'n v. Cascade Natural Gas Co.,* Cause No. U-74-20 (Second Supp. Order)(1974); *Washington Util. & Transp. Comm'n v. Pacific Northwest Bell Tel. Co.,* 11 PUR 4th 166 (1975); *Washington Util. & Transp. Comm'n v. Washington Water Power Co.,* Cause No. U-77-53 (Second Supp. Order)(1977); *Washington Util. & Transp. Comm'n v. Puget Sound Power & Light Co.,* Cause No. U-80-10 (Second Supp. Order)(1980); *Washington Util. & Transp. Comm'n v. Washington Water Power Co.,* Cause No. U-80-13 (Second Supp. Order)(1980); *Washington Util. & Transp. Comm'n v. South Bainbridge Water System, Inc.,* Docket Nos. U-87-1355-T and U-83-50 (Second Supp. Order)(1988); *Washington Util. & Transp. Comm'n v. Richardson Water Cos.,* Docket No. U-88-2294-T (Second Supp. Order)(1983) ; *Washington Util. & Transp. Comm'n v. Alderton-McMillin Water Supply, Inc.,* Docket No. UW-911041 (First Supp. Order) (1992); *Re: Washington Water Power Co.,* 22 PUR 4th 485 (1977); *Washington Util. & Transp. Comm'n v. Washington Natural Gas Co.,* Docket No. UG-950278 (Third Supp. Order)(1995).

Finally, in its August 9, 2000 and January 24, 2001 orders in Docket No. UE-000972, the Commission set forth the explicit conditions for recovery of deferral balances: that Avista prove such costs were prudently incurred, that Company-owned resources have been optimized to the benefit of retail customers, that recovery of these costs through a deferral mechanism is appropriate, that the Company make a proposal for cost of capital offsets to recognize the shift in risk from shareholders to ratepayers, and that the Company have a plan to mitigate the deferred power costs.

Staff's plan, which precludes recovery before these conditions are satisfied, faithfully implements these orders. The determination of the proper levels of deferrals and the plan to recover that amount is the subject of a different hearing.

D. Avista's and ICNU's Plans Are Not Consistent with the Commission's Orders in Docket No. UE-000972

As noted earlier, since July 2000 Avista has proposed several plans related to its deferred power costs. Avista's current plan calls for a 36.9%, 27 month rate increase, subject to refund. The PGE monetization credit approved in the last rate case would be accelerated, and used to offset deferral balances. Avista commits to file a rate case November 1, 2001 in which it will propose a power cost adjustment clause ("PCA") and will address recoverability of deferral balances. (Petition, ¶¶ 8 and 9; Ely, Ex. 50-T, p. 6:8-13, Tr. 146:12). Avista proposes to continue deferral accounting.

ICNU's plan is similar in structure to Avista's. ICNU proposes an 11.9%, 15 month rate increase, subject to refund. ICNU also seeks to use an accelerated amortization of the PGE monetization credit to offset deferral balances. ICNU offers a market/water risk adjustment that reduces deferral balances by $25.6 million annually.

(Schoenbeck, Ex. 651-T, pp. 13:6-14). ICNU also proposes the power cost deferral accounting continue. (Schoenbeck, Tr. 478:21-23).

Based on the following discussion, it is clear that both Avista's and ICNU's plans are inconsistent with the Commission's orders in Docket No. UE-000972.

1. Avista's and ICNU's Plans Violate the Commission's Orders in Docket No. UE-000972 by Requiring Premature Resolution of Recoverability Issues. The "Subject to Refund" Feature Is No Cure

We previously outlined the several conditions imposed by the Commission for recovery of deferred power costs. They have not been satisfied. Both ICNU's and Avista's plans require the Commission to permit premature recovery of deferred power costs, and/or to otherwise reach premature conclusions on recoverability of such costs.

For example, ICNU defended its plan based in part on Mr. Schoenbeck's "95%" satisfaction that the bulk of deferred power costs incurred through June 30, 2001 would survive a prudence test. (Schoenbeck, Tr. 493:4-12).[7] ICNU wants the Commission to decide now what is a "reasonable value" of prudently incurred deferred power costs and allow that into rates now. (Schoenbeck, Tr. 540:10-13). This testimony was offered despite ICNU's other testimony that there was "no time to conduct a prudence review" of the deferral balances. (Schoenbeck, Ex. 651-T, p. 5:21-22).

ICNU's thoughts and proposals about prudence, and its proposed risk adjustment, are interesting. But they address issues that are simply beyond the scope of this proceeding. Recoverability issues, including prudence, are expressly reserved for later

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[7] ICNU reached no such conclusion with respect to post-June 30, 2001 power cost deferral balances. ICNU testified it was concerned that power costs deferred after June 30, 2001 reflected were "very untimely and possibly imprudent purchases…." (Schoenbeck, Ex. 651-T, p. 6:13).

hearings in this proceeding.[8] This is a matter of obvious legal significance, including fairness. Staff has not had time to conduct a prudence review. To adopt a plan that reaches any explicit or implicit conclusions about recoverability of deferred power costs is inappropriate and beyond the scope of this hearing.

Avista's plan suffers from the same infirmity as ICNU's. Indeed, the key component of Avista's plan expressly requires a premature finding of recoverability. Avista emphasized in no uncertain terms that it needs a "clear resolution" *now* of the issue of recovery of deferred power costs through rates. (Eliassen, Ex. 152-T, p. 3:7-8; Tr. 232:16 – Tr. 233:7).

There is also no dispute that Avista's plan constitutes immediate "recovery" or "amortization" of deferred power cost balances through rates, and it wants the financial community to perceive that is what is occurring. (*E.g. Id.* and Eliassen, Tr. 238:15-20, Tr. 244:13-18; Ely, Tr. 144:24 – 145:6, Norwood, Ex. 107-T, p. 3:14-22). Indeed, according to Avista, any failure to permit Avista recovery of deferred power costs immediately "[frustrates] the very purpose" of Avista's proposed rate increase. (Eliassen, Ex. 51-T, p. 2:11-13 ; Tr. 149:16-25). As Staff recognized:

> A: …the very real difference [between Staff and Company plans] is that the Company wants to take those dollars, and once they start collecting them, to begin to amortize the deferred amounts on its balance sheet….
>
> Q: And is that for regulatory accounting purposes, for financial accounting purposes, or both?
>
> A: Both.

