BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. AVISTA CORPORATION, d/b/a AVISTA UTILITIES, Respondent.	DOCKETS UE-090134 and UG-090135 *(consolidated)*
In the Matter of the Petition of AVISTA CORPORATION, d/b/a AVISTA UTILITIES, For an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism.	DOCKET UG-060518 (*consolidated*)

BRIEF OF PUBLIC COUNSEL

NOVEMBER 10, 2009

NON-CONFIDENTIAL VERSION

Confidential information is presented in boldface with "[Begin Confidential] / [End Confidential]" designation.

I. INTRODUCTION

1. In this case the Commission is presented with major issues in three important areas: natural gas decoupling, prudent resource acquisition (the Lancaster Contracts), and the proper application of rate making methodology relating to the test year and the "matching principle." The Commission has the opportunity in this proceeding to establish meaningful precedents in each of these areas that fairly protect the interests of Avista's customers and advance the public interest --- the ultimate goal of regulation under Washington law.

2. This general rate case represents the third request in as many years faced by Avista's customers. Many have taken the opportunity to communicate their concerns with the continuing size and pace of Avista's requests. Approximately 25 witnesses addressed the Commission at hearings on September 30 in Spokane and Spokane Valley.

3. Bethann Daigre of Spokane Valley testified:

> I don't see how Washington Avista can justify giving their shareholders any kind of an increase when the majority of us aren't getting increases, as has been earlier stated, and some of us don't even have jobs…I believe Avista could cut costs, including profit for their bottom line while we're in recession, and they should have to share the stress we're all under in trying to have to pay these kind of bills. I'm a widow on Social Security, and…the cost increases year after year after year are just becoming prohibitive for those of us who have small fixed incomes.[1]

4. At the Spokane hearing, Karen Eberts stated:

> My husband I have put new siding on our house, we've put new windows on our house. We use the little curly lights, I can't remember what they're called. We ended up putting more filler in the attic. All these things were done to promote energy savings. Then, tonight, I was looking through a couple of papers that I was trying to get together for this meeting, and I found that it said that people make the effort to decrease their rates, in the

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[1]TR. 289:3-16.

> end, have to pay more. Because when you decrease it, you actually end up paying more by saving. So I guess I won't do that anymore.[2]

5. A total of 2,102 public comments were received by the Commission and Public Counsel, with 2,063 opposing the requested rate increase.[3] Many customers noted that they have seen their Avista bills increase on a yearly basis, and that those regular increases have put increased pressure on the finances of their families, farms, and small businesses. As Tom Kagi, President of Kagi Heating and Manufacturing, wrote:

> I have replaced bulbs with low consumption energy, lower heat settings, etc and my bill still goes higher all the time. I have laid off workers…I am 80 years old and still have to work. Why don't you cut your staff and lower your pay, especially to your CEOs, like I had to?[4]

These comments from ratepayers provide a reminder of the real and serious impact of the rate increases which Avista customers continue to face.

II. DECOUPLING

A. Overview -- This Case Will Establish Important Precedent.

6. This Avista docket represents the first case[5] in Washington in which the Commission has had the opportunity to evaluate the actual operation of a natural gas decoupling pilot based on empirical evidence and to test the claims of proponents based on that evidence.[6] To aid in that process, in addition to the evidence from the parties, the record includes the report of an

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[2] TR. 351:16-352:2.

[3] Public Comment Exhibit, October 19, 2009.

[4] Public Comment Exhibit, Batch 7, p. 19.

[5] The Commission has previously rejected proposals by Puget Sound Energy for natural gas decoupling, *WUTC v. PSE,* Docket Nos. UE-060266/UG-060267, Order 08, ¶¶ 53-69 (comprehensive discussion of decoupling policy issues (January 5, 2007) and by Pacific Power for electric decoupling, *WUTC v. PacifiCorp*, UE-050684, Order 04 (June 2006). Staff testimony reviews the recent history of decoupling at the Commission. Exh. No. DJR-17, p. 5.

[6] The proponents of decoupling have dwindled since the original UG-060518 docket, with Staff now recommending the mechanism be phased out. NWIGU, a signatory party to the multi-party settlement establishing the pilot, did not file testimony on decoupling and did not participate in the portion of the evidentiary hearing devoted to decoupling.

independent evaluator. The decision in this case will be an important precedent, not just for Avista ratepayers and the company, but for all Washington regulated energy utilities and their customers.[7]

7. The Commission's orders in the Avista decoupling Docket, UG-060518, establish the overall framework for review in this case. In Order 04 approving the pilot, the Commission stated, in pertinent part:

> However, we agree with Public Counsel and the Energy Project that the proposal is not without potential flaws. The settling parties should consider our approval as an opportunity to demonstrate that decoupling mechanisms do indeed increase utility sponsored conservation and that the potential flaws do not outweigh the program's benefits. We will carefully evaluate the mechanism, and will only consider an extension upon a convincing demonstration that the mechanism has enhanced Avista's conservation efforts in a cost-effective manner.[8]

Later in the case, the Commission again took pains to remind Avista of its earlier guidance, reiterating the above passage of its earlier order,[9] as to the burden that Avista must bear in this case. As the following sections will show, the Company has failed to meet that burden.

8. Key areas of concern mentioned by the Commission in its order approving the pilot were the effect of decoupling on utility sponsored conservation, the asserted disincentive for Avista to pursue conservation, the issue of fixed cost recovery, and the question of proportionality of lost margin recovery. Each of these topics will be discussed in this section of the brief, along with other related issues.

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[7] As requested by the Commission, Public Counsel has prepared a review of the status of decoupling in other states. The review is appended as Attachment A.

[8] Order 04, ¶ 33 (footnotes omitted).

[9] Order 05, ¶ 30. Order 05 addressed Avista's failure to meet the deadline for filing an evaluation plan for the pilot and imposed sanctions.

B. DSM Savings.

1. Avista's DSM savings results are inaccurate and unreliable.

a. Accurate measurement of DSM savings data is crucial.

9. The accurate measurement of Avista's DSM savings is critical. In order to persuade the Commission that decoupling should continue, Avista must make a "convincing demonstration" that the mechanism has "enhanced" its conservation efforts.[10] It must also establish that the DSM savings data and calculation methods used in the mechanism as a basis for imposing charges on customers are accurate and reliable.[11] On both issues, the viability of the data presented by Avista is an essential component of any finding in favor of the Company petition. Avista fails to meet this burden.

10. The testimony of Public Counsel witness Mary Kimball discusses in detail the serious flaws in Avista's DSM savings claims, pointing out the inaccuracy and uncertainty that results from Avista's reliance on savings estimates (sometimes known as "engineering estimates") rather than actual measurement, the discovery of serious anomalies in Avista's saving data, and the role which Avista's methodology changes during the term of the pilot played in increasing the claimed savings totals.[12]

11. In reviewing Avista's performance under the pilot, the Titus Report also questioned the quality of the DSM savings data. Titus found that Avista's DSM savings data contained "inconsistencies," "data entry errors" and data that "were not readily available." As a result, according to Titus, "documented savings became a moving target." [13] On cross-examination, when referred to these findings, Avista witness Powell agreed that Titus had concluded that the

[10] Order 04, ¶ 33.
[11] Powell, TR. 1201:12-1202:1.
[12] Exh. No. MMK-1T.

company's data was of poor quality.[14] While there are a number of reasons for terminating Avista's decoupling mechanism, the DSM savings issues alone provide a sufficient basis for finding that Avista has not made its case to continue the program.

b. Avista's DSM savings data are not based on measurement and verification of actual usage.

12. A fundamental weakness in Avista's DSM savings claims is the absence of accurate or actual measurement and verification of savings.[15] Avista argues that its savings claims are confirmed by a "DSM Verification" process conducted by a third-party, Research In Action (RIA). The RIA "verification" process, however, does not involve any measurement or verification of actual usage. As the Titus Report states:

> The verified effect reported in the [DSM Verification] audit is not "measured" energy savings. The auditor verified the engineering estimates and the corresponding assumptions and documentation, but did not perform any post-installation measurement or analysis.[16]

13. In the words of Staff witness Deborah Reynolds, this The DSM Verification Report is only "a process evaluation, not an impact evaluation."[17] The Titus Report expressed concern that "this approach is lacking."[18]

14. While acknowledging the lack of measurement, Avista seeks to set itself a low bar by arguing that the DSM Verification process should be treated as sufficient because that was all that the settlement agreement required.[19] This argument ignores the Commission's clear

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[13] Exh. No. BJH-2a, p. 5.
[14] Powell, TR. 1203:4-10.
[15] Exh. No. MMK-1T, pp. 7-9.
[16] Exh. No. BJH-2a, Titus Report, Section H, p. 61.
[17] Exh. No. DJR-3T, p. 5:13.
[18] Exh. No. BJH-2a, p. 61.
[19] Exh. No. JP-3, p. 2:21-3:20.

directive in its order that Avista has the burden of making a "convincing demonstration" that its energy efficiency programs have been enhanced.[20]

15. In this regard, a seriously troubling aspect of the pilot is that Avista had the opportunity to remedy this defect in the data but actively opposed such an approach. Titus proposed to Avista and the decoupling evaluation Advisory Group that it conduct a non-proprietary analysis of actual customer energy usage data (billing) as part of its independent analysis.[21] In light of Titus' concerns about the reliability of the DSM savings data and the limitations of the third-party DSM verification process, it seems clear such an analysis would have been appropriate and valuable. However, in a "non-consensus" decision, Avista objected to Titus conducting such an analysis, and thus no actual billing analysis was done to measure actual usage as part of the pilot.[22]

16. While Avista has had gas DSM programs for a number of years, in the last five years, no significant evaluation or review of its own DSM programs has been conducted. When asked to provide evidence of such analysis Avista could refer only to the Titus Report, the DSM Verification reports, to an internal spreadsheet with data from a commercial pre-rinse sprayer program, and a document with installation specifications for DSM measures in multi-family residential programs.[23] Of all the documents provided, the only one using actual usage in

[20] Order 04, ¶ 33. Further, in Order 05, ¶ 33, the Commission stated: "All the parties have a responsibility to collaborate in good faith to produce the best possible evaluation under the circumstances. As we have previously noted, however, the ultimate burden in this regard lies squarely with Avista."

[21] Exh. No. MMK-1T, p. 8:1-13.

[22] Exh. No. BJH-2a, Titus Report, p. 63, n. 107; Powell, TR. 1204:6-18.

[23] Exh. No. MMK-1T, p. 9:12-10:2; Exh. No. JP-11X.

evaluation of a program was the internal pre-rinse sprayer spreadsheet, which measured the usage changes of only 20 participants.[24]

c. The quality of DSM savings data is poor.

(1) The "Idaho furnace" data is a case study in complexity and unreliability.

17. The "Idaho furnace" situation is illustrative of the problems with Avista's DSM data. In her testimony for Public Counsel, Mary Kimball identified and discussed a discrepancy in the DSM savings reported for 2006 from the Idaho residential furnace program (Idaho furnace program).[25] The claimed savings from this category were reported to be 144,642 therms.[26] According to the data Avista provided in discovery, however, the actual savings were only a little more than 31,000 therms, a discrepancy of around 113,000 therms.[27]

18. The discrepancy is significant, representing around 10 percent of Avista's total claimed therm savings for 2006.[28] Using these claimed savings, in 2006 Avista reported that it had achieved 99.1 percent of its DSM IRP goal. Accordingly, under the terms of the pilot, the Company was authorized to recover 80 percent of its decoupling deferrals. If 113,000 therms had been removed from its reported savings, however, it would have met only 88.4 percent of the

[24] Late in the process, Avista now claims to be developing a new measurement and verification plan. Notwithstanding promises to do so in rebuttal testimony, Exh. No. KON-1T, p. 46:20-47:4, Exh. No. JP-3, p. 4:4-10, the plan has not yet been made public or distributed to interested parties such as Avista's Triple EEE advisory committee. TR. 1198:24-1200:2; TR. 1204:19-1205:9. The plan is an unknown at this point and there is no information in this record about what it will involve. Avista's representations should have no bearing on the decision in this case.

[25] Exh. No. MMK-1T, p. 28:10-p. 31:6. Idaho DSM savings are included in the DSM analysis for the Washington decoupling mechanism. TR. 1210:25-1211:5.

[26] Exh. No. BJH-2a, Table H3-B, p. 55.

[27] Exh. No. JP-14X (Avista's Response to Public Counsel Data Request No. 283, Attachment A). The residential furnace category includes high efficiency furnaces, and residential boilers. Avista estimated savings of 72 therms for both furnaces and boilers in 2006. *Id.*

[28] Powell, TR. 1210:16-24.

IRP goal, and under the decoupling pilot rules, would have only been entitled to 70 percent of the deferrals.[29]

19. When Public Counsel investigated this discrepancy in further discovery, Avista initially responded that the 113,000 therms came from the "multi-family direct install program."[30] After further inquiry by Public Counsel, however, Avista acknowledged that this statement was incorrect, since no such program ("multi-family direct install") had even existed in 2006. Instead, according to Avista, the 113,000 therms savings actually resulted from three "site-specific" projects at multi-family residential buildings in Idaho. [31]

20. When Avista was asked for more detail on these three projects, further interesting facts came to light. Avista acknowledged that there was a "formula error" in its report and that the total estimated first year savings for these three projects, located in two condominium buildings, was only 19,950 therms, rather than 113,000 therms as reported in the DSM Verification.[32]

21. Moreover, the record shows that even this reduced savings level of 19,950 therms is an overstatement. Of the three Idaho condominium projects, Avista concedes one was withdrawn, and that an incentive payment was made to the owner by the Company for only one of two remaining. Since Avista does not make incentive payments until a project is complete (and DSM savings are not counted until completion under the decoupling pilot),[33] it appears that, at most, the only savings that should have been reported from the Idaho condominium projects was 6,240 therms.

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[29] Exh. No. MMK-1T, p. 36:1-18. The recovery amount would have been reduced $38,210.

[30] Exh. No. JP-19X, response a.

[31] Exh. No. JP-20X, responses a and b. Avista has asserted these "site specific" residential projects were "verified" along with the standard residential "prescriptive" programs. In this case, however, the projects at issue were reported in the standard residential category.

[32] Exh. No. JP-22X.

[33] TR. 1216:17-21.

22. As noted above, Avista's verified DSM savings results reported for 2006 included the 113,000 claimed savings for the "Idaho furnace" program, Avista represented that these savings were verified in the 2006 DSM Verification report provided to the Commission.[34] Avista discovered the "formula error" in 2007[35] but has never corrected the error or notified the Commission of the incorrect filing. Even after acknowledging the "formula error" of which it had apparently been aware since 2007, Avista stated that it had no plans to correct its earlier filings. Avista witness Powell reiterated this at the hearing, asserting that reporting the error retroactively would somehow not be "consistent with the independent verifier's methodology."[36]

23. Avista's response on this issue, until its own error came to light, had been to describe Ms. Kimball's identification of this discrepancy as an error.[37] Avista also attempts to dismiss her analysis as "non-random" in nature.[38] Whether random or non-random, the facts speak for themselves. When a single error can affect as much as ten percent of the claimed savings, and directly affect the amounts recovered from ratepayers, it avails Avista little to say that the method used to uncover the mistake was somehow inappropriate.

24. Avista contends that these claimed therm savings were included in the results supposedly "verified" by the third-party DSM Verification for 2006. As shown in the cross-examination of Avista witness John Powell, however, the DSM Verification reports make no reference to verifying the site-specific project numbers. The DSM Verifier instead comments that every

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[34] Exh. No. JP-19X, response c. This is further confirmed by comparing Avista's *Summary of the Independent Verification of Avista's 2006 Completed Natural Gas-Efficiency Claims*, UG-071863, at Exh. No. BJH-2a, Exh. No. D-2-1, at p. 22, which shows a total of 382,355 therms in the residential category, and Tables H3-A and H3-B of the Titus Report, which also show a total of 382,355 therms for Washington and Idaho residential projects, including 144,642 for the Idaho furnace category. Exh. No. BJH-2a, pp. 54-55.

