BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of AVISTA CORPORATION, d/b/a AVISTA UTILIITES Request Regarding the Recovery of Power Costs Through The Deferral Mechanism, .	NO. UE-010395 POST-HEARING BRIEF OF PUBLIC COUNSEL

I. INTRODUCTION

A. Summary of Public Counsel Recommendation

1. While Avista has provided evidence in this proceeding of financial stress, Public Counsel concludes that the company has not met the requirements for either a surcharge or interim relief. The record strongly supports a conclusion that the company has other sources from which to address its immediate financial needs. Avista's more general financial situation and need, if any, for rate relief, is best addressed in the context of a general rate case. Its request for deferred power cost recovery requires careful review in a thorough proceeding, either separately or combined with the general rate case.

2. Should the Commission conclude, however, that Avista has made a case for emergency relief, Public Counsel recommends that the Commission allow only a surcharge of 14.1%, for a period of 15 months, accounted for in the manner proposed by Avista.[1] This amount should be adequate to address the Company's immediate financial need, while mitigating the dramatic rate shock in the Avista and Staff proposals, and taking into account the alternative sources of financing available. Such relief should only be granted on condition that (1) Avista file a general rate case immediately; (2) that the deferral of power costs be terminated; and (3) that Avista divest itself of its non-regulated subsidiaries by the end of Public Counsel's recommended surcharge period.

[1] Public Counsel's alternative proposal is set out in Section VII and Appendix A to this brief, together with other alternative calculations.

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B. Procedural History

3. Avista's first request for authority to defer certain power costs expenses was filed June 23, 2000. The company asked to have the costs amortized over 10 years if they were not included in a Power Cost Adjustment Mechanism in the general rate case pending at that time.

4. The company request came before the Commission at its August 9, 2000, open meeting. At that time, Public Counsel expressed opposition based on several specific concerns, including the issue of normal power cost fluctuations versus extraordinary costs, the danger of deferring only the high costs to ratepayers without including offsetting low costs, the risk that a a deferred accounting mechanism would be treated as a regulatory asset, and the danger that "unreasonable pressure" would be placed on the Commission to approve the costs, once placed in a deferred account. Statement of Matthew Steuerwalt, Ex. 504, p.3.

5. Brad Van Cleve, attorney for ICNU, also appeared at the open meeting in opposition to the request. He raised several issues including normalization of costs, the fact that the request was in effect a PCA, the fact that the proposal amounted to single issue ratemaking, the type of costs being placed in the account, and other matters, including the danger of creating a regulatory asset. Ex. 504, pp. 5-7.

6. The Commission approved the Avista request, stating that issues raised by Public Counsel and ICNU were not being predetermined and could be appropriately raised on another day. *See* Statements of Chairwoman Showalter, Commissioner Hemstad, Ex. 504, p. 14. The Commission order expressly reserved any decision as to the prudence of the deferred costs, the appropriateness of recovery of the costs through the deferral mechanism, or the optimization of company-owned resources. *In the Matter of the Avista Corporation's Peition for Recovery of Expenditures Related to Electric Deferral Mechanism,* Docket No.UE-000972, Order Approving Establishement of A Deferral Mechanism to Track Power Cost Expenses (August 9, 2000)(copy provided as Ex. 454).

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7. Avista's general rate case was decided September 29, 2000. *WUTC v. Avista Corporation*, Docket Nos. UE-991606, 991607, Third Supplemental Order (Avista 1999 Rate Case order)**.** The Commission ordered a reduction in Avista's electric rates and rejected its request for a PCA. Avista 1999 Rate Case order, ¶1, ¶¶ 167-185.

8. On December 20, 2000, Avista requested modification of the August 9 order to include power supply expenses associated with increased loads. The request was approved on January 24, 2001, but the order required Avista to demonstrate by mid-March 2001 (a) the prudency of the deferred costs; (b) the optimization of company-owned resources for the benefit of consumers; (c) the appropriateness of recovery of power costs through a deferral mechanism; (d) a proposed cost of capital offset to recognize the shift in risk from shareholders to ratepayers; and (e) the company's plan to mitigate deferred power costs. *Petition of Avista Corporation for an Order Regarding the Accounting Treatment of Certain Wholesale Power Costs To Serve Firm Load Obligations*, Docket No. UE-000972, Order Granting Request To Modify Power Cost Deferral Mechanism (January 24, 2001), Ex. 456.

9. On March 23, 2001, the Avista made a filing as required by the January 24 order. The focus of the filing was a plan to eliminate the deferred power costs without increasing rates. The proposal lead to a Settlement Stipulation between Avista, Public Counsel, Commission Staff and ICNU, designed to reduce the deferred power cost account to zero by February 28, 2003. After hearing, the Commission approved the Settlement Stipulation. *In the Matter of Avista Corporation d/b/a Avista Utilities Request Regarding the Recovery of Power Costs Through the Deferral Mechanism,* Docket No. UE-010395, First Supplemental Order Approving and Adopting Settlement Stipulation (May 23, 2001)(Exhibit 457).

10. The Settlement Stipulation provided that Avista could file a petition to alter, amend, or terminate the stipulation in the event of unanticipated or uncontrollable events. Other parties reserved all rights under Title 80 and all rights to raise matters previously at issue in the

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proceeding. Settlement Stipulation II.4, 5. The Commission retained jurisdiction to enforce the terms of the order and all prior orders in the proceeding. First Supp. Order, ¶ 30.