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[8] As we noted on page 1 of this brief, the Commission has given clear direction in this regard: "We are not addressing the prudence of these costs in this phase of this proceeding or other issues subsumed under Mr. ffitch's description of the deferred costs issues…". (ALJ Moss, Tr. 97:10-13). This is confirmed by the Notice of Second Prehearing Conference (August 1, 2001) at 3, ¶¶ 12 and 14, in which the issues in this phase of the case are described. That description excludes recoverability issues, including prudence.

(Elgin, Tr. 644:3-10). So the flaw in Avista's plan is readily exposed: the Commission has stated the conditions of recoverability of deferred power costs, and they have not been met. Avista's plan cannot be reconciled with the orders in Docket No. UE-000972.[9]

Avista then makes the same attempt as ICNU did to justify this key aspect of its plan. Avista opined that the amount of deferred power costs that would be recovered by emergency rate increases or the PGE monetization credit was less "than what could possibly be denied in a refund case or a prudency case." (Ely, Tr. 163:23-25).

But this simply confirms Staff's point: Adopting Avista's plan constitutes prejudgment of the prudence issue, the issue whether the deferred power costs accounting was even appropriate in the first place, as well as other recoverability issues. The Commission has ruled those issues out of this phase of the hearing. *See* footnote 8 at page 24, *supra.*

The "subject to refund" feature of all parties' plans (Staff's included)[10] is no panacea in this specific regard. As just noted, Avista considers its plan, even with the subject to refund feature, to constitute immediate cost recovery of deferred power costs. Avista is eminently correct in this regard. Moreover, Avista vigorously opposes Staff's accounting proposal for emergency rate increase revenues. Staff's accounting proposal explicitly recognizes the subject to refund feature (a subject discussed in detail later). If refunds were an actual possibility, Avista would not oppose Staff's accounting

[9] Staff also cautioned about the general propriety of recovery of specific expenses that have yet to be found prudent. (Elgin, Tr. 643:3-11).

[10] Staff's plan does have a subject to refund feature. However, since under Staff's plan, no deferred power costs would be recovered until the Commission's conditions for recovery have been met, Staff's refund element would be based on a comparison between the result of this case, and the result of any request for interim relief filed in the context of the general rate case.

recommendation. (Falkner, Tr. 451:12-19). This proves Avista's case turns on the prospect of refunds being illusory.[11]

In sum, at a minimum, both ICNU's and Avista's plans are based on an implicit finding that some deferred power costs were prudent, and that deferred power cost accounting is appropriate. The Commission has stated that those issues are not before the Commission for resolution at this time. Accordingly, Avista's and ICNU's plans are flawed and should be rejected.

2. Avista's and ICNU's Plans Also Require Premature Recovery of Deferred Power Cost Balances by Means of the PGE Monetization Credit. That Credit Should Not be Used to Offset Deferrals for Other Reasons as Well

Avista's and ICNU's idea to offset deferral balances using the PGE monetization credit is just another form of cost recovery of deferral balances. It is inappropriate for the reasons just stated above. Moreover, the Commission should recognize that in Docket No. UE-991606, it ordered a portion of the PGE monetization credit to be amortized over an eight year period.[12] The credit will serve to reduce base rates over that period. Avista and ICNU now propose to accelerate the use of that money by amortizing it over a 15 month period, and offsetting the deferrals by an amount equal to the amount of the credit on Avista's balance sheet.

What this proposal means is that all else equal, Avista's base rates will be higher than they would otherwise be for the next eight years and beyond. Avista and ICNU may be willing to make this trade-off of definite ratepayer benefits. Staff is not. This issue

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[11] Moreover, as ICNU pointed out, even assuming there is a refund, at the level of rate increase requested, some businesses may not be around to collect it. (Schoenbeck, Tr. 490:18 – Tr. 491:12, Tr. 499:1-5). As Mr. Andreson and Mr. Parch said, customers need their money today. The wisdom of this testimony is self-evident.

[12] The remaining portion was to be a permanent rate base reduction.

should not be resolved now. It should be dealt with in the rate case. (Schooley, Ex. 401-T, p. 24:1-8).[13]

E. The Deferred Power Cost Accounting Should Terminate Effective June 30, 2001

An issue that has generated much heat in this case is Staff's recommendation that the deferral accounting cease effective June 30, 2001. Staff gave careful consideration to this recommendation. It goes to the heart of what the Commission did, and what it said it did, when it established the tracking of deferred power costs in August 2000. And it goes to the heart of Avista's current financial position.

Staff's recommendation is based on cogent analysis. What Avista has created on its books, and what it now seeks through rates, is not in the public interest. The treatment Avista seeks is far more favorable than the PCA Avista proposed in Docket No. UE-991606, which the Commission rejected as inadequate. Avista should not be able to get more through deferral accounting than what Avista was denied on the merits in Docket No. UE-991606. (Elgin, Ex. 451-T, p. 21:19 – p. 22:5).

Moreover, permitting Avista to continue deferral accounting past June 30, 2001 was a crucial part of the now failed plan to reduce deferrals to zero without a rate increase. That plan is over. As discussed earlier, the Company's Petition is really a petition to terminate the Stipulation. If it is terminated, the deferred accounting would

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[13] Should the Commission disagree, Staff would like to point out that in addition to the $53.8 million balance sheet amount of PGE monetization credit treated by Avista and ICNU in their plans, there is an additional $14.2 million that has not been counted. (Falkner, Tr. 442:19 – Tr. 443:12). This $14.2 million amount, which is currently being amortized over eight years (through August 2008), apparently was not booked by Avista on its balance sheet on the basis of "materiality." (Falkner, Tr. 445:5-8). Staff assumes that in the context of this case, $14.2 million may indeed be material.

end on June 30, 2001 by the terms of the Commission's orders in Docket No. UE-000972.

In addition, there are serious questions about the ability of Avista to manage the deferral balances. All of its past projections have been wrong, and wildly so. Continuing to build the deferral account, coupled with Avista's inability to control the balance will perpetuate an already untenable situation, and add further uncertainty regarding how Avista has booked these amounts.

Finally, as we explain in detail below, terminating the deferral accounting honors the Commission orders in Docket No. UE-000972.