[35] Public Counsel was required to issue four data requests in this case before learning of the error.

[36] TR. 1217:22-24.

[37] Exh. No. JP-3T, p. 6:15, p. 7:8.

[38] Exh. No. JP-3, p.6:8; TR. 1217:16-1218:18.

single project examined for sample and stratum purposes showed savings of 72 therms per project (the standard residential furnace and boiler savings estimate in 2006).[39] Therefore, there is now clear evidence that these three projects, which were reported to the Commission as resulting in over 113,000 therms savings, were in fact not verified, as required under the terms of the decoupling pilot.[40]

25. Public Counsel believes Avista should be required to correct its 2006 DSM filings made with the Commission. Public Counsel recommends that Docket UG-071863 be reopened, and the Commission initiate an own motion complaint proceeding on the issue, or in the alternative, direct the Commission Staff to initiate an investigation docket on this matter to determine how to correct the flawed deferral and surcharges that have occurred.

(2) Avista's 2008 ceiling insulation data was inaccurate.

26. For the year 2008, Avista reported savings of 10,837 therms for its ceiling insulation program for a particular Washington customer. In discovery, Avista admitted that the savings for the customer should have been instead 729 therms.[41] The reported savings were thus fourteen times the actual level for this customer. This overstatement by itself represents 15 percent of the total savings for the Washington ceiling insulation program in 2008.[42] This inaccurate savings claim was included in the total verified savings reported to the Commission for 2008.[43]

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[39] Powell, TR. 1220:12-1224:3.
[40] As discussed above, the evidence is that only one of these projects was completed.
[41] Exh. No. BWF-7X.
[42] Exh. No. MMK-2, p. 1 (shows 2008 total savings of 67,691).
[43] Exh. No. BWF-7X.

(3) 2008 DSM results were revised in Docket UG-091399.

27. Docket UG-091399 was the decoupling surcharge filing for the final reporting period of the decoupling pilot. After the conclusion of the hearing in this docket, Avista filed revised DSM results for 2008 in that docket, reducing its claimed savings from 1.82 million therms, or 127% of its IRP goal to 1.56 million therms, or 110% of its IRP goal.[44] This revision was due to the fact that three large projects that had been verified separately, were incorrectly included in the wrong category in Avista's original summary presentation of the 2008 DSM verified results.[45] Moreover, in addition to that correction, to which Avista agreed, Staff and Public Counsel believed that two additional adjustments should have been made to the 2008 verified DSM results. Staff and Public Counsel's analysis, provided to the Commission at the Open Meeting, shows Avista's performance for 2008 was approximately 1.29 million therms, or 91.2% of the IRP goal.[46] Avista agreed to recover only 80% of decoupling deferrals, as recommended by Staff and Public Counsel, but stated it did not concur with the analysis resulting in the 91.2% figure.[47] The Commission allowed the tariff, as revised, to become effective.

28. It is worth noting that the original reported figure of 1.82 million therms saved for 2008 is reflected in multiple locations in the record testimony, in describing the results of the DSM programs as a result of decoupling. [48]

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[44] Docket No. UG-091399, Replacement Tariff and Revised Exhibits filed by Avista, October 22, 2009.

[45] *Id.*, Avista Cover Letter to Revised filing. *See also*, Comments of Public Counsel, Docket No. UG-091399, October 23, 2009.

[46] Docket No. UG-091399, Staff and Public Counsel Revisions to Avista's Exhibit 4, provided at October 29, 2009 Open Meeting.

[47] Docket No. UG-091399, Avista Cover Letter to Revised filing, October 22, 2009.

[48] The original version of the Titus Report submitted by Avista in UG-060518 reported 2008 verified DSM performance as 1.95 million therms, but the company discovered this calculation contained an error, and thus multiple tables of the Titus Report were revised and filed on August 10, 2009 to reflect the 1.82 million therm figure. The incorrect 1.82 million figure is also referenced in testimony Mr. Powell's testimony. At hearing, during cross examination by Mr. Johnson for the NWEC, Mr. Powell corrected the figures at p. 5 of his testimony,

2. Avista's mid-pilot methodology changes raise further concerns that Avista's savings results are unreliable and overstated.

29. As detailed in Ms. Kimball's testimony, in 2008, during the term of the pilot, Avista made major changes in its savings claim methodology, the assumptions used to calculate its DSM claimed savings. To Public Counsel's knowledge, these changes were not made known to the Commission or stakeholders, and did not come to light until discovery by Public Counsel in this docket. At least nine changes were made, as shown in Ms. Kimball's Table 1.[49] The revised assumptions and changes in reported savings estimates significantly increased the Company's reported performance and would influence any apparent trends in savings. If the savings data is recalculated to use the methodologies in place when the pilot was initiated, Avista's claimed savings would have been reduced by 29 percent, and the lost margin calculations reduced accordingly.[50] Avista did not rebut Ms. Kimball's testimony on this issue.

30. Staff witness Deborah Reynolds agreed with Public Counsel that "the savings estimates increases during the pilot project are troubling."[51] Ms. Reynolds recommended that the savings estimates should not change during the pilot and that the Company's savings should be reduced in the manner shown in Exh. No. MMK-1T, Table 1. Staff and Public Counsel's analysis of Avista's 2008 savings in UG-091399 was that Avista achieved only 91.2% of its IRP goal, which includes an adjustment to remove the impact of the changes to the savings estimates.

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indicating 2008 DSM savings should be 1.82M therms instead of the 1.95M therms he included originally. TR 1238:21-1239:18. The 2008 DSM savings are also shown in testimony of other witnesses, including Staff and Public Counsel. (DJR-1T, p. 8:5, and MLB-1T, p. 11, Chart 2.)

[49] Exh. No. MMK-1T, p. 33; Exh. No. MMK-2. See generally Section IV of the testimony, pp. 31-42.

[50] *Id.*, p. 38:5-12.

[51] Exh. No. DJR-3T, p. 6:6-13.

3. The existing data does not show that increased therm savings in Washington have significantly increased as a result of decoupling.

31. In support of its petition for continuation, Avista asserts that its DSM expenditures and results have substantially increased during the pilot.[52] While the Titus Report does show increases in expenditures during the pilot, it also shows that substantial increases had occurred prior to the pilot.[53] In addition, since 2004, Avista has actually spent more on electric than on gas DSM, even without electric decoupling. This data does not support a conclusion that introducing decoupling in Washington caused the changes in Avista's DSM spending.[54]

32. Likewise, Avista's annual therm savings trends data do not reflect a strong correlation with the introduction of decoupling in Washington. Washington therm savings actually declined between 2007 and 2008.[55] While there has been an increase since 2005, the largest increase (137 percent) in Washington therm savings occurred between 2004 and 2005, prior to the introduction of decoupling. By contrast, however, Avista's Idaho territory has seen even more dramatic increases in DSM savings. During the Washington pilot, between 2007 and 2008, savings in Idaho increased 151 percent, without the benefit of a decoupling program in that state. As noted, in the same time period, savings actually declined in Washington. If Avista's changes to its savings estimates for 2008 are removed, and if the Washington data had been updated to reflect

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[52] Exh. No. BJH-1T, p. 4:9-10.

[53] Exh. No. MLB-1T, p. 8:4-14.

[54] This section generally references the original reported therm savings in the record to dispute Avista's claims of improvements tied to decoupling. As noted elsewhere in the brief, however, there are questions about the accuracy of these DSM savings data.

[55] Exh. No. MLB-1T, p. 11:1-14, Chart 2.

Avista's revised 2008 DSM results as filed in UG-091399, the decline in Washington is even steeper.[56]

33. Avista has failed to show that "decoupling mechanisms do indeed increase utility-sponsored conservation" and failed to make a "convincing demonstration that the [decoupling] mechanism has enhanced Avista's conservation efforts."[57] Perhaps most damaging to Avista's case is that even NWEC, the only other party supporting decoupling in this case, agrees. After reviewing the responses to NWEC discovery requests on this point, NWEC's witness Ms. Glaser testifies that "[d]espite the strong energy efficiency performance, Avista has not yet provided clear evidence that the Decoupling Mechanism, per se, has materially contributed to its decision-making with regards to energy efficiency." She goes on to state that "[i]t does not appear from the responses that the Decoupling Mechanism had a significant effect in any briefing or decision-making discussion on the future of DSM investments."[58] Finally, she concludes:

> There is little documentation that implementation of the Decoupling Mechanism to date has caused Avista to behave any differently than it otherwise would have given the steady rise in therm savings since 2002; nor that the Company took any specific actions due to the Decoupling Mechanism's existence.[59]

Here, Ms. Glaser points out, as did Michael Brosch for Public Counsel, that Avista's DSM savings have been increasing since well before the decoupling pilot and no correlation has been shown between current savings levels and the mechanism. This is yet further evidence that

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[56] Exh. No. MMK-3 shows re-stated Washington 2008 results of 871,426 therms, to remove the impact of the changes to the savings estimates, while Chart 2 at Exh. No. MLB-1T shows Washington 2008 results of 1,053,244. In addition, Exh. No. MMK-3 shows 429,104 therms for commercial/industrial for WA and 503,878 for Idaho (total combined of 932,982), but in UG-091399, revised Exhibit 4, Avista provided revised results for this group on a combined WA/ID basis of only 715,966 therms. Therefore, if the Washington results were revised to reflect the correction in UG-091399, the decline from 2007 to 2008 would presumably be more significant.

[57] Order 04, ¶ 33.

[58] Exh. No. NLG-1T, p. 14:7-16.

[59] Exh. No. NLG-1T, p. 14:24-27.

Avista has not satisfied the key criteria established by the Commission to warrant continuation of the mechanism.

C. Disproportionality of Lost Margins.

1. The Titus Report verifies disproportionate recoveries of lost margins under the decoupling pilot.

34. A fundamental problem with virtually all decoupling proposals, and one important basis for Public Counsel's opposition to such mechanisms, is that decoupling is at best a "blunt instrument." While purporting to remove the disincentive for a company to pursue energy savings, decoupling typically compensates utilities for much more than lost sales reasonably attributable to the company's own energy savings efforts. This policy concern was one basis for Public Counsel's opposition to adoption of Avista's decoupling proposal in the original docket.

35. In Order 04, the Commission recognized this as a key issue, stating that:

> The proportion of margin lost to company sponsored DSM relative to the amount subject to recovery is of great interest to us, and we will closely scrutinize this factor in reviewing the results of this pilot decoupling program.[60]

Now that the results of the pilot are in, there is no more room for debate on this point. The data is clear that decoupling deferrals are seriously disproportionate to the lost margins which result from Avista's own conservation efforts. The Titus Report data shows that the ratio of deferrals ("benefits" to Avista) to lost margin ("costs" to the Company) was over 10:1 in 2007, while in 2008 it was about 8:1.[61] To illustrate this in dollar terms, Avista's cumulative lost margins in the

[60] Order 04, ¶ 26.

[61] Exh. No. MLB-1T, p. 16:5-9, and Chart 3. Titus Report, p. 45, Table E-2. The amount of lost margins referenced here, as shown in the Titus Report, do not reflect Avista's revised 2008 verified DSM results, filed in UG-091399, which reduced 2008 DSM savings from 1.82M therms to 1.56M therms. Actual lost margins would therefore be lower if Avista's revised 2008 results were used for the calculation.

2007 and 2008 period were $253,090, while its decoupling deferrals recoverable from ratepayers at the 90% level for that time period were $2,233,172, assuming no general rate case.[62]

36. The proponents of decoupling no longer contest the disproportionality of decoupling recoveries. Avista witness Kelly Norwood himself acknowledges that the proportions are roughly 6 or 8 to 1.[63] Brian Hirschkorn testified that lost margins from company DSM were only 16 percent for Schedule 101 customers in 2007 and 2008.[64] Nancy Glaser, testifying for NWEC, also acknowledged the disproportionality.[65]

2. The scope of lost margin recovery is not related to the alleged Avista "disincentive."

a. Avista does not face serious disincentives to invest in DSM.

37. The record in this case calls into serious question the basic premise of decoupling -- that Avista faces a disincentive to invest in DSM significant enough to create economic effects on management decision making and investments. Avista is required by law to pursue DSM programs through the IRP process.[66] Avista has never refused to implement any DSM measure that was reviewed and acknowledged by the Commission in its IRP process.[67] Avista does not dispute that "the Company has had robust electric and natural gas DSM programs for many years."[68] This robust investment in DSM occurred while the purported "disincentive" operated unrestrained upon Avista management. Its electric DSM expenditures and programs are more

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[62] *Id.* WA Sched 101 lost margins of $90,429 + $162,661=253,090 compared to 90% decoupling deferrals of $938,329 + $1,294,843 = $2,233,172 with no general rate case. This comparison without a general rate case is valid because the effect of rate cases is to periodically "roll in" the lost margins when calculating test year revenue requirement, restating the deferral basis toward zero while charging customer through base rates for such lost margins.

[63] Exh. No. KON-1T, p. 34:18-21.

[64] Exh. No. BJH-1aT, p. 11:5.

[65] Exh. No. NLG-1T, p. 8:26-p.9:12.

[66] WAC 480-90-238.

[67] TR. 987:21-988:17.

[68] Exh. No. KON-1T, p. 36:13-14.

extensive and better funded without decoupling than those on the gas side with decoupling. Its Idaho gas programs, without decoupling, exceed the Washington programs with the mechanism. While Avista suggests that the absence of a "mechanism for fixed cost recovery" will be a major factor considered by the Company in its DSM plans, the Company stated at the hearing that it is committed to DSM and it will continue to have a meaningful DSM program with or without decoupling.[69]

38. When its DSM efforts without decoupling are pointed out, the best response Avista can muster is that it has pursued DSM out of an "expectation" that decoupling would be allowed.[70] No Commission order or other source for the "expectation" is cited, which would be difficult, given that the Commission has rejected both gas and electric decoupling proposals in Washington and has expressed reservations about the concept, even in approving this pilot.

39. It is also worth recalling the scale of the "problem" giving rise to the asserted need for decoupling. During the term of the pilot, Avista's annual lost margins due to its own conservation programs ranged from $90,429 in 2007 to $162,661 in 2008. When compared to Avista's total proposed gas margin revenue in the rate case of $56 million for the test year, lost margins represent less than 0.3 percent of total margin revenues.[71]

40. It also is not at all clear that there is a serious problem with declining use per customer. For example, analysis in the Titus Report shows increasing usage per customer for existing customers, and decreasing usage for new customers only.[72] In addition, total weather normalized sales volumes for Avista's Schedule 101 have been stable during the decoupling pilot period, and

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[69] Norwood, TR. 983:14-16.
[70] Exh. No. KON-1T, p. 36:18-19.
[71] Exh. No. MLB-1T, p. 36:2-5.
[72] Exh. No. BJH-2a, p. 52, Table G-5.

total Washington weather normalized sales volumes have increased.[73] Avista's own forecasts anticipate that sales volumes and margin revenues will increase over the next five years.[74]

b. The three parts of Avista's decoupling mechanism.

41. At the hearing, Chairman Goltz observed that the costs which can potentially be recovered through decoupling can be categorized as falling into three parts.[75] These are (1) the lost sales margins attributable to the Company's own energy efficiency programs; (2) lost sales margins from non-programmatic Company activity (e.g., advertising encouraging conservation)[76]; and (3) lost sales from any other exogenous factors not related to company programs (e.g. the economic downturn, building code requirements, changes in appliance standards).[77] It is not a matter of dispute that Avista's decoupling mechanism allows the Company to recover for all three of these "buckets" of lost sales margins.[78] As discussed further below, not only is this unfairly burdensome to ratepayers, it is poor public policy.

42. Avista's decoupling mechanism is not linked directly in any way to savings from its own energy efficiency programs. Instead, during the pilot Avista recovered for all causes of margin losses, including overall economic conditions (which were dire during the pilot), price elasticity related to increases in natural gas prices; ordinary customer home improvements or construction of new homes in compliance with new energy efficiency codes; ordinary cycles of replacement

[73] *Id.*, p. 67, Table J1.
[74] Exh. No. BJH-2a, p. 75, Tables J8-D and J8-E.
[75] TR. 1029.
[76] As discussed below, Public Counsel does not view the "non-programmatic" DSM lost margins as a true separate category for tracking or deferral purposes.
[77] TR. 1027:13-1029:7
[78] TR. 1038:5-21. When questioned earlier by Chairman Goltz, however, Mr. Norwood repeatedly created the misleading impression that Avista's mechanism was "primarily" aimed only at lost margins from programmatic and non-programmatic DSM. TR. 1028:4-8; TR. 1029:8-14; TR 1030:4-9. Avista did not design its mechanism that way and has never advocated such an approach to decoupling.

of older less efficient appliances with new appliances complying with higher standards; and voluntary ratepayer conservation measures outside of any company program.[79]

43. There is no dispute in this case that Avista's decoupling deferrals result from many causes unrelated to company efforts. That fact, however, fatally undermines the fundamental policy and logical justification offered for decoupling -- the premise that the Company's "disincentive" (lost sales) must be removed so that it will invest, or invest more, or invest more willingly, in DSM. If Avista is allowed to recover funds from ratepayers for losses which have no demonstrable operational or financial connection with Avista's own programs, then allowing that recovery, by definition is entirely unrelated to Avista's incentives to pursue or not pursue those programs. In other words, these factors would not affect Avista's incentives to pursue or not pursue energy efficiency.

c. Decoupling is not visible to Avista customers.

44. Decoupling remains largely hidden from Avista's customers. Customers do not see the decoupling surcharge on their bills. Avista's response to Bench Request No. 11[80] shows that if information is supplied at all, it is limited, unclear, and blended with information about the PGA. Public Counsel recommends that if decoupling is continued, that Avista be required to show the decoupling surcharge as a separate line item on the bill, appropriately labeled, and to provide individualized notice in bill stuffers, as well as clear information on the Company website.

3. "Non-programmatic" DSM issues.

45. As noted above, it has been suggested that Avista's "non-programmatic" conservation efforts (the "second bucket") also have a lost margin "cost" and should be appropriately

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[79] Exh. No. MLB-1T, p. 13:11- p. 14:13.
[80] Exh. No. B-12.

recovered through decoupling. This argument is advanced by Avista and NWEC, essentially in response to the "disproportionality" criticism as a way to justify the broad scope of deferral recoveries.[81] Avista focuses on its "Every Little Bit" program in this regard. The "Every Little Bit" program is a customer outreach program consisting of an informational campaign that uses advertising, printed brochures, electronically distributed information, and bill stuffers to make customers aware of energy efficiency actions they can take, including directing them to Avista's DSM programs.[82]

46. While the outreach campaign may be an appropriate activity for Avista, the record does not support a conclusion that the existence of this program is tied to any quantifiable broader margin losses for decoupling purposes. Avista has not provided any quantifiable evidence of such effect.[83] The outreach itself contains many features which relate to electricity usage only, or to both gas and electric.[84] There is no way to quantify the impact of the program's advertising message on gas usage alone, and Avista has not offered any.

47. One impact of Every Little Bit is that it may encourage Avista customers to use Avista's own gas and electric energy efficiency programs. Indeed, one of the "primary messages" of the Every Little Bit campaign is to direct customers to the rebate programs.[85] This is further demonstrated by Mr. Powell's Exh. No. JP-2, which he describes as "a sampling of materials developed and distributed under the Company's 'Every Little Bit' energy efficiency

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[81] In this way, this is a cousin of the Company argument that because it is a generally a supporter of energy efficient building codes and appliance standards, any lost margins from those factors are properly recoverable.

[82] Exh. No. MLB-1T, pp. 18-20.

[83] Exh. No. KON-2X (no statistically valid surveys of customer DSM adoption resulting from Every Little Bit and not claimed for decoupling DSM purposes). The results are "difficult to quantify." Exh. No. JP-1T, p. 5:2.

[84] Exh. No. KON-2X; TR. 992:5-10; TR. 997:12-998:9.

[85] Exh. No. BJH-2a, p. 27.

campaign."[86] Notably, all eight pages of Mr. Powell's exhibit, which include examples of outdoor, print, web and radio advertising, and excerpts from Avista's website – direct customers to Avista's rebate programs.[87] If programmatic DSM gas lost margins result, then there is a high risk of double-counting recovery of additional lost margins is allowed.

D. Fixed Cost Recovery.

48. While Avista and the Northwest Energy Coalition generally emphasize the energy efficiency disincentive argument in support of decoupling, a second persistent theme is the assertion that Avista is failing to recover its fixed costs due to declining usage. In Order 04 approving the pilot, the Commission noted this rationale for the mechanism.[88] However, concerns about fixed cost recovery do not warrant of approval of Avista's decoupling mechanism on a permanent basis.

1. Avista is not entitled to guaranteed recovery of fixed costs.

49. Consistently, the tone and terminology of Avista's argument suggests that Company has an entitlement to recover fixed costs authorized by the Commission.[89] A discussion of this issue, therefore, must begin with recalling the basic premise of ratemaking --- Avista is not entitled to, nor has it ever been provided with, any guarantee that it will recover its fixed costs. It is black letter law, recognized by the United States Supreme Court, that ratemaking is not a guarantee of a certain level of recovery or rate of return.[90] When pressed, Avista concedes that this is the case.[91]

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[86] Exh. No. JP-1T, p. 1:17-18.
[87] Exh. No. JP-2.
[88] Order 04, ¶ 8.
[89] *See e.g.,* Exh. No. BJH-8T, p.2:14-17.
[90] *Bd. of Pub. Util. Comm'rs v. N.Y. Tel. Co.,* 271 U.S. 23, 31 (1926).
[91] Norwood,TR. 1037:25-1038:3.

50. Utility rates are set based upon a test year snapshot comparing overall costs to overall revenues under present rates. New rates are designed to produce revenue sufficient to recover total costs, including an authorized return on investment. This process provides some efficiency incentives to management in the form of regulatory lag. If costs are successfully controlled, a higher return can be earned between test years.

51. Every element of ratemaking is subject to change after the test year. If productivity gains and revenue growth are sufficient to offset inflation and other cost changes, the utility could go several years between rate cases. Piecemeal ratemaking through riders such as decoupling upset this balance, effectively guaranteeing recovery only of selected costs or protection against certain changes in revenues. A decoupling mechanism like Avista's, adjusted for usage per customer, but not weather or growth in number of customers, is precisely this type of piecemeal approach.[92]

2. There are no studies or quantification that verify failure to recover fixed costs.

52. Decoupling has produced consistent rate increases between test years, because of Avista's selection of a single persistently negative trend in weather adjusted usage per customer – while ignoring favorable trends in numbers of customers served. Avista focuses on the downward trend in per-customer usage,[93] while disregarding the offsetting effects of gradual growth in the number of customers on Schedule 101, as shown in Chart 4 of Mr. Brosch's testimony. Decoupling is not needed to stabilize gas margin revenues or fixed cost recovery. The Company's Schedule 101 therm sales volume increases and resulting margin revenues have

[92] Exh, No. MLB 1T, p. 33:11-34:5.

[93] This trend is not a new phenomenon, but has existed for several decades. Exh. No. MLB-1T, p. 14:10 and Chart 6, p. 34.

been stable and generally increasing without decoupling since 2002, when viewed on a weather normalized basis.[94]

53. Avista has sponsored no evidence of financial need or earnings attrition to support the rate increases caused by decoupling, nor has it provided such evidence specifically with regard to fixed costs. The only indication of any financial need is in the rate case filing, in which Avista presents a comprehensive request to recover all of its prudent costs and expenses. Of course, in rate cases test year therm sales volumes are updated to account for the cumulative effect of conservation, customers added to the system and all other drivers of sales, while rate base and operating expenses are adjusted to reflect current conditions in a properly "matched" test year.

54. Ultimately, the best study of whether overall revenues are sufficient to meet overall costs, including fixed costs, is a periodic rate case. Avista retains its legal right to file a rate case whenever new revenues are needed based upon overall cost changes – it has not offered to forego this right if decoupling is extended. Clearly, decoupling has not allowed Avista to avoid rate cases. Two general rate cases were filed by Avista during the term of the pilot. [95] Avista has allowed little time to elapse between these filings**.** This case was filed only three weeks after the effective date of rates from the 2008 docket. The instant case represents the third general rate request since the pilot began. At the hearing, Kelly Norwood acknowledged that Avista plans to file a new rate case in 2010, possibly as early as January.[96]

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[94] Exh. No. MLB-1T, p. 22.

[95] 2007 General Rate Case, Docket Nos. UE-070804, UG-070805; 2008 General Rate Case, Docket Nos. UE-080416, UG-080417.

[96] TR. 1008:5-17.

3. Fixed costs are not truly fixed.

55. The term "fixed costs" is something of a misnomer. So-called fixed costs are not constant in amount, but are subject to continual change between test years for factors such as inflation, improvements in management and productivity, changes in regulations, and other factors.[97] In defense of the decoupling mechanism carve-out that allows the Company to retain therms sold to new customers, Avista argues its fixed costs grow directly as new customers are added.[98] The only place where all drivers of changes in fixed costs can be studied and quantified is a rate case. It is incorrect to assume that Avista's cost are "fixed" or that decoupling will ensure recovery of this "fixed" amount of cost and thereby avoid any need for rate cases.

56. In fact, as this brief addresses elsewhere, Avista wants more than recovery of its allegedly fixed costs, it wants to keep margins from new customers while fixing the margin revenues from existing customers – effectively ensuring a growing gas margin revenue amount between test years.[99]

E. Structural Problems with Avista's Decoupling Mechanism.

1. Avista's decoupling mechanism is complex and burdensome.

a. Decoupling requires at least twelve steps.

57. In his rebuttal testimony, Kelly Norwood dismisses concerns raised by Staff and Public Counsel regarding the complexity and administrative burden of decoupling, testifying that the decoupling deferral calculation is a simple and straightforward seven step process.[100] At the hearing, however, Mr. Norwood was unable to explain most of the seven steps he had listed in

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[97] Norwood, TR. 993:1-6; Glaser, TR. 1250:20-25.
[98] Exh. No. BJH-8T, p. 3:3-16.
[99] Exh. No. MLB-1T, p.25.
[100] Exh. No. KON-1T, p. 42:11-23.

his testimony, deferring most questions to Mr. Hirschkorn or Ms. Knox.[101] Mr. Norwood also admitted that five steps had been omitted from his list.[102]

58. In fact, the decoupling mechanism is significantly more involved than Mr. Norwood suggests. Many of the steps require significant data review and analysis. The following chart summarizes what is involved with each stage of the analysis.

The 12 Steps to Avista's Proposed Decoupling Mechanism

Step	Description
Monthly Deferral Calculation	
1. Determine Schedule 101 Actual Billed Therms	Monthly accounting data of billed therms (sales volumes) for Schedule 101 customers, from Avista billing data. Norwood, TR. 998:24-999:11.
2. Deduct New Customer Usage	A computer program query is written against Avista's customer billing system to identify customers added to the system since the corresponding month of the test year. The sales volumes associated with those new customers are then determined and subtracted.
3. Adjust for Unbilled Therms	Multiple data sources are used to estimate how much of the Schedule 101 therm sales are unbilled each month (i.e. volumes sold but not yet billed), including a meter reading schedule, and the results of the regression analysis prepared for weather normalization to determine estimates of use per customer per degree day, which is then weighted for each individual customer based on billed usage within or outside the calendar month. Hirschkorn, TR. 1112:12-1114:16.
4. Perform Weather Adjustment	Regression analysis performed using historical billing data to determine a base load amount (estimated amount of usage per customer that does not vary based on the weather). The resulting estimated use per customer per degree day is then multiplied by the difference between actual and normal degree days for the month, times the number of customers. Seasonal coefficients are developed using regression analysis to translate degree day weather data into equivalent therm adjustments. Hirschkorn, TR. 1116:22-1119:15.
5. Subtract Test Year Therms Adopted in Most Recent Rate Case	Base level of therm sales (weather normalized) for Schedule 101 from most recent general rate case.
6. Multiply the	Margin Rate for Schedule 101 as established in most recent rate case,

[101] TR. 998:15-1007:24.
[102] TR. 1003:12-1006:14.

Difference between Billed and Test Year Therms by Margin Rate.	but adjusted to remove revenue related expenses such as taxes, Commission fees, and uncollectibles.
7. Multiply by 70%	Pilot Mechanism multiplied deferrals by 90%, which Avista initially proposed to continue. In Rebuttal, Avista reduced this amount to 70%.

Additional Steps Related to Decoupling Deferral and Recovery Not Included In Norwood Rebuttal	
8. Rate Switching Modification	A new adjustment to the deferral calculation proposed by Avista to adjust actual monthly customer usage to remove the net effect of customers switching between rate schedules 101 and 111 during the month, based on Avista's monthly "rate schedule comparison" report. Exh. No. BJH-1aT, pp. 12-13.
9. DSM Savings Test	DSM Savings associated with Avista's natural gas DSM programs are estimated and then verified. Avista's verified DSM savings performance relative to the IRP goal determines level of decoupling recovery, according to matrix. (Exh. No. KON-1T, p. 36).
10. Earnings Test	Assessment of whether Avista exceeds the most recent authorized rate of return, based on the Commission Basis Report filed on or about April 30th, to determine whether decoupling recoveries should be reduced or eliminated.
11. Annual 2% Rate Change Limitation	Annual surcharge cannot exceed 2% each year. Percentage increase of the decoupling surcharge is divided by total "normalized" revenue for Schedule 101 for the most recent July to June period. (Exh. No. BJH-1aT, p. 17).
12. Limited Income DSM Savings Test	Avista proposed in Rebuttal that Decoupling deferral recovery be limited if estimated DSM savings from limited income programs do not account for at least 5% of Natural Gas DSM Savings, according to matrix in Mr. Norwood's Rebuttal Testimony. (Exh. No. KON-1T, p. 49, line 1).
13. Interest Calculation	Interest is accrued on the deferred decoupling balance after the balance is approved for recovery and amortization by the Commission. (Exh. No. BJH-1aT, p. 18, ll. 13-15).

59. Several of the steps outlined above are performed using estimates, for example, the unbilled and weather adjustments which involve regression analysis. At hearing, Mr. Hirschkorn admitted that any time regression analysis is performed, there is a confidence interval and degree

of possible error.[103] After describing the unbilled adjustment (Step 3), which involves examining the meter reading schedule and determining an estimate of use per customer per degree day, Mr. Hirschkorn for Avista conceded "It's quite an adjustment."[104]

60. Adequate review of decoupling filings by Commission Staff, Public Counsel and other parties is neither simple, nor straightforward. Ms. Reynolds testimony contains another table graphically illustrating the tasks involved and the number of documents in the annual review of the decoupling surcharge filing.[105] The time frames under which the reviews must occur place added pressures on the process. The possibilities for error are myriad. The necessity for a process of this complexity questionable, given that this entire Byzantine mechanism is constructed to account for annual lost margins averaging less than $200,000, and historically representing a fraction of one percent of Avista margin revenues. These challenges will be multiplied if Avista's program is continued and other companies seek to institute their own decoupling programs.