Staff's recommendation that deferral accounting be terminated will not impact Avista's fixed charge coverage ratio. That ratio is computed by assuming, in effect, that the deferred power costs are expensed currently. This is seen from Mr. Schooley's Ex. 403, p. 1, line 17. The figure of $138,857,000 represents the power costs deferred during calendar year 2001 (line 51), reduced by 37.5% for federal income tax and other tax effects. From a cash basis, it makes no difference if the power costs are reflected as a reduction to net income (line 1) or later removed as a deferral (line 17). The total on line 23 would be the same.

Staff's recommendation does not mean that all post-June 30, 2001 power supply costs cannot be addressed by the Commission. The Company retains alternatives for recovery of these costs.[14] For example, Avista may request side record accounting. (Elgin, Tr. 641:18 – Tr. 642:3). If there is a continuing problem with financing, Avista

[14] Any concerns that side record accounting poses a retroactive ratemaking issue would apply equally to the existing deferral accounting procedures under Docket No. UE-000972.

can request interim relief in the context of the general rate case. But perpetuating Avista's existing accounting practice of treating every dollar of deferred power costs as a regulatory asset, expecting full recovery in rates, is not in the public interest.

1. The Issues Surrounding Avista's Accounting of Deferred Power Costs are Important

This is an important issue, because Avista's ability to book deferred power costs, and thereby deferring recognition of such costs as an expense for reporting purposes, depends on Avista's compliance with FAS 71. It appears that bond rating agencies may be making that evaluation for us, by their expressions of concerns regarding recoverability The Commission should fully understand the nature and implications of the situation in which we now find ourselves.

This issue is relevant on several fronts. First, deferred power costs on Avista's balance sheet have created a significant problem for Avista, and consequently for the Commission. There is a substantial question whether the deferred power costs belong on the balance sheet, and if so, in what amount. The resulting uncertainty impairs the Commission's ability (and the financial community's ability) to accurately assess Avista's true financial condition.

Second, it is fair to say that the magnitude of deferred power costs is forcing Avista to seek immediate, premature recovery of deferred power costs. And it is forcing the Commission to act at this time. The propriety of the existence of such deferrals is therefore a key issue.

Finally, this issue also relates to the substance of Avista's request to continue on with deferral accounting through December 2003, beyond what even the Settlement Stipulation provided. The propriety of this request is another major issue in this case.

Below we outline the background of Avista's deferral accounting for power costs. We explain what FAS 71 is and what it does. We then discuss the available evidence there is to determine compliance with FAS 71.

2. Background for Avista's Deferred Power Cost Accounting

As Staff described in detail (*see* Elgin, Ex. 451-T, p. 5:12 – p. 12:11, and Lott, Ex. 501-T, p. 5:12 – p. 11), in June 2000, Avista requested permission to begin deferred power cost accounting, if its request for a PCA[15] was not granted in the pending rate case, Docket No. UE-991606. The deferral balance was projected to be $19.7 million at June 30, 2001. (Ely, Tr. 152:8-14).

In its August 9, 2000 Order in Docket No. UE-000972, the Commission permitted Avista to track power costs, but stated several explicit conditions for recovery, which have been described elsewhere. The Commission later rejected a PCA in Docket No. UE-991606, but stated the conditions under which one would be considered.

In December 2000, Avista requested amendments to the deferral accounting. In its January 24, 2001 Order in Docket UE-000972, the Commission granted those amendments, but none of the conditions for recovery were changed in any respect.

Later in January 2001, Avista published its 10-K (Ex. 505, second document). At this point, the deferral balance was projected to be $55 million at June 30, 2001. (Ely, Tr.

[15] A PCA is a mechanism that provides for recovery of changes in power costs through changes in customer rates. Under these mechanisms, utilities record the costs as regulatory assets since the mechanism provides probable recovery.

152:18-24). Avista was reporting every dollar of its deferred power costs as a regulatory asset. (Lott, Ex. 501-T, p. 9:13-19).

At June 30, 2001, Avista's deferred power costs on its balance sheet had ballooned to $109.4 million. (Ely, Tr. 153:19-21). Avista's booking of regulatory assets is now a major issue for Avista's banks and rating agencies. Uncertainty of recovery of these huge amounts of deferred costs has placed the Commission, its Staff, and Avista's customers "between a rock and a hard place." At any time after the Commission's order in UE-991606, Avista could have sought a PCA under the criteria stated by the Commission. (Eliassen, Tr. 240:3-6). It has yet to do so.

Staff firmly believes Avista was wrong to create a regulatory asset for the full amount of deferred power costs on its financial books after the orders in Docket No. UE-000972 were issued. (Lott, Ex. 501-T, p. 6:9 – p. 9:11). But the burgeoning totals of deferred costs on the balance sheet now may justify a different conclusion, because of the pressure on the Commission to grant some recovery of these costs. (Lott, Tr. 688:24 – Tr. 689:5).

This is not how regulation is supposed to work. The time has come not to perpetuate uncertainty by perpetuating deferred accounting that is now out of control. It is time to confirm the Commission's intent as expressed in its orders and in its statements when the accounting was established. This was a tracking mechanism, not a mechanism for purposes of creating a regulatory asset.

3. Avista's SEC Form 10-K for the Year 2000 (Ex. 505, second document)

Avista's description of its power cost deferrals in its financial statements to the public is also important to the analysis. In its 2000 SEC Form 10-K (Ex.

> 505, second document), Avista explains the history of the deferred power costs accounting. On page 53, Avista describes the changes that occurred as a result of the Commission's January 24, 2001 Order in Docket No. UE-000972 as "a modification to the deferral mechanism to recover power supply costs associated with meeting increased retail and wholesale system load requirements…"
>
> Thus, what started as a power cost "tracking" mechanism is now called a "mechanism to recover" power supply costs.
>
> This theme is echoed on page 32 of the same report. In discussing Avista's liquidity condition, Avista stated that "[t]he purchased power and natural gas costs incurred to serve the utility's retail customers are generally recovered or expected to be recovered in retail rates, however, there is a lag between the time the costs are incurred by the Company and the time they are collected from customers."
>
> The report then refers to Note 1 to the financial statement, and mentions the creation of regulatory assets for costs in excess of those included in rates. Note 1 (which is on pp. 50-55 of the report) describes the deferral accounting procedures, including the effect of the January 24 Order, as described above. And it does describe the conditions for recovery. (pp. 52-53).

However, the characterization of deferral accounting as a "recovery mechanism" on page 53, and the coupling of deferred power costs with purchased gas costs on page 32, goes beyond what commitments the Commission made in Docket No. UE-000972.