2. The "New Customer Adjustment" should be eliminated.

61. As currently constituted, Avista's decoupling mechanism includes a "New Customer Adjustment" that allows the Company to carve out and retain for shareholders the incremental margin revenues earned from serving new customers.[106] The magnitude of the adjustment is so significant that in most months, decoupling would actually produce *negative* deferrals (i.e., credits for customers) if the New Customer Adjustment were removed, as both Staff and Public

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[103] TR. 1119:16-20.
[104] TR. 1114:4-5.
[105] Exh. No. DJR-1T, pp. 28-29.
[106] Exh. No. MLB-1T, p. 24.

Counsel testimony points out.[107] Both Public Counsel and Commission Staff recommend elimination of this adjustment, in the event that decoupling is continued.

62. Avista states that it cannot continue with decoupling unless the New Customer Adjustment is retained. In defense of the adjustment, Avista relies on the unproven assumption that there is a need to recover incremental costs of new customers. Mr. Brosch provides an analysis of the data in this case which shows that new customer fixed costs are likely to be exceeded, probably significantly, by new customer revenues.[108]

63. There is no showing by Avista that the New Customer Adjustment is cost-based.[109] Instead, according to Brian Hirschkorn's hearing testimony, it is "rough justice" for Avista to keep new customer margins for shareholders via the decoupling carve-out.[110] Avista ignores the fact, however, that it is line extension policies and tariffs, that are intended to protect existing ratepayers from subsidizing utility costs incurred to connect and serve new customers. Avista's line extension tariffs have not been reviewed in ten years. If Avista has a legitimate concern about recovery of incremental costs of new customers, it should review whether to update the line extension tariffs, rather than perpetuating this imbalanced approach to decoupling. [111]

F. Decoupling Reduces Company Risk And If Adopted Should Reduce Avista's Return on Equity.

64. The Partial Stipulation reached in this case establishes a return on equity of 10. 2 percent.[112] As the Joint Testimony noted, however, this represents a "cap" on ROE.[113] The

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[107] Exh. No. MLB-1T, pp. 25-26; Exh. No. DJR-1T, p. 22:2-5.
[108] Exh. No. MLB-1T, p. 29:3-11
[109] Exh. No. MLB 1T, p.25.
[110] Hirschkorn,TR. 1130:4-10.
[111] TR. 1132:1-1133:24; Exh. No. BJH- 13X (reference to rate pressure from new customers).
[112] Exh. No. B-1, Partial Settlement Stipulation, p. 3.
[113] Exh. No. JT-1T, p. 18:5.

settlement in effect sets the ROE for the scenario where decoupling is discontinued. If decoupling is approved to continue, the unresolved issue is whether and how much the ROE should be adjusted downward to reflect a shift of risk.

65. This Commission has recognized that "a key disadvantage [of decoupling] … is the potential shifting of risk ratepayers."[114] In Order 04 approving the pilot, the Commission identified the need to examine the shift of risk to ratepayers as part of the decoupling evaluation.[115] Notwithstanding the identification of this issue, Avista's decoupling filings before the Commission have not included any reduction in ROE to recognize the reduction in risk.

66. Public Counsel and ICNU jointly present the only testimony in this case by a cost of capital witness analyzing the impact of permanent implementation of decoupling on Avista's ROE.[116] Michael Gorman concludes that the decoupling mechanism will lower operating risk for Avista because the deferral mechanism "provides a safety net to ensure that Avista will more likely earn its authorized return on equity."[117] Based on a comparison of utility bond yield spreads as a risk comparison metric, he recommends a reduction in the authorized ROE for Avista of 25 basis points in this case if decoupling is continued.

67. Avista's cost of capital expert, Mr. Avera, did not provide any rebuttal of Mr. Gorman. Instead, the topic is mentioned briefly in the rebuttal of Kelly Norwood, who argues that decoupling "does not significantly affect the Company's business risk" and that impact of the mechanism is so negligible that no adjustment is required.[118] This is strikingly at odds with the

[114] Order 04, ¶ 17.

[115] *Id.* Deborah Reynolds concluded in her testimony for Staff in this case that "the company experienced a reduction of risk" which may even be larger than it appears. Exh. No. DJR-1T, p. 23-24.

[116] Exh. No. MPG-1T, p. 5 et seq.

[117] *Id.*, p. 6:7-8.

[118] Exh. No. KON-1T, p. 37:9.

Avista mantra that its failure to recover fixed costs is so significant that it compels the adoption of decoupling.[119] Both statements cannot be true. Mr. Norwood does not specifically dispute the 25 basis point reduction, but instead suggests that Avista achieves the same result by its move from 90 to a 70 percent deferral. This deferral change is not at all the same thing as a reduction in ROE however. Even with the reduced deferral, the Company's risk of fully recovering its cost of service is significantly improved by a decoupling mechanism. This increased cost recovery assurance reduces risk, and justifies a reduction in ROE.[120]

68. Testimony of Staff cost of capital witness David Parcell was silent on the risk shifting effect of decoupling or of Staff's high fixed charge proposal. He filed no cross-answering testimony to respond to Mr. Gorman's recommendation.[121] In response to discovery, he agreed that "decoupling mechanisms, straight fixed variable rate designs, and rate designs such as that proposed by Ms. Reynolds help to stabilize utility revenues in varying degrees and thus are risk reducing to utilities, other things being equal."[122] He suggested, however, that the risk reduction was not a new factor because decoupling had already been in place for over two years. This is apparently based on an assumption that Avista's previously established ROE took full account of the impact of decoupling. The record of Avista's relevant prior rate cases does not support this assumption, nor does Mr. Norwood make this argument in his rebuttal on the ROE issue.

69. The Commission has not had occasion to establish a return for Avista based on a contested case record since the decoupling pilot was adopted. The current ROE rate of 10.2 percent was established in a settlement in the 2007 rate case as a reduction from the prior rate of 10.4 percent.

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[119] *See also,* Exh. No. MPG-1T, p. 15:27 (favorable mention by Moody's of decoupling pilot).

[120] If decoupling is adopted with a 70 percent rather than 90 percent deferral rate , the 25 basis point ROE reduction could appropriately be reduced proportionately by 2/9 to a range of 20 basis points.

[121] Mr. Parcell did not file cross-answering testimony.

[122] Exh. No. DCP-18X.

In that case, Public Counsel had recommended an ROE of 9.35 percent for gas service, reflecting market trends and incorporating a 15 basis point reduction for decoupling.[123] The ROE established in settlement, while it moved in the appropriate direction (down not up), was agreed to as a compromise for settlement purposes and was agreed to be non-precedential.[124] It clearly did not fully reflect Public Counsel's recommendation or a determination by the Commission of the proper adjustment to be made to reflect decoupling. This ROE level was then simply maintained as the *status quo* in the 2008 rate case settlement.[125]

70. While Public Counsel here recommends termination of decoupling, should the Commission decide to authorize its continuation, it is critical that in doing so it preserve the principle that the reduction of risk must be recognized in Avista's ROE.

G. Proposed Modifications To The Decoupling Mechanism.

71. As a general matter, Public Counsel does not devote significant attention in this brief to the proposed modifications, given our position that the mechanism be terminated. The proposed modifications do not remedy the underlying fundamental problems with the decoupling mechanism. A few observations are appropriate, however.

72. After initially proposing almost no changes to its mechanism, in rebuttal Avista offered modifications in reaction to multiple criticisms of the mechanism. Chief among these is Avista's proposal to reduce its maximum deferral from 90 percent to 70 percent. In offering this change, Avista witness Kelly Norwood concedes that "the Company's deferrals are six to eight times

[123] 2007 Avista GRC, Docket Nos. UE-070804/UG-070805, Direct Testimony of William Marcus, Exh. No. WBM-1TC (Revised), p. 43-46.
[124] *WUTC v. Avista Corporation*, Docket Nos. UE-070804/UG-070805, Order 05, App. A (Full Settlement Stipulation), Sec. III.A., Sec. IV.7.
[125] *WUTC v. Avista Corporation,* Docket Nos. UE-080416/UG-080417, Order 08, Appendix A, p. 10.

larger than programmatic DSM lost margin"[126] but still argues Avista should recover these "non-energy efficiency reductions" where customers reduce use outside of Company DSM programs. Apparently in recognition of the dramatic mismatch between lost margins and deferrals, Mr. Norwood's testimony offers to reduce deferrals to 70 percent.[127] No analytic basis was provided for this percentage in the testimony, nor was any produced in response to discovery.[128] Rather it is a "judgment call" offered in reaction to criticism of the mechanism by other parties.[129] Certainly it reduces size of the disproportionate recovery somewhat, but it does not eliminate it, nor does it eliminate the recovery of lost margins which have no relation to company DSM.

73. NWEC also recommends a reduction in the deferral amount, essentially in response to the disproportionate level of deferrals. Nancy Glaser recommended a range of deferrals from 30 percent to 70 percent, depending on certain factors. [130] The selection of these percentages, described in Exh. No. NLG-7X, also appears to be essentially a matter of judgment. No other reports, analyses, workpapers, or calculations were offered in support of the percentages to show how they relate to the alleged need for fixed cost recovery, or removal of Avista's alleged disincentives to invest in DSM. While narrower than Avista's proposal at the low end, NWEC's proposal likewise fails to remove overbroad recoveries for lost margins not related to Avista programmatic DSM.

74. Both Avista and NWEC propose a Limited Income DSM test although they do not agree on how this would work. Avista differs with NWEC on the design of the proposal,

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[126] Exh. No. KON-1T, p. 23.
[127] Exh. No. KON-1T, pp. 33-36.
[128] Exh. No. KON-5X.
[129] Norwood, TR. 986:17-987:15.
[130] Exh. No. NLG-1T.

recommending its own "two trigger" design.[131] Public Counsel does not believe that adoption of such a Limited Income test is a remedy for the myriad problems with Avista's decoupling proposal. Public Counsel supports the position of the Energy Project on this issues and its briefing of this issue.

H. Gas Customer Charges and the Staff Alternative to Decoupling.

75. The only rate design/rate spread issue not resolved in the case is the level of the natural gas customer charge. Public Counsel has accepted in testimony Avista's initial proposal to increase its gas customer charge from $5.75 to $6.00 as a reasonable modest (4%) increase in the charge. Avista's general rate case proposal gas rate design was not presented as conditional on the outcome of the decoupling issue.[132] Nonetheless, since the decoupling filing, Avista appears to have altered its position on the appropriate rate design for residential customers. The Company did not accept the issue as resolved in its rebuttal, and appears to be keeping its options open to argue for some higher level of customer charge, whether or not decoupling is continued.

76. In testimony for Staff, Deborah Reynolds proposed an alternative approach which would ultimately increase the gas customer charge to $10 in conjunction with elimination of the decoupling proposal. While Public Counsel supports an end to decoupling, adoption of this proposed movement toward "straight-fixed variable rate design" simply substitutes for decoupling another objectionable and regressive residential rate design.

77. There are multiple economic and public policy problems with Staff's proposal. First, as NWEC also points out, adoption of high customer charges would discourage conservation and

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[131] Exh. No. KON-1T, p. 49:12-19.

[132] Exh. No. BJH-1T, p. 22:2-12. While this testimony was filed prior to the decoupling continuation petition, Avista was presumably aware that decoupling would be considered in the near future.

result "in an incorrect price signal to customers."[133] With a higher fixed customer charge, customers see less reduction in their bills from participation in energy efficiency programs.

78. It is noteworthy that Avista, while on the one hand justifying its decoupling program on energy efficiency grounds, in this context, states that it would support Staff's $8 or $10 customer charge *in addition* to decoupling as a "move in the right direction," [134]and that "ideally" customers should pay over $22 per month for service "irrespective of how much energy they use."[135]

79. As NWEC also states, there is no analytical support for the specific level of fixed charges proposed by Staff. Gas rate spread issues in this case have been settled by maintaining the status quo via a uniform percentage increase across classes, in large measure because Avista's gas cost of service study is not yet complete.[136] Brian Hirschkorn, Avista's own rate design witness in the GRC initially testified that a 25 cent increase to $6.00 was the proper level for the charge, without elaboration or citation to analytic support. While Public Counsel does not oppose this modest increase, there is inadequate cost study support in the record to make any dramatic changes in Avista's gas rate design, particularly the customer charge.

80. To the extent it is offered as a way to address fixed cost recovery, Staff offers no evidence that current ratemaking precludes Avista from recovering its fixed costs, or that the natural gas industry has suffered financially from declining sales. As Mr. Watkins shows in his cross-answering testimony, the natural gas LDC industry has relied on volumetric pricing for

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[133] Exh. No. NLG-5T, p. 8:3-10.
[134] Exh. No. KON-1T, 45:18-19.
[135] *Id.*, line 15 (emphasis in original).
[136] Exh. No. BJH-1T, 3:15-24.

cost recovery for many decades, while remaining financially viable and showing strong earnings.[137]

81. High fixed charges have an inequitable impact on low volume users (including limited income customers). Staff acknowledges this and attempts to deal with it by proposing a lower customer charge for low income customers. Avista responds that it would be "burdensome, if not impossible" to administer such a program. Ms. Barbara Alexander addresses this issue on behalf of the Energy Project and Public Counsel supports their position in opposition to this proposal. There are numerous practical and theoretical objections to Staff's proposal. Public Counsel recommends it be rejected by the Commission.

I. Targeted Incentives: An Alternative Approach.

82. As discussed above, much of the rationale for decoupling centers on incentives and disincentives for energy efficiency investments. As Public Counsel has argued, as a threshold matter, it is not clear that disincentives are significant, if they exist at all, or that incentives are required. Lost margins are tiny. There is no evidence that fixed cost recovery is not addressed through rate cases (currently filed annually). Avista's DSM expenditures and programs are and have been robust without decoupling and theses costs are fully recovered from ratepayers. Avista is in fact required by law to engage in DSM programs. Moreover, its customers, regulators, and public policy makers have a reasonable expectation that Avista will pursue DSM as part of the prudent operation of a modern utility.

83. If the Commission concludes that there is a need to provide ratepayer- funded financial incentives to Avista, then Public Counsel recommends that the better approach is to design a

[137] Exh. No. GAW-3T, pp. 3-4, Table 1 (Value Line Natural Gas Utility Group Rate of Return on Common Equity (showing 10 year average of 12 percent return).

direct incentive program that is narrowly tailored to address the Company's conservation performance. Such a program would include: (1) clearly defined DSM performance targets with meaningful measurement and verification; (2) incentive structures to encourage cost-effective management of DSM programs; (3) incentive amounts properly proportioned to the lost margins resulting from the Avista's own programs; and (4) an administratively simple and efficient program design.[138] The program should be broad enough to encompass customers beyond Schedule 101 who participate in and benefit from DSM.

84. If the Commission favors this approach, Avista could be directed to work with interested stakeholders through the Triple EEE committee to develop an incentive program to present in a future rate case.

J. Avista's Gas DSM Programs May Need a Major Review.

1. Avista maintains two sets of DSM books.

85. An issue that was explored at hearing was the fact that Avista, maintains two sets of books for DSM savings.[139] Savings for decoupling purposes are measured on a "completed" basis, while savings for purposes of the "cost-effectiveness" analysis used to determine prudence of DSM programs and expenditures uses a method Avista calls "de-rated" therms. The Titus Report explains that for this reason, the DSM savings data in the Titus Report do not match the DSM data provided to Staff, Public Counsel and other members of Avista's Triple EEE report.[140]

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[138] Exh. No. MLB-1T, pp. 41-42.

[139] Powell, TR. 1207:14-20.