4. The Importance of FAS 71

The Financial Accounting Standards (FAS), of which FAS 71 is but one, are the highest level and authority in the pronouncement of Generally Accepted Accounting Principles (GAAP). (Hoover, Tr. 416:20 – Tr. 417:7). GAAP governs the rules under which Avista reports its financial results to the public. (*Id.*). FAS 71 permits a utility such as Avista to capitalize (that is, to include as an asset on its balance sheet) current period expenses. Absent such a rule, Avista would reflect such current period expenses as simply that: current period expenses. (Hoover, Tr. 418:1-15).

A regulator such as the Commission has authority to establish a regulatory asset for regulatory purposes, but that regulatory action "may or may not establish an asset … for GAAP purposes." (Hoover, Tr. 424:17-19). Accordingly, what Avista records as a

regulatory asset on its reports to the Commission may not be what it must report in its financial reports to the public. The former depends on the Commission. The latter depends on whether FAS 71 applies. (Hoover, Tr. 419:2-7 and 424:23 – Tr. 425:5).

In sum, if FAS 71 applies, Avista can record deferred power costs as a regulatory asset. If FAS 71 does not apply, Avista may not do so.

5. The Relevant Text of FAS 71

FAS 71 states in pertinent part:

> 9. Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable that future revenue in an amount *at least* equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate making purposes. [emphasis added]
>
> b. *Based on available evidence*, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost. [emphasis added]

Footnote 6 to this paragraph states:

> The term *probably* is used in this Statement with its usual general meaning, rather than in a specific technical sense, and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain or proved…That is the meaning referred to by FASB Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises.* [emphasis added, citation to dictionaries omitted].

Thus, FAS 71 specifically requires that the Commission, in a "rate action," provide reasonable assurance of the existence of an asset. Moreover, a regulatory asset exists only if "based on available evidence," it is probable that future revenue will be

provided to permit recovery in an amount “at least equal to” the amount of the previously incurred expense.

6. There Has Been No Compliance With FAS 71 Demonstrated With Respect to Avista’s Deferred Power Costs. All Available Evidence Was Not Considered, Contrary to the Express Requirements of FAS 71

In Exhibits 351 and 352, Staff asked Avista and Deloitte and Touche to identify the evidence they considered in reaching their conclusion that FAS 71 permitted Avista to create a regulatory asset for its deferred power costs. None of the analysis actually conducted regarding compliance with FAS 71 was reduced to writing. (Ex. 351; Ex. 352; Hoover, Tr. 411:5-8 and Tr. 414:20-25).

The universe of documents that were considered by Avista and its auditors consisted of: Avista’s 10Qs, Avista’s petition, the Staff memo and the Commission’s order, all related to the events that occurred in Docket No. UE-000972 in the summer of 2000. (Ex. 351 and 352; *See also* Hoover, Tr. 411:17 – Tr. 413:23). Exhibit 352, p. 2, also indicates the activities of other regional utilities was considered. Deloitte and Touche admitted it conducted no independent prudence review of any Avista deferred power costs. (Hoover, Tr. 415:9-11).

It is not clear that the Commission’ orders in Docket No. UE-000972 constitute “rate action” for purposes of FAS 71. But assuming they do, Exhibits 351 and 352 plainly show why there has yet to be demonstrated compliance with FAS 71.

First, in Exhibit 352, p. 2, Avista tries to favorably compare its activities to other regional utilities for purposes of FAS 71 analysis. Yet Avista agrees that “Avista’s power supply decision making should [not] be analyzed based on what [Puget Sound

Energy and Portland General Electric] have done." (Ely, Tr. 154:4-10). Avista cannot have it both ways.

Second, consideration of the available evidence as FAS 71 requires was not done, Mr. Hoover's testimony to the contrary notwithstanding. (Hoover, Ex. 350-T, p. 4:10-12). Readily available was the tape of the Commission's open meeting of August 9, 2000 (when the deferral was originally approved). This document was not considered. A transcription of that meeting is Exhibit 504. That exhibit constitutes significant available evidence regarding how the Commission viewed its action when it approved deferral accounting. In that document, it was observed that all the Commission was doing was creating a method to track power costs. (Ex. 504, p. 2, p. 3 and p. 7 ; Lott, Tr. 697:11-25). This is plainly relevant to an interpretation of the order that was issued, and whether recovery was probable.

Moreover, Exhibit 504 shows that two parties strongly opposed the accounting petition at that time. Public Counsel, through Mr. Steuerwalt, was concerned that the adoption of the accounting order would create pressure on the Commission by establishing a presumption that the deferrals would be recovered. (Ex. 504, p. 3). It was indicated from the bench that there should not be any presumption one way or the other on that issue. (Ex. 504, p. 4).[16]

After further dialogue with the commissioners, Public Counsel indicated that what the Commission was doing was "to create a system of accounts and not a presumption that there is a regulatory asset." (Ex. 504, p. 4). No one took issue with that statement of

[16] Mr. Hoover, by contrast, applied such a presumption in reaching his conclusion. (Tr. 415:12-14).

understanding. Indeed, the Staff's memo (Ex. 503, p. 3) specifically rejected the use of a regulatory asset account for the deferral balances. That was accepted.

The transcript goes on with several comments by the Commission explaining the importance of the qualifications that apply to the accounting order.

This available evidence surely is relevant to a correct interpretation of the Commission's orders in Docket No. UE-000972. Mr. Lott considered this evidence in reaching his conclusion that a regulatory asset had not been created. (Lott, Ex. 501-T, p. 10:7 – p. 11:19).

Nor was there any review of previous Commission orders regarding the requirements of PCA mechanisms. A review of this available evidence would have shown that Avista (formerly Washington Water Power) has been refused a PCA at least twice previously. The first time was in 1988, in Docket No. U-88-2363. The Commission refused the PCA because it did not include a cost of capital offset, and it did not promote rate stability. (*See* First Supplemental Order Denying Petition, Sept. 19, 1989). The second time was last year in Avista's general rate case: Docket Nos. UE-991606 and UG-991607. This rejection of Avista's proposed PCA was after the creation of the deferral accounting, but before the release of Avista's 10-Q for the 3rd quarter of 2000. (*See* Third Supplemental Order, p. 52, ¶¶ 184 and 185). In that same order, the Commission indicated that Avista could propose a PCA in the future, but any proposal would have to meet the criteria previously established by the Commission. (*Id.* p. 43, ¶ 143).