[140] Exh. No. BJH-2a, Titus Report, p. 9; TR. 1205:11-1208:13 (Powell). On a related point, surprisingly, the independent RIA DSM verification reports to not actually include the final, total amount of 'verified' DSM savings. Instead, Avista itself has prepared the DSM Verification Summary documents provided to the Commission in their annual decoupling surcharge filing. Titus called attention to this and expressed their view that "the DSM Savings Verification auditor should be responsible for summarizing and providing the verified savings in a format suitable for use in the Mechanism." (Exh. No. BJH-2a, p. 64)

86. Avista has recognized that maintaining two sets of DSM data "is difficult and causes confusion to external evaluators."[141] At the hearing, Mr. Powell stated that Avista would no longer be using the "de-rated" therm approach for cost-effectiveness analysis beginning in 2010.[142]

2. The cost-effectiveness of Avista's DSM programs should be reviewed.

87. The change from "de-rated" therms to "completed" therms analysis would appear to have a major impact on Avista's DSM programs going forward. In each rate case, Avista provides evidence of cost-effectiveness of its DSM portfolio, to support prudence of DSM expenditures collected through the tariff riders. In order to demonstrate cost-effectiveness, the Total Resource Cost test (TRC) result should be equal to or greater than 1.0.[143] In this case, Avista witness Bruce Folsom provided that analysis using "de-rated" methodology.[144]

88. In discovery, Public Counsel asked Avista to provide a revised version of the TRC Exh. No. BWF-2, using the 2008 verified savings, i.e. using "completed" instead of "de-rated" therms. Avista's response showed a TRC of 0.71 using "completed" therms, well below the 1.0 standard showing "cost effectiveness."[145] Ms. Reynolds' testimony states that the TRC result exceeded 1.0 for Avista's gas DSM programs in Washington.[146] The 2008 Triple E Report, included as Exhibit 8 to the Titus Report, shows the Washington TRC result as 1.05 for the gas DSM portfolio.[147] These results are based on the "de-rated" method. When the comparable

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[141] Exh. No. JP-12X response a.

[142] Exh. No. JP-12X, responses a and c; Powell, TR. 1208:11-13.

[143] Exh. No. BWF-1T, p. 13:3.

[144] Exh. No. BWF-2.

[145] Exh. No. BWF-6X, p. 2. Moreover, this analysis used 2008 'verified' savings of 1.82M therms, but just recently, in UG-091399, Avista filed revised 2008 gas DSM results of 1.56M therms. The result would likely be even lower if the revised 2008 DSM savings amount had been used.

[146] Exh. No. No. DJR-1T, p. 11:7-10 and p. 10:4-10.

[147] Exh. No. No. BJH-2a (Titus Report), Exhibit 8, 2008 Triple E Report, Table 9G (WA).

TRC analysis is performed on a "completed" basis, the result is only 0.69 for Washington, well below the cost-effectiveness 1.0 threshold.[148]

89. In terms of the decoupling pilot, this analysis raises serious doubt as to whether the surcharges being collected from ratepayers to incentivize Avista's DSM investments are being spent prudently on cost-effective programs. Evaluation of increases in cost-effective DSM was one of the specific criteria listed by the Commission in approving the pilot. What the pilot has revealed is new doubts about the cost-effectiveness of Avista's programs.

90. Decoupling aside, however, this TRC analysis would suggest that due to the change in methodology, there appears to be a need for a major review by Avista, in conjunction with the Triple E Board, of the Company's gas DSM programs to examine their cost-effectiveness.[149] This is important, whether or not decoupling continues. Avista DSM programs that have been passing the cost-effectiveness test using "de-rated" therm measurements may no longer do so. Although Public Counsel did not address this issue in testimony, this analysis would seem to call into question Staff's conclusion in testimony that DSM expenditures and programs are prudent.[150] A review of Avista's DSM programs and their cost-effectiveness would also be appropriate in connection with the development of an incentive program of the type proposed by Public Counsel.

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[148] Exh. No. BWF-6X. p. 4. As noted above, this analysis was performed using the now incorrect 2008 DSM savings of 1.82M therms, subsequently revised by Avista to 1.56M therms, and therefore the Washington result would be even lower if the revised savings amount had been used.

[149] New program investments required by such a review could be affected by the large 'negative' tariff rider balance Avista currently carries. Avista is allocating a significant portion of rider revenues toward write-down of negative balance as opposed to investing in current programs. Exh. No. JP-26X.

[150] In addition to referring to the TRC result for gas programs in Washington, Staff witness Ms. Reynolds states that Avista exceeded its IRP goal for 2008. However, in Docket UG-091399, Staff and Public Counsel presented an analysis that in 2008 Avista had achieved only 91.2% of its IRP goal.

K. Conclusion: The Mechanism Should Be Terminated.

91. For the foregoing reasons, the Commission should terminate Avista's natural gas decoupling mechanism. Avista has been unable to make a "convincing demonstration" that decoupling has any correlation to its DSM performance, which even NWEC concludes would likely have been similar without decoupling. The DSM data presented contains so many inaccuracies, errors, and methodology changes that it does not provide any reliable basis for a conclusion about the DSM results Avista has actually achieved. In addition, the DSM data is not based on actual measurement and verification, an improvement which Avista actively opposed when requested by the independent evaluator. Finally, Avista's double bookkeeping for measuring DSM indicates a serious need to re-evaluate the cost-effectiveness of its existing DSM programs.

92. The decoupling mechanism surcharges are fundamentally arbitrary, and excessive, collecting many multiples of the revenues Avista loses from its own conservation efforts. Avista's proposes to slightly moderate, but not to eliminate this effect. Avista seeks the benefits of decoupling, while at the same time keeping all the risk reduction benefits for its shareholders, steadfastly opposing any ROE adjustment or removal of the new customer adjustment. Avista has not made the case that it faces any fixed cost recovery issues that cannot be addressed through the test year ratemaking process.

93. The Commission at the outset described the pilot as the opportunity to determine whether the potential flaws of decoupling outweigh its benefits. Public Counsel submits that on this record , it is clear that the flaws are many and serious and that there is no persuasive evidence of any benefit to the public interest from this mechanism.

III. THE LANCASTER CONTRACTS

A. Background/Overview.

1. Key issues.

94. While a number of power cost issues were settled in the Partial Stipulation, there remains for resolution the important issue of whether the Lancaster Contracts should be transferred[151] to Avista Utilities and their costs assumed by ratepayers beginning on January 1, 2010. If Avista's proposed assignment is approved, the ratepayers would become responsible for over $30 million of fixed costs annually.[152] The Lancaster issues are important not only because of the amounts involved, but because they present policy questions about the application of the Commission's prudence , affiliate interest, and resource procurement standards.

95. Public Counsel has identified several key problems with this proposal: Avista has known since early 2007 that it does not have a need for either the Lancaster energy or the capacity in 2010; Avista was fully aware that the contracts would have a negative financial impact on its ratepayers at the time the transfer was decided upon; the cost and hence the value of the contracts after 2010 is uncertain; the affiliate nature of the transaction did not protect the utility or its ratepayer interests and there is no obligation on the part of Avista Utilities to actually assume the Lancaster contractual obligations in 2010. Finally, the transfer is not permitted under the terms of an earlier Avista settlement agreement until the ERM balance is retired.

96. For these reasons, Public Counsel recommends that the transfer not be approved as filed. Public Counsel believes the Commission has sufficient grounds to reject the assignment of the Lancaster Contracts outright. However, Public Counsel is also offering an alternative middle

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[151] The transaction is referred to either as a "transfer" or "assignment" at various points in the record.
[152] Exh. No. KDW-1T, p.7:22.

ground that would eliminate the harm Avista's proposed assignment would do to ratepayers in 2010 , while preserving the potential long-term value of the Lancaster Contracts.

2. Lancaster Contracts overview.

a. The three contracts.

97. The Lancaster Contracts consist of a power-purchase agreement (PPA), a transmission contract, and gas transportation agreements. The Lancaster PPA provides the assignee the right to operate the 275 MW Lancaster Combined Cycle power plant near Rathdrum, Idaho, a merchant plant which went into commercial operation in 2001. The PPA provides such rights through October 2026. The Lancaster PPA is a referred to as a "tolling agreement." Under Avista's proposal, Avista Utilities would be required to pay all of the PPA's fixed costs and would also receive the benefits of the PPA.[153] The related BPA transmission and gas transportation contracts are described in the testimony of Mr. Storro[154] and Mr. Woodruff.

98. While Avista's proposal is to assign all three contracts in their entirety, and the 2007 analyses assumed this package treatment, Avista has acknowledged that the contracts are severable. There is nothing within any of the contracts that requires them to be held, assigned, or administered together.[155] This severability means that the value of each contract to Avista Utilities can be assessed separately or in different combinations to determine what is the best value for ratepayers. This was not done by Avista.

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[153] Exh. No. RLS-1T, p. 8:14- p. 9:14 (describing Lancaster PPA); Exh. No. KDW-1T, p. 6 (general description of three contracts).

[154] Exh. No. RLS-1T, p. 10:10-p.11:3.

[155] Exh. No. KDW-1T, p. 28:13-21, n. 45 (Avista's Response to Public Counsel Data Request No. 229). All three contracts are currently temporarily assigned to Coral until December 31, 2009. TR. 835:6-836:2.

b. The transfer of the Lancaster contracts.

99. The Lancaster Contract assignments are not an "arms-length" transaction with a third-party utility, power generator or marketer. The details of the Lancaster PPA transfer are shown in Exh. No. RLS-19X which includes a chart depicting the Avista corporate structure and sequence of transactions involving Lancaster. The chart is appended to the brief as Attachment B.[156] The transaction history begins with Avista Energy's assignment of the Lancaster PPA to Avista Turbine Power (Avista Turbine) in June 1999.[157] Avista Turbine thus received the contractual right to all of the capacity and electrical output of Lancaster. In June 2007, Avista Energy sold its assets to Coral Energy. At that same time, as part of the sale, Avista Turbine assigned the Lancaster PPA to Coral Power LLC for two and one half years, ending December 31, 2009. On that date, the rights to Lancaster revert back to Avista Turbine. There is no contractual obligation which requires that Avista Turbine assign the Lancaster PPA to Avista Utilities on January 1, 2010, although that is Avista's stated intention.[158]

B. Legal Framework.

1. Prudence.

100. Public Counsel and Avista agree that the leading decisions in which the Commission articulates its standard for determining prudence are the Eleventh and Nineteenth Supplemental Orders in Puget Sound Power & Light's 1992 general rate case and other consolidated

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[156]Exh. No. RLS-22X also includes detailed narrative descriptions of the transactional history of Lancaster. Public Counsel understand that the chart and discussion also apply to the control of the BPA transmission contract and gas transportation contracts.

[157] Mr. Storro's description of the Lancaster PPA assignment does not mention Avista Turbine, nor does the internal analysis in Exh. No. RLS-4, which refers to the Lancaster PPA as being "owned by Avista Energy" as of early 2007. Exh. No. RLS-4, p. 1.

[158] Exh. No. RLS-22X response b. ("There is no written documentation that requires Avista Utilities to take the Lancaster PPA pending successful regulatory cost recovery.")

dockets.[159] The decisions reviewed, *inter alia*, the recovery of Puget's costs for purchased power. The Commission held, pursuant to RCW 80.04.130, that the utility had the burden of proof on prudence, and "must make an affirmative showing of the reasonableness and prudence of the expenses under review."[160]

101. The Commission stated the basic standard for prudence review:

> The test this Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures.[161]

The order further held that "[t]he Commission's acceptance of a Company's least cost plan does not represent a finding of prudence of a particular resource."[162]

102. In the Nineteenth Supplemental Order, after extensive and detailed review of several resource acquisitions, the Commission held that Puget had not carried its burden of showing both need and that it had filled the need "in a cost effective manner."[163] The Commission noted that the prudence standard was not met simply by showing that there was no bad faith or mismanagement in the contract selection, although it did find that Puget had not met even this lower standard.[164]

103. The Commission held:

> The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and

[159] *WUTC v. Puget Sound Power & Light,* Docket Nos. UE-920433, UE-920499, UE-921262 (consolidated)(*Puget Prudence Case)*; Eleventh Supplemental Order, Nineteenth Supplemental Order. Avista cites these orders in Exh. No. RLS-6, p. 1; *See also*, Exh. No. KDW-1T, p. 10:10-p.11:2, p. 11:23-p. 12:6.

[160] *Puget Prudence Case,* Eleventh Supplemental Order, p. 19.

[161] *Id.*, p. 20 (quoting Fourth Supplemental Order, Cause U-83-54, pp. 32-33).

[162] *Id.*, p. 21.

[163] *Id.*, Nineteenth Supplemental Order, p. 11.

[164] *Id.*, p. 10.

methods that a reasonable management would have used at the time the decisions were made.[165]

104. An important aspect of the two decisions is the Commission's emphasis on documentation of the resource acquisition process. Companies are expected to "make an adequate study at the time" and "keep adequate contemporaneous records of its decision process which will allow the Commission subsequently to evaluate its decision. This is the minimum standard to which a regulated utility should be held."[166] For the reasons discussed in this brief, Avista has failed to meet these standards.

2. Affiliate interest requirements apply to the transfer of the Lancaster Contracts.

105. It is not disputed that the Avista Utilities and Avista Turbine Power are affiliates.[167] The proposed transfer of the Lancaster Contracts between Avista Turbine and Avista Utilities is an affiliate interest transaction under Washington law, within the meaning of RCW 80.16.010. The transfer of the Lancaster Contracts is a "contract or arrangement" between a public service company and an affiliate interest as described in RCW 80.16.020.

106. As such, Avista is required to file the "contract or arrangement" with the Commission. The Commission can then disapprove the transaction if it finds that Avista "has failed to prove that it is reasonable and consistent with the public interest." RCW 80.16.020. The statute adds that "the commission may disapprove any such contract or arrangement if satisfactory proof is not submitted to the commission of the cost to the affiliated interest of rendering the service or of furnishing the property or service described in this section." Avista's filing did not acknowledge or address the applicability of these statutory requirements.

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[165] *Id.*, p. 10.
[166] *Id.*, p. 37. *See also*, Eleventh Supplemental Order, p. 24

3. RFP requirements.

107. The Commission has established requirements for resource procurement in chapter 480-107 WAC.[168] In general, the rules require a company to issue a request for proposal to acquire resources after an IRP filing.[169] In addition, the rules permit utilities to issue RFPs more frequently at their own discretion.[170] WAC 480-107-105(3)(a) does exempt utilities from RFP requirements when its "integrated resource plan, prepared pursuant to WAC 480-07-238, demonstrates that the utility does not need additional capacity within three years." WAC 480-107-135 permits a utility or its own affiliates to offer resources in that utility's RFP, but subjects such transactions to "additional scrutiny" to ensure that "no unfair advantage is given" and the "ratepayer interests are protected." Avista did not issue an RFP in connection with the Lancaster Contracts.

4. Avista is barred from transferring the Lancaster Contracts until the ERM deferral balance has a net credit balance.

108. As a threshold matter, whether or not the Lancaster Contract assignments are prudent, the transactions are barred by the Settlement Stipulation in Docket No. UE-011595, under which Avista agreed that it "would not enter into electric or natural gas commodity transactions with Avista Energy related to Avista Utilities' electric operations until the Energy Cost Deferral Balance carries a net credit balance."

109. Public Counsel raised this issue in its testimony.[171] In response, Avista takes the position that the Lancaster Contracts are not a commodity transaction. Avista's position, as explained by

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[167] TR. 810:2-16 (Storro).

[168] *See,* Exh. No. KDW-1T, 12:7-13.

[169] WAC 480-107-015(3)(b). The rules, however, do not establish the sole procedures for acquiring new resources. WAC 480-107-001(1).

[170] WAC 480-107-015(4).

[171] Exh. No. KDW-1T, p. 11:3-22.