Considering this available evidence, it would be extremely difficult to conclude that the Commission would grant through a deferral accounting subject to numerous conditions a greater level of cost recovery than in a PCA it had just denied.

Had other relevant available documents been considered, it would have been discovered that the Commission has twice adopted and then eliminated PCAs for Puget Sound Power & Light Co. In Cause No. U-81-41, the Commission created the Energy Cost Adjustment Clause (ECAC). In Docket Nos. U-89-2688 and U-89-2955, the Commission determined that Puget's ECAC failed to meet the Commission's criteria, including the fact that it lacked a cost of capital offset.

In Docket Nos. UE-901183 and UE-901184, the Commission again allowed Puget a PCA, called "PRAM," as part of its experiment with a decoupling mechanism. This mechanism attempted to eliminate many of the problems of the ECAC. Moreover, in adopting the new PRAM mechanism, the Commission approved a cost of capital adjustment. The PRAM was subsequently eliminated after large cost increases had been passed through to customers via that mechanism. (*See* Third Supplemental Order in Docket No. UE-950618).

Had this available evidence been considered, at a minimum, it would be extremely difficult to conclude that it was probable that a zero cost of capital offset would be accepted by the Commission.

Moreover, at the open public meeting where the deferred accounting was considered, Staff specifically raised the question of what constituted an "extraordinary" level of power costs. Exhibit 503 is the Staff's memo to the Commission. Page 4, Item 1 at the top of the memo states the issue of "when and to what extent should power

supply costs be considered "extraordinary" versus "non-extraordinary"… Staff repeated this concern orally. (Ex. 504, p. 1). The point being made was simply that while actual costs during the last year exceed certain critical water years included in the power cost model, it is unreasonable to assume that 100% of the difference between normal and actual should be considered "extraordinary." Avista has deferred power costs on the basis that all of its power costs above the level of the last rate case are extraordinary and fully recoverable in rates. But this significant issue is yet unresolved.

> At bottom, in order for the deferred accounting to constitute a regulatory asset, one would have to conclude that the Commission intended, by way of an accounting order, to provide for rate recovery more generous than in any PCA that had been approved (ECAC and PRAM) or recently rejected (Avista in Docket UE-991606). (*See* Elgin, Ex. 451-T, p. 22:1-5).

> As indicated by both Mr. Hoover for Avista (Tr. 420:5-9 and Tr. 420:15-24) and Mr. Lott for Staff (Ex. 501-T, p. 10:7-17), for the deferral to be a regulatory asset it must be probable that the company will receive revenue in an amount at least equal to the deferral (100% or more).[17] Considering all available evidence, one cannot conclude that recovery through rates of all of Avista's deferred power costs is probable. What the record unmistakably shows is that creation of a regulatory asset on Avista's financial reports for deferred power costs was not based on evaluation of all available evidence as required by FAS 71. Avista's balance sheet cannot be said to conform to FAS 71 as a result.

> **7. Conclusions on the Deferral Accounting Termination Issue**

> For all of the reasons stated above, Staff's recommendation that the deferral accounting be terminated effective June 30, 2001 is reasonable. Continuing the mechanism will simply continue to build a balance of regulatory assets that adds more and more uncertainty to an already uncertain situation. In Docket No, UE-000972, the Commission established a tracking mechanism, not a recovery mechanism like a Purchased Gas Adjustment (PGA).

> This situation requires decisive action. Terminating the deferral, coupled with a prompt determination of the recoverability of deferral balances is in the

[17] In this regard, Avista has mischaracterized Staff's position. Mr. Falkner opined that Staff was testifying that under FAS 71, there needs to be a 100% probability of recovery. (Ex. 252-T, p. 5:2-3). Rather, Staff's position is the same as Mr. Hoover's in this regard: it must be probable that the company will receive revenue in an amount at least equal to the amount of deferred power costs. That is what FAS 71 expressly requires. That issue has yet to be resolved based on an independent review of all available evidence.

short and long term interests of Avista, its ratepayers, and the financial community.

F. The Rating Agencies and Lenders

The record is replete with speculation on how rating agencies and lenders may or may not respond to the various plans offered to the Commission in this case. No lender and no rating agency was either a party or a witness in this case.

It is therefore difficult to separate fact from overstatement. For example, in its direct case, Avista went so far as to offer one lender's statement that unless Avista receives "full recovery" of deferrals, it will not lend. (Peterson, Ex. 200-T, p. 6:5-7). What Avista did not disclose until questioned was that this lender was making an overstatement: it would in fact lend absent "full recovery." (Peterson, Tr. 288:4 – Tr. 289:6).

The point is that neither Avista, nor any other party to this case can assure what the rating agencies will or will not do. As Mr. Ely pointed out, "There's no guarantee with them. They sit down and rate it." (Tr. 220:21-22).

The Company insists that the rating agencies want a plan. As we described above, Staff's plan is consistent with the Commission's orders in this docket, and in Docket No. UE-000972. In those orders, the Commission has stated as clearly as it can be said that it will not provide recovery of deferred power costs unless the conditions of recovery are met. While Avista suggests the rating agencies want more, the Staff's plan is the only realistic plan to get the recoverability issues resolved, and reach finality on that issue. The Company's plan delays that issue, perpetuates uncertainty, and asks for promises the Commission has already said it will not make.

VI. ISSUES RELATED TO DEFERRAL AMOUNTS

A. Deferral Balances Should Not Be Allowed to Include Return and O&M Costs

Staff pointed out that Avista had begun to include capital costs (return) and O&M costs in its calculation of deferred power costs. Staff opposes that treatment, since such costs are properly considered in a general rate case when permanent rates are established. The deferrals were never intended to include the total costs of new resources. (Schooley, E. 401-T, p. 24:15-16).

Avista claims it is appropriate to include capital and O&M costs in the deferral balances. The Company relies on part of ¶ 2 of the Settlement Stipulation that states: "Monthly deferral entries in the existing mechanism include both the total costs and total benefits of the measures taken by the Company to mitigate the deferred costs." (Norwood, Ex. T-107, p. 7:22-25 – p. 8:1-3).

The Company obviously has misinterpreted ¶ 2 of the Stipulation. Avista has deferred power costs based on the variation between actual recorded power costs and the level of power costs authorized in the last rate case. (Ely, Tr. 143:9-12). Mr. Norwood explained that Ex. 106 accurately describes the current accounting and accounts that are involved. (Norwood, Ex. 100-T, p. 23, 18-23). Nothing in Ex. 106 includes accounts for depreciation, insurance, property taxes, return or any other O&M account not specifically identified therein.

The Commission should order that Avista remove the return and all O&M costs from deferral balances, related to accounts not specified in Ex. 106. The propriety of these O&M costs and return costs are issues for evaluation in the general rate case.

VII. ACCOUNTING FOR SURCHARGE REVENUES

A. Staff's Proposed Accounting for Any Revenues Received from Emergency Rates Properly Reflects the Subject to Refund Condition Proposed by All Parties. It Also Reflects the Fact that Deferred Power Costs Recovery Issues Have Not Been Decided

Staff recommends that any emergency rate revenues collected prior to any decision on recovery of deferred power costs should be booked in Account 254, Other Regulatory Liabilities. (Parvinen, Ex. 551-T, p. 2:13-14). The Commission should require Avista to create a specific sub-account within Account 254 to record emergency rate relief revenues as a separately identifiable revenue item. (*Id.* at p. 3:16-18). Interest should be accrued on the balance of that Account at 9.03%. (*Id.* at p. 3:15-16,18-19). The amount of emergency revenues received may eventually be credited to the balance of power costs deferred, but only after, and only to the extent that those costs have been determined to be prudent and otherwise appropriate for recovery. (*Id.* at p. 3:7-10).[18]

This accounting treatment will provide Avista cash to help address its liquidity problems. The uncertainty surrounding the deferrals must be addressed in another hearing or another proceeding. Staff proposes that issue be addressed expeditiously.

This accounting treatment is also true to the Commission's prior orders in this docket as well as to the "subject to refund" condition on the surcharge that is proposed by all parties. What the Company is really seeking here is for the Commission to tacitly

[18] As explained previously, under Staff's plan, no deferred power costs would be recovered until the Commission's conditions for recovery have been met. Thus, the subject to refund element under Staff's plan would be based on a comparison between the result of this case, and the result of any request for interim relief filed in the context of the general rate case. If the Commission decides to approve emergency rate relief in this proceeding, and adopts this subject to refund condition, it would be appropriate to book those revenues to Account 253, Other Deferred Credits. (Parvinen, Ex. 551-T, p. 5:12-17).

nullify the "subject to refund" condition that *Avista* was the first to propose, and to convince the financial community (through its accounting) that the emergency revenues are not really subject to refund.

Staff's accounting proposal still recognizes that the Company is receiving new revenue to address its cash needs in order eventually to comply with financial covenants. And it properly accounts for the revenue on the balance sheet in order for it to be used as an offset to the deferral balances at the appropriate time. (Parvinen, Ex. 551-T, p. 4:15-16). Most importantly, it is consistent with the Commission's prior orders in Docket No. UE-000972, and in this docket. It reflects the fact that no recovery of deferred power costs can occur prior to a determination of the prudence and appropriateness of the deferred power costs.

It is important to note those respects in which Staff's proposed accounting and that of the Company do *not* differ. First, there would be no difference in the effect on Net Income. (Parvinen, Ex. 551-T, p. 4:22). Moreover, the balance would be the same if the deferred debits and deferred credits proposed by Staff were netted together. (*Id.* at p. 4:22 - p. 5:1). As will be discussed in further detail below, Staff's proposed accounting fares the same as the Company's in meeting the covenants under Avista's line of credit.

Until the recoverability issues are resolved, it is only Staff's accounting proposal that satisfies the Commission's Orders in this docket and in Docket No. UE-000972. Staff's proposal would also disclose to readers of Avista's financial reports the refund status of the emergency rates.

B. Avista's Proposed Accounting for Any Revenues Received from Emergency Rates Improperly Assumes the Commission Has Made Decisions on Cost Recovery. Those Decisions Are

Beyond the Scope of this Hearing

Avista proposes to record as current revenues the revenues it receives from any emergency rate relief. Avista also proposes to immediately amortize an associated portion of the power cost deferrals as an offsetting current period expense. (Falkner, Ex. 252-T, p. 10:18-20).

The problem with the Company's proposed accounting is that it would constitute prejudgment of the prudence of the deferred costs, as well as the appropriateness of recovering those costs through rates. The proper accounting should reflect the fact that these determinations have not been made. (Parvinen, Ex. 551-T, p. 4:10-14).

Avista argues that Staff's recommendation concerning accounting for revenues "does nothing to improve the Company's situation with regards to dealing with the financing issues. In fact, it doesn't advance the process in any meaningful way." (Falkner, Ex. 252-T, p. 9:21-22). Avista also contends that "[t]he Staff incorrectly assumes recording the emergency revenue in a deferred liability account provides an **offset** to the deferred power costs already on the balance sheet. That couldn't be more wrong. The additional liability, or burden on the balance sheet, in conjunction with all the Staff testimony surrounding recovery, will only serve to create a short-term loan of 90 days, 'subject to refund.' The power cost deferral balance would not be directly offset." (*Id*. at p. 10:1-5).

This is truly remarkable testimony. Recall that it was Avista that first proposed that the surcharge be subject to refund. And all parties propose that any emergency rates be subject to refund. Moreover, the Commission has stated the conditions for recovery of

deferred power costs. These conditions have not been satisfied. The proper accounting should reflect these realities, not obscure them. (Parvinen, Ex. 551-T, p. 4:10-14).

To support its proposal to account for emergency revenues as current revenues, Avista argues that it is actually very unlikely that it will not be able to prove the prudence and appropriateness of at least that portion of deferred power costs that it would amortize prior to a prudence or recoverability determination. According to Avista, disallowance of any part of what the company has recovered before Staff's proposed 90 day prudence filing would require a 90% disallowance. (Falkner, Ex. 252-T, p. 11:4-14). According to Avista, there is nothing wrong with immediately beginning amortization of deferrals, since in its view, at least the first portion of the revenues recovered is very unlikely to be refunded. (*E.g.* Peterson, Tr. 296:18 - Tr. 297:3).

This testimony defeats Avista's accounting proposal. It is proof positive that Avista is advocating that the Commission make a premature finding of prudence in particular, and of deferred power cost recovery in general. That is simply not appropriate in this stage of the proceeding. The proper accounting should reflect that.