Clint Kalich, is that "the Lancaster plant is not a commodity and it is clearly not a purchase of natural gas or electricity. The gas plant allows the conversion of one commodity (gas) into another (electricity). There were no electricity or natural gas transactions associated with the purchase [.]"[172] Mr. Storro made a similar argument at hearing. In response to questions from Commissioner Oshie, he stated that "we are not buying gas or buying electricity from Avista Energy or Avista Turbine Power. We are purchasing in this case the right to convert gas to electricity"[173] He later stated "we are paying the plant to convert one commodity to another."[174]

110. These arguments defy logic and the plain meaning of the English language. There would be no purpose for Avista Utilities to operate a plant solely for the purpose of engaging in the conversion process. Both Mr. Kalich's and Mr. Storro's explanations expressly acknowledge that the operation of the plant creates a commodity – electricity. As Mr. Storro explains, once the gas commodity is converted to the electricity commodity "we take the electricity away."[175] That commodity is then to be provided, via transmission, from the Lancaster plant to Avista Utilities. The Power Purchase Agreement that allows this to happen is a "transaction" that involves electricity – a commodity according to both Messrs. Kalich and Storro. By any reasonable definition, this is a commodity transaction.

111. The narrow meaning now being ascribed to this settlement provision was not included in the settlement's language nor was it otherwise evident at the time. In advance of the June 2002 hearing to review the settlement, the Commission issued a bench request asking the parties to orally address the meaning of this provision. Mr. Norwood for Avista and Public Counsel

[172] Exh. No. CGK-4T, p. 9:11-24.
[173] TR. 820:20-23.
[174] TR. 848:19-20.
[175] TR. 820:5.

representatives addressed the Commissioner's and ALJ's questions.[176] A review of the hearing transcript indicates that no party made any mention of a narrow limitation or interpretation of the provision of the type now suggested.

112. Mr. Norwood stated: "we recognized as a company that the review of transactions between the corporation and its subsidiaries requires closer scrutiny…. so for purposes of this settlement, the Company agreed until the deferral balance goes to zero to simply not enter into *any further commodity transactions on electric and gas side that related to the electric operations, and therefore, there wouldn't be further transactions that would go into the ERM."*[177] Mr. Norwood later stated: "The Company did voluntarily offer to go ahead and agree to this provision of not entering into *any further transactions* during the time period that the balance was greater than zero."[178]

113. Relevant to this case, Judge Moss inquired what effect the stipulation would have in precluding a transaction if it turned out "the best deal out there might be a deal between Avista Energy and Avista Utilities for a block of power or gas."[179] In response, Mr. Cromwell explained that the provision "takes what could be a very contentious and otherwise fact-driven and painful for all involved inquiry *off the table,* in essence, while we are still paying off the deferral. It allow us to focus, again from our perspective, on the merits of what the Company is putting in *and not have to think about that there is a possibility that these transactions were*

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[176] Assistant Attorney General Robert Cromwell and analyst Mary Kimball attended the hearing for Public Counsel. Staff witness Ken Elgin did not offer any comment on the provision, but requested clarification on his own behalf. *WUTC v. Avista Corp.,* Docket UE-011595, Hearing Transcript of June 12, 2002, Transcript Vol. IV, (Settlement TR), at 226:16-227:1

[177] Settlement TR. 227:5-15

[178] Settlement TR. 229:23-230:2

[179] Settlement TR. 230:18-20

proper."[180] Mr. Norwood, also responding to the Judge's question, added that "by not entering into these transactions, it just reduces the amount of effort that goes into reviewing these types of transactions, *so we have agreed not to do that for this period of time.*"[181]

114. These statements seem clearly intended to assure the Commission that no affiliate transactions whatever involving electricity as a commodity and impacting the ERM would occur. There is no evidence here supporting the interpretation now offered that the agreement was somehow intended to permit some kinds of energy commodity transactions between Avista Utilities and Avista Energy or other affiliates, while precluding only a subset of such transactions. Even if the Commission concludes that the Lancaster agreements are prudent, it should enforce the provision of the settlement stipulation and order that the assignment not occur until the ERM deferral account has a net credit balance.

C. Avista Knew In 2007 That It Did Not Need Lancaster Energy Or Capacity In 2010.

115. In support of the prudence of the Lancaster transaction, Avista primarily relies [182] on its 2007 Integrated Resource Plan (IRP), an internal study (the "Lancaster Generating Facility Power Purchase Agreement Evaluation Overview"),[183] and, a consultant study by Thorndike Landing LLC titled "Independent Valuation of Lancaster Facility Tolling Agreement."[184] Avista also supplied a "white paper" summarizing the earlier studies.[185]

116. The only analysis completed prior to the announcement of the decision regarding the Lancaster assignment was the Agreement Evaluation in April 2007. The Thorndike Landing

[180] Settlement TR. 231:14-21
[181] Settlement, TR. 232-3-7.
[182] Exh. No. RLS-1T, p.11:4-p. 12:19; p. 16:13-17:2.
[183] Exh. No. RLS-4 (Agreement Evaluation).
[184] Exh. No. RLS-5 (Thorndike Landing study).
[185] Exh. No. RLS-6.

study was conducted between August and October 2007, several months after the decision to assign the contracts to the utility. The IRP is dated August 31, 2007, although work was ongoing prior to that date. The "white paper" is dated November 2, 2007.

117. There is ample evidence in the record that Avista was aware in 2007 that there was no energy or capacity need until 2011. Avista's own power cost witness Richard Storro states that "the Company had forecasted annual energy and capacity deficits starting in 2011 in the 2007 Electric IRP, without the addition of the Lancaster Power Purchase Agreement."[186] Avista's 2007 IRP states that "annual energy deficits begin in 2011" and that "the company will be short 146 MW of capacity in 2011." Table 1 in the 2007 IRP, the "Net Position Forecast" confirms that the Company's projections showed no energy or capacity deficit until 2011, excluding Lancaster.[187] The Agreement Evaluation prepared in April 2007 restates the IRP conclusion that deficits did not begin until 2011.[188]

118. Although prudence review primarily focuses on the understanding of management at the time of the decision, the record also contains information about the current situation, reflecting that the energy and capacity deficit remains the same as was forecast in 2007 – no deficits until 2011. Avista confirmed this in discovery. When asked what capacity needs it was currently projecting on a quarterly basis, through 2028, Avista's response showed surplus capacity through 2010.[189] Mr. Storro also confirmed that Avista's 2009 IRP is consistent with these capacity projections.[190]

[186] Exh. No. RLS-1T, p. 4:10-12.
[187] Exh. No. KDW-7, p. 1.
[188] Exh. No. RLS-4, pp. 4-5.
[189] Exh. No. RLS-9X, p. 2.
[190] TR 760:16-762:12, discussing Exh. No. RLS-24X (2009 IRP tables).

119. The situation is similar for energy. In discovery, Avista provided data showing that without Lancaster it forecast only small energy deficits for only two quarters in 2010, at a level well below Lancaster's capacity. On cross examination, Mr. Storro confirmed this conclusion, agreeing that this level of deficit would normally be dealt with by short term market purchases.[191]

D. Lancaster Was Known In 2007 To Have Negative Value in 2010; Lancaster's Value Is Uncertain Today.

1. Lancaster was a "loser" in 2007 and was then forecast to increase costs for Avista Utilities in 2010.

120. At the time when Avista asserts it was analyzing the appropriate date to assign the Lancaster PPA to Avista Utilities, Avista's own analysis showed the lowest cost outcome was for Avista Utilities to take on the PPA starting in 2011, not in 2010.[192] The analysis in the Agreement Evaluation compared costs of PPA transfer dates of 2009, 2010, and 2011. Table 3 in the evaluation shows that the costs of the Lancaster PPA to the utility declines each year moving from 2009 through 2011.[193] At the same time, the table indicates that the savings to the utility increase as the start date for the transfer is delayed from 2009 to 2011.[194] Consistent with this analysis, the Agreement Evaluation states that "the early inclusion of the Power Purchase Agreement prior to the deficit year decreases its value relative to the other options."[195]

121. This conclusion reached in early 2007 was confirmed in the "white paper" review conducted after the decision to assign the contracts in 2010. The "white paper" compares the "Annual Revenue Impact" of Lancaster and other CCGT alternatives, finding that in 2010, the

[191] TR, 763:25-764:19.
[192] Kalich, TR. 866:16-867:9.
[193] Exh. No. RLS 4. Table 3, p. 7 (Lancaster Lease Value – Cost of Lease); TR. 865:21-866:1.
[194] *Id.*, (Lease Savings Versus); TR. 866:2-866:8.
[195] Exh. No. RLS 4, p. 5 of 7.

alternatives would have zero impact, but Lancaster would increase costs to ratepayers by $12.9 million.[196]

122. Avista made public that Lancaster was a losing proposition in its 2007 Annual Report, disclosing that losses experienced by Avista Energy were in part due to "losses on the power purchase agreement for the Lancaster plant [.]"[197]

In this docket, Avista has predicted that the Lancaster Contracts will further increase Avista's costs in 2010. In its initial filing Avista forecasted that Lancaster would increase costs by $16.6 million, or $10.7 million on a Washington allocated basis.[198] Subsequently, Avista provided an updated forecast showing that the Lancaster Contracts would increase costs by $18.3 million on a system basis in 2010.[199]

2. BPA transmission contract costs significantly affect the value of the Lancaster PPA.

123. Avista also seeks approval to transfer to ratepayers the responsibility for the BPA transmission contract related to Lancaster. The BPA transmission contract is an important component of the value analysis for the overall Lancaster transaction. An underlying premise of the internal Agreement Evaluation undertaken in April 2007 was that Avista would develop its own interconnection to the plant and would recover approximately 75 percent of the BPA transmission costs through remarketing or optimization.[200] In part on this basis, the deal was determined to be financially beneficial.

124. The transmission issue is also addressed in the Thorndike Landing study. Table 6

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[196] Exh. No. RLS-6, p.13, Table 10; TR, 767:19-769:18 and 838:9-839:21.
[197] Exh. No. KDW-7, p. 2.
[198] Exh. No. WGJ-1T, p. 5:9-10.
[199] Exh. No. CGK-5X, p.2.
[200] Exh. No. RLS-4, p 3.

(Lancaster Tolling Costs As A Function of BPA Transmission Costs Remarketed) shows that the Lancaster PPA has a negative value of $7.5 million if there is no remarketing of BPA transmission. Even where 25 percent is remarketed, the PPA value is *de minimus* ($500,000). The same effect is reflected in Appendix C of the Thorndike Landing study (Lancaster Toll – Base Case).[201] The costs shown assume 75 percent remarketing of BPA transmission. For example, for 2010, the cost shown is $1.17 million. If the BPA transmission is not remarketed, however, that figure should be four times larger, or $4.68 million, reflecting the full cost of the transmission. This in turn would reduce the "net present value" of the Lancaster Contract shown on the table. The greater the number of years that pass before direct connection, the lower the project's value.[202]

125. Notwithstanding these data, Avista is asking ratepayers to assume responsibility for the full costs of the BPA transmission contract on January 1, 2010. Avista has acknowledged that "no revenue from the resale of BPA transmission from the Lancaster plant…is included in the rate case." [203] On the one hand, therefore, Avista is asking to have the Lancaster Contracts included in 2010 revenue requirement because they allegedly provide value to customers and the utility, when on the other hand, its own supporting exhibits show that the contracts have a $7.5 million negative value when the BPA remarketing is zero.[204]

3. Gas transportation costs are much higher than forecast.

126. The third set of contracts proposed to be transferred to ratepayers are the gas transportation contracts. The record evidence in this case initially indicated that the gas

[201] Exh. No. RLS-6, p. 28 of 31.
[202] Kalich, TR. 869:6-12.
[203] TR:921:5-922:8.
[204] Exh. No. RLS-5, (Thorndike Landing study), Table 6, p. 22 of 31 (and p. 19).

transportation capacity provided by the contract exceeded the Lancaster plant's needs by approximately 20 percent. The Thorndike Landing study made note of this fact and excluded "excess gas supply" from its analysis of cost, in addition, calculating that this excess would be remarketed for approximately $900,000.[205] This revenue, however, does not appear to be included in Avista's revenue requirement filing. The Thorndike Landing study concluded that the gas transportation cost would be $3.4 million.

127. In rebuttal, Avista stated that the gas contract capacity was not in fact surplus to Avista's needs. Furthermore, in discovery, Avista provided new information that fixed gas transportation costs for 2010 would be approximately $5.3 million, nearly $2 million higher than the Thorndike Landing analysis. Inclusion of gas transportation costs at this level would significantly reduce the net present value calculated by Thorndike Landing for the Lancaster contract.[206]

4. The long-term value of the Lancaster contracts is uncertain.

128. Even though as recently as 2007 Avista Energy was losing money on Lancaster, the overriding theme now offered in support of the Lancaster Contracts assignment is that, no matter what other issues have been raised, over the long-term Lancaster supposedly is an indisputably "good deal" for the Company and its customers. The problem is, as the foregoing analysis shows, the value of the contracts is highly uncertain. According to the Thorndike Landing study, even with the resale of 25 percent of the BPA transmission, the transaction has no real significant value. If the new gas transportation costs are added to the calculation, the contractual value appears to again go negative. Not only are these calculations of negative value essentially

[205] The Thorndike Landing study also stated that Avista had not completed its gas transportation study at the time of the Agreement Evaluation. The Agreement Evaluation does not appear to analyze the gas transportation costs. Mr. Kalich testified he was simply "informed the plant would come with appropriate amount of transportation." TR. 872:11-8.

[206] Exh. No. RL-5X; TR. 907 (Lafferty).

unrebuttable for 2010, the long term prospects are also negative. Until Avista actually builds the direct transmission interconnection to Lancaster, the revenues from resale of BPA transmission that were expected to put the transaction in the black will not be available. How long that will be is not known at the present time.

129. This delay is not merely a hypothetical issue. Although the "direct interconnection/BPA resale" plan was key to the economic projections in 2007, Avista has been slow to move forward on building the interconnection. In discovery, Public Counsel learned that Avista apparently did not initiate the required BPA process until 2009. There now appears to be no likelihood that the Avista connection will be in place in 2010, and it may not be available 2012 at the earliest.[207] This means that for an unknown period, Avista's customers will not receive the benefit of the 75 percent remarketing built in to the value analysis of the transaction.

5. The Avista analysis of the Lancaster Contracts' value had added flaws.

130. In his direct testimony, Kevin Woodruff describes the flaws in Avista's 2007 analysis of "comparables" and in its DCF analysis. As he points out, as part of its early 2007 review of the Lancaster, Avista did not issue an RFP to conduct an actual market test to determine whether CCCT capacity or energy could be procured on terms better than those of the Lancaster Contracts. Avista now argues that an RFP was not required under Commission rules because Avista had no identified resource deficiency within three years after the 2007 IRP filing.[208] Avista thus is simultaneously arguing two sides of the question --- ratepayers should assume financial responsibility for the resource in 2010, but, at the same time, since there is no resource deficiency in 2010 there was no RFP requirement. Indeed, only three pages after making the

[207] Exh. No. RJL-2X and Exh. No. RJL-3X and TR 904:12-907:13.
[208] Exh. No. CGK-4T, p.8:16-20.

"no-deficiency" RFP argument, Mr. Kalich is rebutting Public Counsel by arguing that Lancaster is needed to serve load in 2010.[209]

131. A central purpose of the RFP requirement is to subject potential transactions to an actual market test, as well as to test the Company's own projections. Such requirements are a beneficial and necessary protection because in some cases, "if a deal seems too good to be true, it probably is." An RFP in this case would have inserted an element of business objectivity and caution that was lacking in this acquisition of a "loser" contract from an affiliated company. Avista has had adequate time to issue an RFP to confirm its internal study.