C. The Staff's Accounting Proposal Recognizes that Revenues Contribute to Consolidated Cash Flow for Purposes of Avista's Financial Covenants

The Company suggests that Staff's accounting proposal would prevent it from meeting the "fixed charge" coverage test under its credit line. (Falkner, Tr. 448:11-22; Peterson, Ex. 200-T, p. 2:1-2). Avista alleged that under Staff's accounting, the emergency rate revenue could not be counted in "Consolidated Cash Flow" for purposes of meeting the fixed charge coverage ratio. (Peterson, Tr. 296: 2-5).

In fact, Staff's proposed accounting would not prevent the Company from including the income it receives from emergency rate relief as part of Consolidated Cash Flow as defined in Avista's agreement with its revolving credit line lenders. (*See* Ex. 210).[19] The emergency rate relief revenue would be included in the Consolidated Cash Flow under the definition contained in Exhibit 210, page 6, for purposes of determining compliance with the fixed charge coverage ratio. That definition states, in relevant part:

> "Consolidated Cash Flow" means . . . for any four-fiscal-quarter period, Consolidated Net Income . . . plus, without duplication and, in the case of clauses (a), (b), (c), (d) and (f), to the extent deducted in computing such consolidated Net Income, the sum for such period of (a) income tax expense, (b) interest expense, (c) depreciation and amortization expense, (d) any extraordinary or non-recurring losses, (e) any decrease (on an after-tax basis) in gas and electric deferrals as of the last day of such period from the gas and electric deferrals as the date that is 12 months earlier, (f) other non-cash items reducing such Consolidated Net Income, and (g) all cash on the balance sheet as of the last day of such period (net of all outstanding Loans), minus [various items]. . ."

Avista's preferred accounting of emergency revenues would enable it to make an addition to consolidated net income under item (e) of this definition. (Peterson, Tr. 294:3 – Tr. 295:2; Parvinen, Tr. 711:21-24). As Mr. Parvinen testified, Staff's accounting would permit any emergency revenues authorized by the Commission in this phase to be counted in the calculation of Consolidated Cash Flow under item (f):

> Under Staff's proposal . . . the cash would show up under item F, which would be a non-cash item reducing the consolidated net income. And how that would . . . come about is that the revenues collected under the tariff based on … FERC uniform system of accounts for account 254 of the regulatory liability is that the revenues generated under the tariff would be booked as revenues, and that there would be . . . a non-cash entry to account 407.4, which is a reduction in Net Income, a debit to that account and a credit to the deferral account, deferred revenue account. So therefore, it would qualify under this if it did not qualify under item G as cash on the balance sheet or as a reduction to the line of credit.

[19] Note that Avista has testified that it may be in default at the end of September (Eliassen, Ex. 252-T, p. 3:10-12), and this will continue until the second quarter of 2002, even under Avista's proposal. (Peterson, Tr. 290:10-11). The Company is therefore seeking waivers from its creditors. (*Id.* 290:20-24).

(Parvinen, Tr. 711:24 – Tr. 712:14, and Tr. 721:3-13). Both Mr. Peterson and Mr. Falkner agreed a non-cash transaction could be used to increase cash flow under the covenant. (Peterson, Tr. 295:12-16, Falkner, Tr. 435:18-23).

> Thus, the Company's objection that Staff's accounting fails to satisfy the definition of Consolidated Cash Flow simply distracts the parties from the Company's real objection to Staff's accounting. That objection is that, consistent with the Commission's accounting order, Staff's proposed accounting would prevent the Company from communicating to the financial community, through its financial statements, that the Commission is allowing recovery of deferred costs prior to time the Commission has decided such costs are recoverable.

Moreover, adopting the Company's accounting proposal will constitute agreement that none of the surcharge revenues received prior to the prudence determination are actually subject to refund. In sum, at least for a portion of the deferral balance, the Commission will have inappropriately pre-judged prudence and propriety for recovery. To accept Avista's proposed accounting would alter the terms of the accounting orders in Docket No. UE-000972. If this is the Commission's intention, it should state it explicitly.[20] *If the Commission intends to follow the terms of its orders, it should adopt Staff's accounting proposal.*

VIII. RATE DESIGN ISSUES

A. A Uniform Cents Per kWh Rate Design Should Be Accepted Since it Reflects Cost Causation and is Supported by Longstanding Commission Policy. A Uniform Percentage Approach Inappropriately Shifts Costs to the Small Commercial Customers and Street Lighting Customers

Staff proposes that any emergency rate relief be collected by applying a uniform rate, expressed as 1.5 cents per kWh to all schedules. The only exception would be for schedules 41-49 (Street Area Light Schedules), which are flat rate schedules that are not based on usage. To those schedules, Staff would apply an average percentage increase of 32.6%. (Parvinen, Ex. 551-T, p. 6:12-16 ; Schooley, Ex. 401-T, p. 20:1-11).

[20] If the Commission agrees with Avista that it is very unlikely that it will order a refund of any surcharge revenues collected prior to a prudence determination, but the Commission wishes to reserve that possibility, Staff would recommend ordering the Company to book the revenues to Account 253, Other Deferred Credits. (Parvinen, Ex. 551-T, p. 5:12-17).

Staff's proposed rate design is consistent with a) principles of cost causation (Falkner, Ex. 252-T, p. 12: 2, as amended by eliminating the word "not" at Tr. 432; Hirschkorn, Tr. 466); b) the method authorized by the Commission in past interim relief cases (Parvinen, Ex. 551-T, p. 7:7-16); c) the way in which purchased gas adjustments are recovered (Parvinen, Tr. 713:20-24); and d) the way in which other power supply-related rates have been designed (*i.e.* in the Puget Sound Energy "ECAC" and "PRAM" mechanisms). (Hirschkorn, Tr. 467:9 – Tr. 468:5).

Staff's approach would also afford greater ease of tracking and verifying revenues collected, since volumes would not have to be tracked separately by class; greater ease of tracking for purposes of refund calculations; and greater ease of understanding for customers. (Parvinen, Ex. 551-T, p. 7:3-6 and p. 4:1-8).

Avista and ICNU propose a uniform percentage rate design. The Company's specific proposal is that the overall electricity bill of a customer in any given class should increase, on average, by a uniform 36.9%. (*See* Hirschkorn, Ex. 300-T, p. 2; Ex. 302). ICNU proposes the same rate design, but proposes an increase of not more than 11.9% to all classes. (Schoenbeck, Ex. 651-T, p. 3:1-3).

Avista is relying on not a single past order of this Commission to support its proposal. (Hirschkorn, Tr. 454:12-17).

While the Company disputes that greater administrative ease should be a weighty consideration in favor of Staff's rate design (Falkner, Ex. 252-T, p. 12:17-20), there is no dispute that a uniform cents per kWh rate design reflects cost causation.[21] Avista

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[21] The Company also applies its "uniform percentage increase" to the three energy block rates under Schedule 1, which applies to residential customers. The reasoning is that applying a uniform cents per kWh increase to the inverted rates under Schedule 1 would reduce the degree of inversion among the three

conceded the point. (Falkner, Ex. 252-T, p. 12: 2, as amended by eliminating the word "not" at Tr. 432:5-7; Hirschkorn, Tr. 466:23-25).

In the last general rate case, the primary allocator used to allocate power supply costs to customer classes was volume. (Parvinen, Ex. 551-T, p. 7:19-20). Consequently, power supply costs are a larger portion of the large volume customers' overall monthly bills. (*Id.* at p. 8:16-19). Since it is power supply costs that are responsible for the emergency rate relief request, a uniform cents per kWh rate design accurately reflects causation. (Hirschkorn, Tr. 461:16-20; Parvinen, Tr. 718:7-14).

It is true that if the power supply component increases in cost, then as compared to the total bill, the large volume customers will see a greater percentage increase than the average customer. This is appropriate. (Parvinen, Ex. 551-T, p. 8:16-19). But this did cause Avista to express concerns about rate shock to larger industrial customers. (Hirschkorn, Tr. 466:20-23). For that reason, the Company proposes to apply a surcharge that differs on the basis of cents per kWh for each class of customers under its tariff.

> There are several responses to the Company's concern. First, historically the Commission has approved rate increases on a volumetric basis in the context of purchased gas adjustments that resulted in overall bill increases to industrial customers of similar magnitude. (Parvinen, Tr. 713:20-24). The Commission did not adopt a uniform percentage rate design for those large increases.

Second, if the Commission fails to adopt a uniform cents per kWh rate design, and adopts a uniform percentage increase instead, the result will be an unfair shift in cost

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blocks and result in a higher percentage increase for a low-use customer than a high use customer, thereby deadening the energy conservation signal. (Hirschkorn, Ex. 300-T, p. 3:11-18). On the narrow matter of the effect of applying the uniform cents per kWh increase to each of the residential energy rate blocks, Staff concedes the logic of the company's argument. However, Mr. Parvinen's testimony points out that the percentage increase to the total electricity bill of the average customer within each block would be almost identical even under Staff's proposal. (Ex. 551-T, p. 9:1-5). Given this *de minimus* difference in the effect of using Staff's uniform cents per kWh approach versus the Company's average percentage approach, Staff's uniform cents approach is preferable on the basis of simplicity, fairness and cost causation.

responsibility. For the Residential class, there is almost no difference between Staff's rate design and the Company's rate design. (*See* Ex. 302, p. 2, columns 4 and 8). Therefore, a uniform percentage rate design would shift cost responsibility from the highest volume customers (industrial, large commercial, and institutional customers in Schedule 25) to the small commercial customers (Schedule 11) and the street lighting customers (Schedule 41-49). (Hirschkorn, Tr. 461:21 – Tr. 465-25). That is not fair and should not be accepted.

In addition, the Bonneville Power Administration (BPA) Residential Exchange Credit that would reduce rates for residential and small farm customers (Hirschkorn, Ex. 300-T at p. 4:3-12), does nothing to help small commercial and street lighting customers, who would bear an unfair burden under a uniform percentage rate design.[22]

In sum, Staff's uniform cents per kWh rate design is the correct rate design. It reflects cost causation principles. It is easy to administer. It imposes no improper cost shifting. It is consistent with all past orders granting emergency rate relief, and in setting rates for recovery of power costs in other contexts (i.e. ECAC and PRAM). It should be accepted.

IX. SPECIFIC RECOMMENDATIONS

For the reasons stated in this brief, the Commission should do the following:

1. Avista should be authorized to file an emergency rate adjustment to all rate schedules in the amount of 1.5 cents per kWh, except for Schedules 41-49 (Street

[22] Staff is also concerned that if the Residential class is given a disproportionate increase because of the existence of the Residential Exchange Credit, this could violate the terms of the contract and/or the underlying statute. The rate design should not be based on consideration of the level of the Residential Exchange Benefits that exist, and the Commission should clearly state that in its order.

Lighting). Schedules 41-49 would receive an increase of 32.6%. The tariff sheet(s) should bear a termination date of December 31, 2001, and should state that the revenues collected under the tariff are subject to refund.

2. Avista should record the revenues received under the tariffs in a subaccount within Account 254. Interest should be accrued at the rate of 9.03%. No crediting of such revenues against deferred power cost balances would be permitted until Avista has met the Commission's conditions for recovery.

3. Avista should be required to promptly file a rate case, and would retain the right to seek interim rate relief in that context.

4. Avista should be required to promptly file a complete direct case on recoverability of deferred power costs. Discovery would continue. The issue would be resolved as expeditiously as possible given the nature of what it is that Avista files, and Avista's ability to promptly respond to data requests.

5. Power cost deferral accounting would terminate effective June 30, 2001.

6. The Commission should retain continuing jurisdiction over the tariff.

X. CONCLUSIONS

The Staff's plan for Avista recognizes the Company's near-term need for additional revenue, in a context that provides for certainty for the Commission, Avista, investors and the Company's ratepayers. Under Staff's plan, the parties will be encouraged to work together in order to expeditiously resolve the issues identified by the Commission relating to the conditions for recovery of deferred power costs. Staff's plan

provides a process for examining Avista's revenue requirements and continued need for emergency rate relief.

Staff's plan applies the standards of this Commission for analyzing emergency rate relief. Staff's plan also respects the Commission's Orders in Docket No. UE-000972, in which the Commission established the conditions that Avista must meet before ratepayers are called upon to pay for the power costs deferred.

Staff has carefully considered the Company's case for emergency. Staff's plan is designed to expeditiously resolve the issues facing Avista and return it to financial health. If Avista does its part, that plan can succeed.

Respectfully submitted this 17th day of September, 2001.

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