E. Avista Presents The Commission With A False Dilemma.

1. The transfer of the Lancaster Contracts is not required to take place on January 1, 2010.

132. Avista has attempted to frame its Lancaster proposal as an all or nothing choice for the Commission. In discovery, the Company has stated that "full cost recovery beginning on January 1, 2010" is the "minimally necessary" requirement for the assignment to take place.[210] If Avista's terms for "full cost recovery" are not approved, "Avista Corporation would seek to remarket the Lancaster PPA for the rest of the contract period. This would require Avista Utilities to either purchase or construct a new CCCT, at a significantly higher cost than the Lancaster PPA, which would be submitted for future regulatory approval."[211]

133. At the hearing, Avista acknowledged its options are not so limited. On cross-examination, Mr. Storro said that "I think if we do not get full recovery, corporately we will

[209] *Id.*, p. 11:8-17. On cross-examination, Mr. Storro acknowledged that the small energy deficits in 2010 would normally be met by short term purchases, not plant acquisitions or long term PPAs. TR.764:13-18.

[210] Exh. No. RLS 22X, p 1 (response part b).

[211] *Id.*, pp. 1-2 (response part c).

have to take another look at where we stand relative to this contract"[212] and would have to "revisit" the issue.[213] If the assignment is rejected, Avista Turbine will still retain its rights and will operate the project and would not face particular urgency to decide how to proceed between a Commission decision and December 31, 2009.[214]

134. The problem with Avista's case is that there is no contractual obligation for the Lancaster PPA to be transferred to the utility on January 1, 2010. As noted above, Avista has stated that "[t]here is no written documentation that requires Avista Utilities to take the Lancaster PPA pending successful regulatory cost recovery."[215] The lack of a contractual option was confirmed several times at the hearing.[216]

135. The record establishes that Avista is free to transfer the Lancaster Contracts on a later date, such as January 1, 2011, when the resource is needed. Until that date, shareholders would continue to absorb the costs of the contracts, as they were doing prior to the transfer to Coral, as well as receive any benefits from Lancaster during the period. If there is no binding obligation for the transfer to occur on January 1, 2010, then a Commission decision disallowing the assignment on that date does not necessarily mean that the benefits of Lancaster are lost. If Avista were to decide to transfer the Lancaster Contracts rights elsewhere, rather than to assign them as a 15 year PPA to the utility, and instead acquire other more expensive power for the utility, it would need to justify the prudence of those decisions in future cases. In Public Counsel's view, this could prove to be a difficult case to make.

[212] TR 778:6-10.
[213] TR. 828:4-5.
[214] TR. 815-816.
[215] Exh. No. No. RLS-22X, response b.
[216] TR. 840:10-14; TR. 817:22-24; TR. 827:13-18.

F. The Assignment of the Lancaster Contracts Does Not Meet The Commission's Prudence or Affiliated Interest Standards.

1. The details and timing of the 2007 analysis and transaction undermine Avista's request for approval.

136. In its initial filing, Avista characterized the "acquisition of the Lancaster PPA by Avista Utilities" as follows:

> "The opportunity to acquire the power purchase agreement (tolling) rights for Lancaster was a result of negotiations related to the sale of Avista Energy which held the rights to the this tolling arrangement. In April 2007, the utility completed an initial assessment of the Lancaster PPA utility the 2007 IRP model….As part of the April 17, 2007, announcement of the sale of Avista Energy to Coral Energy, the Company also announced that Avista Utilities would have rights to the Lancaster PPA beginning on January 1, 2010.[217]

Mr. Storro's testimony also cited the April 11, 2007, Agreement Evaluation Overview as the basis for how the "Company determine[d] the need and suitability of the Lancaster PPA."[218] Subsequently the Thorndike Landing study and the white paper were described as confirming the initial analysis.[219]

137. A more complete picture of the Lancaster Contract transaction and the Avista analysis has emerged as a result of discovery, evidence and examination at hearing, and the response to Bench Request No. 10. Perhaps the most significant new development is new information in the response to Bench Request No. 10.

138. According to Board finance committee minutes produced in response to Bench Request No. 10, **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

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[217] Exh. No. RLS-1T, p. 9:9-19.
[218] *Id.,* p. 11:4:-14.
[219] *Id.,* p. 16:13-20.

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139. In response to Public Counsel discovery, Avista stated that "the decision regarding the date on which the Lancaster PPA would be available to Avista Utilities was made as part of the ongoing negotiations between March 2007 *when Energy Resources was asked to study the transaction,* and the April 17, 2007 public announcement regarding the sale of Avista Energy to Coral Energy."[223]

140. At the hearing, Mr. Storro testified that the decision to assign the contracts from Avista's unregulated affiliates to the utility ratepayers was made in that same time frame "as part of the negotiations *after our initial assessment of the value and its fit with the utility's need."*[224] He also testified that there was a "very short time frame" to take up the "opportunity" and there was a

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[220] See Bench Request 10, Attachment A, page 26 (of the pdf file), page 1 of the minutes of the March 20, 2007 Board Finance Committee.

[221] TR. 842:11-12 ("Coral wanted the project or at least accepted the project."; TR: 854:4-5 ("for all I know they wanted 5 ½ and only got this period of time.")

[222] This would be consistent with the information provided to investors in the 2007 Annual Report, acknowledging that Avista Energy had experienced losses in 2007, but that it was being sold, and that the only remaining source of revenues and costs for the segment was Lancaster (already described as experiencing losses), which was being transferred to Coral, and ultimately to the regulated utility.

[223] Exh. No. RLS-18X (emphasis added).

[224] Storro, TR. 773:15-774:2 (emphasis added). *See also* TR. 775:7-16 (request from Malyn Malquist re "opportunity as a result of negotiations"); Mr. Storro also stated that Mr. Malquist may have first contacted him in late February or early March , but could not recall the exact date. TR. 794:21-23

need to "take action."[225] Mr. Kalich, however, testified that he did not start his analysis until late March and that it was completed six days prior to the April 11 publication date, in turn only six days prior to the announcement of the sale to Coral.[226] He could not confirm whether his analysis actually went to Company management or negotiators during the Coral negotiations.[227] This appears to confirm that the Agreement Evaluation was not performed **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. **[End Confidential]**

141. While the Agreement Evaluation on its face considered the three different start years for the assignment, at one point, Mr. Kalich testified that "all things being equal the utility would take it in 2011. However…the utility was afforded an option to grab the – an option isn't the right word actually. *We were afforded the project in 2010* if it was something we were interested in."[228] Later, he confirmed in response to a question from Commissioner Oshie that he "was told it would be made available to the utility" in 2010.[229] These statements appear more consistent with the Bench Request response.

142. Avista "does not have any recorded internal communications amongst the Utility or its affiliates" related to the request to the Energy Resources unit (Kalich and Storro) for an analysis, nor regarding the subsequent analysis. Mr. Storro confirmed on cross that "Avista has no documentation of how it balanced the interests of shareholders and ratepayers in these communications with regard to the contract assignment."[230]

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[225] TR. 813:8-13.
[226] TR. 891:3-4, TR. 897:6-14.
[227] TR. 891:11-17 ("I don't recall"); TR. 892:7-11.
[228] TR. 873:24-874:4.
[229] TR. 885:25-886:3.
[230] TR. 776:16-20.

143. The negotiating team for Avista was the CFO Malyn Malquist, and General Counsel Marian Durkin.[231] No Avista Utilities employees were involved in the negotiation as representatives of solely the utility's interest. The same individuals were negotiating on behalf of the parent, of Avista Energy, the utility, and Avista Turbine Power, "all wearing the same hats."[232] Their interests were "in very close alignment."[233]

2. Avista has failed to show that the assignment of Lancaster is prudent or in the public interest and reasonable as required by the affiliate interest statutes.

144. Avista's own analysis in 2007 showed that 2010 transfer was disadvantageous to the utility and its ratepayers. The Commission's prudence standard requires both an adequate study at the time of the transaction and adequate contemporaneous records to allow the Commission to review management's decision making. It now appears that no study was done prior to the decision. Even the Agreement Evaluation was done on short notice. Subsequent studies were not done until after the fact. Avista provided essentially no contemporaneous record of Avista Utilities' management decision-making process regarding the Lancaster assignment, either in its initial filing or subsequently. The response to Bench Request No. 10 does not help Avista satisfy this requirement.

145. The proposed assignment is an affiliate transaction. Avista Utility interests were not separately or fairly represented. It is reasonable to conclude that a primary motivation for the decision regarding the timing of the assignment was the avoidance of shareholder responsibility for Lancaster during a period when it was known the contracts would have a negative value.

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[231] TR. 777; Exh. No. RLS-12X.
[232] TR. 808:9-809:-21.
[233] TR. 809:2-8

There is no evidence that, if not assigned on January 1, 2010, the Lancaster Contracts will be unavailable to Avista at a later time (e.g. January 1, 2011) for any legal, contractual, or operational reason. The matter resides with the discretion of Avista itself. Avista has failed to show the transaction is prudent.[234]

146. Avista's proposal also runs afoul of the affiliated interest statutes. Avista did not acknowledge in its initial filing that these statutes even applied. As a practical matter, the pre-approval requirement to file the "contract or arrangement" for review has been met. However, the Company has failed to prove that the transaction is "reasonable and consistent with the public interest" as required by RCW 80.16.020. In the absence of proof that the amounts to be paid as a result of the transaction are reasonable, the statute states that the Commission "shall disallow the payment or compensation, in whole or in part."[235]. This standard provides a separate and independent basis for rejecting the Company's proposal.

G. Public Counsel's Recommendation.

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[234] Staff did not file testimony in the case regarding the Lancaster Contracts issues. When called to the stand by the Commission, Staff witness Alan Buckley, however, made a number of statements and observations about prudence of the Lancaster Contracts. Public Counsel recommends that Mr. Buckley's statements not be accorded any substantial weight in the Commission's analysis for several reasons. Mr. Buckley stated that no testimony was filed because he initially decided that no prudence determination was necessary for the Lancaster issues, even thought Avista specifically argued prudence in its filing. TR. 938:8-10, 970 and didn't believe it was required for large PPAs, TR. 940, notwithstanding the Commission's review of such resource acquisitioning the *Puget Prudence* docket. Mr. Buckley agrees that the Avista has no energy or capacity need until 2011, and that the assignment would increase ratepayer costs in 2010. TR. 1051:18-1052:7. He stated his opinion on the transaction rendered at the hearing was essentially a "judgment call" and was largely influenced by his view that the transaction was a good deal in the long term. TR. 972. Mr. Buckley did not know whether or not an RFP was required for this kind of transaction. TR 958:10-23. He stated he did not examine affiliate issues. Mr. Buckley was candid that the "structure between affiliates, who holds what in the contracts is not something I spent a lot of time on" and his views were "definitely more the bottom line." TR. 957, 966. He was apparently unaware until the hearing that there was no contractual obligation for Avista Turbine to transfer the Lancaster PPA to Avista Utilities on January 1, 2010. TR. 946-947 Mr. Buckley stated he was aware of the fact that there would be significant costs for ratepayers in 2010, but was unaware of whether Lancaster was "in the money" in 2007, TR. 964, or at any time thereafter, even though this issue was addressed by Mr. Woodruff in his testimony and his Exh. No. KDW-7. He apparently did no separate analysis of Lancaster costs. TR. 954-955. Mr. Woodruff pointed out problems with Mr. Buckley's chief points in his oral rebuttal. TR. 1059:7-1066:25.

[235] RCW 80.16.030.

147. Public Counsel recommends that the Commission find that Avista has failed to establish prudence in deciding to assign the Lancaster Contracts to Avista Utilities in 2010, and that as an affiliated interest transaction, it is not reasonable or in the public interest. Public Counsel, therefore, recommends that the Commission disapprove assignment of any of the Lancaster Contracts to Avista for calendar year 2010.

148. For the time period from 2011 forward , the Commission could also conclude that Avista has not made a prudence showing for the contracts for the entire term 2011 to 2026. However, in light of the evidence showing some potential long-term benefits for customers from the contracts, Public Counsel recommends a middle ground approach which avoids imposing improper contract costs on customers, while allowing other aspects of the transaction to go forward to the benefit of the Company and its customers. Public Counsel recommends[236] that the Commission:

- Allow the Lancaster PPA assignment starting in 2011, the first year of Avista's demonstrated need.
- Allow all of the gas transportation contracts starting in 2011, based on Avista's revision of its position in its rebuttal that showed that all of the gas contracts' capacity could be useful at Lancaster on peak days, and may also be useful at other gas plants, particularly Coyote Springs.
- Disallow the assignment of the BPA transmission contract entirely, due to Avista's delay in starting development of interconnection and lack of need for the transmission in the long-term.

[236] Exh. No. KDW-9 presents the revenue requirement impact of the earlier Public Counsel compromise alternative presented in Mr. Woodruff's testimony. This proposal differs in that it allows 100 percent of the gas transportation contracts, rather than 80 percent as in the initial proposal.

IV. REVENUE REQUIREMENT ISSUES

A. Overview of Public Counsel Revenue Recommendation

149. Public Counsel's revenue requirement analysis and response to Avista's proposals is provided by Hugh Larkin, Jr.[237] Public Counsel's updated revenue requirement analysis in this case recommends an electric revenue requirement increase for Avista of $4.336 million and a gas revenue requirement increase of $431,000. A detailed presentation of Public Counsel's updated recommendation is set forth in Exhibit No. B-5, constituting Public Counsel's revised Response to Bench Request No. 2. This update reflects the effects of the Partial Stipulation in this case.[238]

150. Public Counsel and Commission Staff have generally consistent positions on many revenue requirement issues in this case. In particular, Public Counsel joins in Staff's concern about Avista's violation of the matching principle, and improper application of test year and pro forma rules and definitions. Public Counsel concurs with and adopts by this reference Staff's analysis and policy recommendations on these important issues. Public Counsel's brief is intended to be complementary to Staff's on these points.

151. Public Counsel's brief will highlight some chief points from Mr. Larkin's testimony. Unless specially noted, Public Counsel supports all the recommendations made by Mr. Larkin in testimony, although not all are addressed in the brief.[239]

B. Fundamental Ratemaking Principles Have Been Violated in Avista's Filing.

152. As Mr. Larkin describes in his testimony, the Commission's rules set out the correct

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[237] Exh. No. HL-1T (Revised 9/3/09).

[238] The update does not incorporate Mr. Gorman's proposed downward adjustment to return on equity. If the Commission approves the extension of decoupling, and in conjunction Mr. Gorman's adjustment, a modification would need to be made to the Public Counsel results.

[239] Mr. Larkin listed uncontested adjustments in his testimony at Exh. No. HL-1T, p. 7. In addition, Exh. No. B-5 lists adjustments where Mr. Larkin has agreed with the position of Avista or Staff.

methodology for adjusting test year data in setting rates.[240] In summary, the rules incorporate a fundamental element of ratemaking, the "matching principle" by requiring that any restating actual adjustments or pro forma adjustments must properly match the test year data. The adjustments must first be known and measurable, and second, must relate to the level of service performed during the test year. Adjustments which do not properly match current test year level sales, are not known and measurable, or are offset by other factors, do not comply with the Commission's rules, or with the matching principle.[241]

C. Capital Additions.

153. Mr. Larkin recommends rejection of Avista's adjustments for 2008 capital additions (PF 6 Electric, PF 4 Gas). Avista's proposal violates the matching principle because the revenue reflected in this case was generated over the average period from October 1, 2007 through September 30, 2008, with the corresponding average plant in service during that time period. In this adjustment, Avista has sought to include capital additions and associated expenses for the remainder of 2008, through December 31. Doing so without reflecting a corresponding increase in revenues creates a mismatch between revenues and rate base. Mr. Larkin recommends rejecting this adjustment with the exception of additions to production plant reflected in the power supply model.[242]

154. Avista's case also includes projected capital additions for 2009 (PF 7 Electric, PF 5 Gas). Mr. Larkin recommends rejecting these on similar grounds, with the exception of the Noxon 1

[240] WAC 480-07-510. Exh. No. HL-1T, p. 4:11- p.5:10.
[241] Exh. No. HL-1T, p. 5:11-23.
[242] Exh. No. HL-1T, p. 14.

upgrade. Public Counsel also does not oppose the 2010 additions included for the Noxon 3 upgrade (PF 8 Electric).[243]

155. This is an area where Public Counsel and Staff are in agreement on the underlying policy issues presented by Avista's filing. Public Counsel believes it would be appropriate for the Commission in this case to clarify and, to the extent necessary, re-establish the "bright line" for application of the test year, pro forma, and restating adjustment rules, and of the matching principle. While Staff and Public Counsel agree on the policy, Public Counsel's recommendations in the instant case represent a stricter application of the underlying principles.

156. Public Counsel believes that Mr. Larkin's approach to capital additions follows the spirit and intent of WAC 480-07-510 (3)(e) regarding "pro forma adjustments". Mr. Larkin's proforma adjustments PF6, PF7 and PF8 allow for the addition to rate base of only those production plant additions which have been reflected in test year data. Specifically, Mr. Larkin allowed into the rate base plant additions to production facilities which had been reflected in the pro forma power cost adjustment. This means that, for these facilities, the offsetting factors related to their additions to plant in service were reflected in the test year. On the other hand, the Company adjustments reflect each and every addition between October 1, 2008 and December 31, 2009, with the exception of minor amounts the Company removed from distribution plant additions for new customer hook-ups. The Company did not reflect any offsets for any plant additions other than what would have been incorporated in the power supply adjustment. Clearly, this is a mismatch of the intent of the legislature in defining "pro forma adjustments".

157. Commission Staff, while adhering more closely than the Company to the WAC definition

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[243] Exh. No. HL-1T, p. 15:9-24.

of pro forma adjustments, allowed significant amounts of additional production, transmission and distribution plant. While Public Counsel agrees that the Staff's analysis is superior to the Company's, Staff's recommendations go beyond what is permitted by the WAC. Staff's proforma adjustments 6, 7 and 8 total to an adjusted rate base of $35,844,0000 which includes both Noxon 1 and 3 improvements.[244] These latter items are the only capital additions which the Public Counsel feels are appropriate to include in the test year. Mr. Larkin's adjusted rate base for plant additions for 2008, 2009 and 2010, reflected in PF 6, 7 and 8, total to $8,425,000. The Staff's adjusted rate base therefore exceeds the maximum allowed under a proper interpretation of the WAC by $27,419,000. ($35,844,000 - 8,425,000=$27,419,000). The difference between Staff's and Public Counsel's adjustments result in a revenue requirement difference of approximately $4 million. Public Counsel respectfully submits that its proposed adjustments are more appropriate for adoption as consistent with the matching principle.

D. Asset Management (PF 9 Electric, PF 6 Gas).

158. Avista's Asset Management Program is a relatively new program which incorporates well-established programs such as vegetation management, wood pole inspections and transformer management. Avista is requesting a 57 percent increase over test year levels for this expense item, $2.89 million for electric and $88,048 for gas. Avista states that there are no benefits or offsets for this expense.[245] This adjustment violates the Commission's requirements in rule that pro forma adjustments must known and measurable and must be offset by the benefits or cost savings from the new item.[246] In this case, Avista has simply incorporated its budgeted

[244] Exh. No. DPK-2 Schedules updated 10/5/09.
[245] Exh. No. EMA-8T, p. 20:11-14.
[246] WAC 480-07-510(3).

amounts for the program. This is a projected expense substantially within the control of company management as to initial projection and actual future expenditure. This does not meet the definition of known and measurable expense.

159. While asserting there are no true offsets, Avista seeks to bolster its case by offering several reductions in an "alternate" proposal.[247] Avista conceded, however, that these were "essentially just estimates" for purposes of the alternative proposal and that no other analysis, exhibits, or workpapers in the record support these offsets.[248]

E. Information Services (PF 10 Electric, PF 8 Gas).

160. As with the Asset Management Program, Avista uses budgeted rather than known and measurable amounts for this adjustment, and did not initially incorporate any offsetting cost savings, other benefits, such as productivity increases.[249] Mr. Larkin identified through discovery that a substantial portion of the adjustment ($1.12 million of the total) related to the "New Work Management System" that had been delayed until 2010.

161. In rebuttal, Avista withdrew the expense for the New Work Management System, previously represented to by known and measurable, but continues to seek $1.066 million. Avista justifies the remaining expense as a proper pro forma adjustment because in rebuttal it has identified "efficiencies" for several expense items.[250] Avista's discovery of offsetting savings in rebuttal is too convenient. The amounts appear to have been arbitrarily developed as token figures without empirical support, offered as bargaining chips in order to retain a substantial portion of the adjustments. There are no supporting studies or analyses for these amounts.

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[247] Exh. No. EMA-4T, pp. 21-22. *See*, Exh. No. EMA-8, p. 13 (showing the amounts as "built in for settlement purposes").

[248] Andrews, TR. 549:1-552:8.

[249] Andrews, TR. 539:3-17.

[250] Exh. No. EMA-8T, p. 9 (20 percent "efficiency" estimates for two categories).

F. Production Property Factor (PF2 Electric).

162. The intent of this adjustment is to properly match the recovery of test period resources with rate year loads. Avista proposed to use uses a new type of two stage (2009 and 2010) method which has departs from precedent and which is inconsistent with the intent of the adjustment. Public Counsel recommends that the Commission adopt the approach described in Mr. Larkin's testimony as a more appropriate adjustment.[251]

G. Labor Non-Executive (PF 3 Electric, PF 1 Gas).

163. Public Counsel recommends that the Company's adjustment be reduced to reflect the amount actually approved by the Board for March 2009, not the higher amount included in the rate case. In addition, Public Counsel recommends complete removal of the proposed 2010 rate increases as not known and measurable, because it is an estimate, is not known and measurable, and relates to a future period when sales will be at a different level than the test year ending September 30, 2008.[252]

H. Labor Executive (PF4 Electric, PF 2 Gas).

164. Public Counsel recommends that the level of increase in executive labor expense be reduced to the same percentage annualization level received by administrative employees in 2008. Avista requests an increase of 17.2 percent in this category. Executives did not receive an increase in 2009, however, Mr. Larkin uses the level of administrative increase (1.519 percent) to calculate the appropriate adjustment. In addition, the estimated 2010 increase is not known and measurable and should be excluded. [253]

[251] Exh. No. HL-1T, pp. 10-11.
[252] Exh. No. HL-1T, pp. 11-12.
[253] Exh. No. HL-1T, pp. 12-13.

I. Incentive Compensation (PF 15 Electric, PF 7 Gas).

165. In this adjustment, rather than using the actual test year incentive compensation expense of $2.8 million, Avista adds a pro forma increase of $1.2 million to bring the expense up to the six year average. As Mr. Larkin shows in Table 2 in his testimony, Avista's incentive compensation has been declining steadily since 2005. The six year average figure is also higher than four of the past six years, dating back to 2003. Given this trend, and the current economic climate, it is unreasonable to expect that the actual incentive compensation levels will increase to over $4 million per year, or to build that expectation into rates. Indeed, if the current trend continues, the rate year level could be even lower. Public Counsel recommends the test year level should be adopted for rate purposes and the $1.2 million pro forma increase rejected.[254]

J. Board of Directors Expenses and Directors and Officers (D&O) Insurance Expense (PF 18 Electric, PF 20 Gas).

1. Board of Directors Meeting Costs and Fees.

166. Avista's rate filing assigns 100 percent of the responsibility for its Board of Directors meeting costs[255] and Board of Directors fees to ratepayers.[256] This is not a reasonable allocation of the expense. The Avista Board of Directors is elected by shareholders.[257] Its primary responsibility is to protect shareholder interests and ensure that they receive a reasonable return on investment. The Board's functions include establishing corporate policies and objectives, selecting the CEO, approving dividend payments, and a broad range of other duties related to

[254] Exh. No. HL-1T, p. 20.
[255] $22,615 for electric operations and $6,251 for gas. Exh. No. HL-1T, pp. 24-25.
[256] $544,333 for electric operations and $150,452 for gas. Exh. No. HL-1T, p. 25.
[257] Exh. No. EMA-11X, p.2 (Avista Corporation Corporate Governance Guidelines).

shareholder and overall corporate interests.[258] Avista's board also has responsibilities with respect to the unregulated subsidiaries of Avista Corporation.[259]

167. Avista's formal corporate policies recognize and seek to further the alignment of directors' interests with those of shareholders. To that end, directors are required to make a minimum investment of $200,000 or 9500 shares of stock.[260] Directors receive quarterly dividends and are responsible for approving the amount of the dividend payouts.[261]

168. As reviewed at the hearing, Avista's requested Board meeting costs in this case include such items as catered meals at Arborcrest Wine Cellars, tickets to the International Spy Museum, Valentines Day candy, a gift of crystal glassware, a special performance at the Lake City Playhouse, and a cruise on Lake Coeur D'Alene.[262] None of these items are necessary for the provision of utility service.

169. Public Counsel's recommendation that the Commission share these expenses equally between shareholders and ratepayers for ratemaking purposes is conservative. This represents a fair and a reasonable allocation recognizing the duties of the Board of Directors has to further the interests of shareholders.

2. D&O Liability Insurance Expense (PF 18 Electric, PF 20 Gas).

170. Avista also proposes to assign the full cost of D&O Liability Insurance to its ratepayers. As discussed above, the directors have substantial obligations with respect to shareholder interests, as do company officers. In addition, as directors of Avista Corporation, the board

[258] Exh. No. EMA-11X; Exhibit No. EMA-16X.

[259] TR. 565:10-566:1.

[260] Andrews, TR. 562:9-565:9; Exh. No. EMA-11X, p.2 (alignment of interest); Exh. No. EMA-16X, p. 43 (proxy statement containing investment requirement).

[261] Andrews, TR. 565:2-9.

[262] Exh. No. EMA-17X (itemization of board expenses); Andrews, TR. 569:1-575:17.

members have duties with respect to unregulated subsidiaries of Avista Corporation. D&O Liability Insurance protects the directors and officers against claims, primarily raised by shareholders, that they have acted in a manner detrimental to corporate and shareholder interests. These suits are not ordinarily brought to challenge operational mistakes or service quality problems or failure to invest in infrastructure, *i.e.* claims that ratepayers would have an interest in. Plaintiffs, and the beneficiaries of successful claims, are typically company shareholders. Ratepayers rarely, if ever, receive the proceeds from successful litigation or settlements.

171. There is no reasonable basis for assigning the entire obligation for these insurance expenses to Avista's customers. Public Counsel agrees with the recommendation of Commission Staff witness Ann M.C. Larue[263] that a more reasonable and equitable approach is to share the expense equally between shareholders and ratepayers.[264]

K. Customer Deposits.

172. Public Counsel recommends removing amounts from the Company rate base that represent the average of monthly averages amount of customer deposits held by Avista. These are not investor supplied funds. The Company holds the deposits from customers for a period of time. It is obligated to return the funds with interest, however, while held by Avista, they are available for the Company's use.[265]

L. Injuries and Damages Reserve.

173. Avista has collected amounts in rates to build up a reserve for future injuries and damages costs. In order to properly match the rate base with injury expense, the injuries and

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[263] Exh. No. AMCL-1T, pp. 16-18 (including citations to other regulatory Commission decisions.

[264] Avista's new proposal to assign 10 percent of the expense to shareholders appears to acknowledge that they receive a benefit, Andrews, TR. 526:9-22, but it is an inadequate sharing.

[265] Exh. No. HL-1T, p. 28:6-p. 29:4.

damages reserve liability must be deducted from rate base. Mr. Larkin updated his initial injuries and damages adjustment based on additional information provided by the Company. However, the basis rationale for making the adjustment, at the revised level, still remains valid.

M. Carrying Charge on Contributions in Excess of Pension Expense.

174. Avista is requesting that it be allowed to recover (through creation of a regulatory asset) a carrying charge on the difference between the amount of pension expense recognized in rates and the Company's actual contributions to the pension plan. Public Counsel recommends the request be denied. As explained by Mr. Larkin, the increase in pension contribution is related to the current recession and is temporary. The assets in the plan can be expected to recover over time. Allowing Avista to earn its full rate of return on the difference in expense and contributions would be exorbitant and unfair to customers. The consequences of this temporary situation should not be built into permanent rates.[266]

N. Avista's Annual Rate Case Filings Do Not Appear Reasonable or Necessary.

175. This is Avista's third general rate case in three years, and a new case is apparently to be filed next year. Avista appears to have adopted an approach which treats rate case filings as routine annual events. In combination with the operation of the ERM, by filing nearly continuous rate cases, Avista has established a regime in which it reduces to the minimum the time its management must "live within its means," that is, operate efficiently and earn a return within a set rate level for a reasonable period. Instead, the built-in efficiency incentive created by so-called "regulatory lag," as well as the ratemaking policy goal of rate stability for customers and the local economy have been effectively abandoned.

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[266] Exh. No. HL-1T, p. 31-33.

176. Frequent rate filings are not unknown in periods of rapidly increasing costs, inflation, or other volatile factors. The fact that Avista is continuing the pattern in a time of falling power costs, low inflation, and essentially flat or slow economic growth casts suggests a misuse of the of the regulatory system, to the detriment of its customers and the economy of its service territory. The rate filing does not evidence significant effort by Avista to limit its impact. Many of the revenue requirement proposals made by Avista in this case are poorly supported or excessive or both. New theories for recovery are proposed and old ones stretched to justify increased levels of expense. Reasonable sharing in areas such as Board of Directors expense is rejected. Avista's customers deserve better in these difficult economic times. Avista's revenue requests should receive full and careful scrutiny to ensure that any rate increase allowed is kept to the absolute minimum required.

O. The Energy Recovery Mechanism (ERM) Balance Should Have No Bearing On The Revenue Requirement Set In This Case.

177. At the time of the original rate case filing, Avista projected that the ERM would reach a zero balance, such that the ERM surcharge (Schedule 93) surcharge would no longer appear on customer bills. Avista incorporated this projection into its rate case filing and its public statements. [267] Avista presented the filing in terms of "bill impact," pointing out that even though it was requesting an 18 percent increase in residential customer rates, the impact if the temporary elimination of Schedule 93 was considered, would only be 8.6 percent.[268]

178. The ERM recommendation here is misleading. It appears intended to the extent it is used to mask the effect of a very large base rate increase filed on the heels of 9 percent increase from

[267] Norwood, TR. 495:22-497:25.

[268] *See, e.g.,* Direct Testimony of CEO Scott Morris, Exh. No SLM-1T, p. 3 (referring to a "net increase" in rates). *See* "Summary Document" filed with initial rate case materials .

the 2008 rate case. It also disregards the fact that the ERM will continue to operate and that surcharges could again appear on the bill some time in the future. In part, Avista's appears to take credit for ending or terminating the surcharge, when in fact the reduction of this balance represents the culmination of seven years of burden borne by ratepayers to address excess power costs incurred by Avista beginning in the Western energy crisis.

179. A further problem for Avista is that its projections were incorrect and the ERM balance will not reach zero until early 2010.[269] In order to remain consistent with its characterization of the rate filing, Avista is now requesting permission to tinker with the ERM by creating a fictional zero surcharge to coincide with the effective date of rates allowed in this case and to defer the unrecovered balance for later recovery. The Commission should reject this proposal to skew the operation of the ERM and decide this case on the merits of the rate request.

V. CONCLUSION

180. For the reasons addressed in this brief, Public Counsel respectfully requests that the Commission terminate the Avista decoupling mechanism, that it disallow the Lancaster Contracts in part consistent with the Public Counsel recommendation, and that it adopt Public Counsel's recommended revenue requirement, providing clear guidance with respect to test year and pro forma adjustment methodology.

181. DATED this 10th day of November, 2009.

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Attorney General

Simon J. ffitch
Senior Assistant Attorney General
Public Counsel

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[269] TR. 498:21-499:2 (Norwood)

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