11. This phase of the proceeding was initiated when, on July 10, 2001, less than two months after the approval of the settlement, Avista filed a proposed tariff to implement a power cost surcharge by September 15. On August 2, 2001, the company followed the tariff filing with a petition to alter, amend or terminate the Settlement Stipulation, and related testimony and exhibits. The proceedings have been expedited. Parties were allowed three weeks to conduct discovery and respond to the company's case. Two days of evidentiary hearings were held just over one month after the initial filing of company testimony.

II. GENERAL PRINCIPLES

A. The Standards For Granting Relief

12. Avista's request for emergency relief in this case is not well-defined. While the company seeks a surcharge, it likewise asserts that its filing meets the standard established by the Commission for interim relief. Public Counsel submits that Avista's showing to date in this proceeding fails to meet the requirements for either form of relief (See discussion in Sec. III.B).

13. Even a cursory review of the precedent cited in the testimony and briefs reflects that the Commission does not walk an untrodden path in this case. This is far from the first time that a Washington utility has sought emergency relief on the basis of assertions of severe financial circumstances. The Commission has granted some of these requests, but by no means all of them. No electricity or telecommunications company denied emergency relief by this Commission has ever gone "out of business." The mere assertion of difficulty, no matter how urgently pressed, has never been enough to warrant relief under Washington law. Instead, in the exercise of its statutory duty to regulate in the public interest, the Commission has carefully developed and applied a thorough set of critieria to ensure that company claims have merit. A careful application of these critieria in this case will lead to a reasoned decision that will protect

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ratepayers and shareholders alike, as well as the integrity of the Commission's decisional process as it examines future cases.

1. Commission standard for allowing a surcharge.

14. As Staff witness Elgin testified, the Commission has established the standards under which a surcharge is appropriate. Ex.. 451, p.15. In its decision in *WUTC v. Washington Natural Gas*, Cause No. U-80-111, the Commission stated that an emergency surcharge was:

> a vehicle to compensate a utility for extraordinary expenses and charges over which the utility has little or not control and the cost thereof is passed on to the consumer on an actual or reasonably known and measurable basis. A surcharge is not intended to be employed, nor will it be considered as a stop gap or piecemeal approach to a utility's overall financial requirements.

Id., Second Supplemental Order, p. 3.

15. In addition, at a minimum, this type of case ordinarily requires a prudence determination before the costs are put in to rates. Ex. 451-T, p. 16, lines 1-2. This principle is illustrated in a prior Avista, then Washington Water Power (WWP) case, Cause No. U-83-26, in which the Commission rejected a surcharge request to begin recovery of investment and operating costs of Kettle Falls, prior to a pending rate case. The Commission rejected emergency relief in any form and required the Company to establish the prudence of Kettle Falls in the general rate case. *WUTC v. Washington Water Power*, Cause No. U-83-26, Fourth Supplemental Order (October 17, 1983).

2. Commission standard for allowing interim rate relief.

16. There is no dispute among the parties that the standard for determining whether interim relief is appropriate is the six-part test set forth in the Commission's decision in *WUTC v. Pacific Northwest Bell***,** Cause No. U-72-30, Second Supplemental Order Denying Petition for Emergency Relief (October 10, 1972), p. 13. Ex. 451-T, pp. 17-19; Ex. 52. The six elements of the *PNB* test are:

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

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17. In applying the *PNB* criteria, the Commission has added to the foregoing framework an emphasis on existing conditions rather than projections, stating:

> "[It] will not consider or give weight to long-range economic projections but will concern itself only with an analysis of existing and actual conditions and short-range projections, which in the main are least subject to volatile economic winds and are more conducive to credible reliability than long range plans."

WUTC v. Washington Water Power, Cause No. U-80-13, Second Supplemental Order Granting Petition for Emergency Rate Relief in Part (June 2, 1980), p.3.

18. In looking at financial indices, the Commission has reviewed whether "the deteriorating position manifests itself in the declining trend of the company's rate of return, interest coverage, earnings per share, and market-to-book ratio and whether the company has an inability to generate sufficient capital from internal sources. Id, p. 5.

19. Finally, in looking at the *PNB* test, the Commission has also considered whether the applicant utility has made a showing that all elements of its construction budget are necessary for it to carry out its obligations as a public service company.

20. In addition to issues presented under the *PNB* criteria, Avista's filing presents two additional questions. First, the company's request for interim relief is a dramatic departure from Commission and regulatory precedent in that it is not accompanied by a general rate filing. Public Counsel is unaware of any instance where the Commission has previously granted, or even considered, relief in the absence of a general rate case filing. On the other hand, precedents in which the Commission considered interim relief in the general rate context are legion. The purpose of this approach is that it provides the Commission with a significantly broader set of information about the company, including the critical restated and pro forma results of operation against which to measure the interim request. In this way, the utility (and the Commission) are able to avoid the pitfall of in appropriate "single issue" ratemaking.

21. Second, the request contains a significant component best characterized as a power cost adjustment (PCA). The Commission's most recent pronouncement on the proper requirements

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for a PCA was in Avista's last rate case. In that decision, the Commission reaffirmed its previous stated conditions that must be met by a PCA proposal:

(1) Ratepayers should receive the benefit of a cost-of-capital reduction for a PCA to be approved.

(2) A PCA should be linked to those factors that are weather related.

(3) A PCA should be a short-run accounting procedure that reflects changes in short-run custs affected by unusual weather. Avista 1999 Rate Order, ¶¶ 169-172, 184-185 (citing *In re the Washington Water Power Company's Petition for an Accounting Order Permitting Implementation of a Power Cost Adjustment Mechanism*, Docket No. U-88-2362-P, First Supplemental Order Denying Petition (September 1989).

B. Rate Shock

22. This is the largest rate request in the history of this company. Tr. 469-470; Tr. 602-603. Public Counsel has reviewed all past requests by Avista and its predecessor, Washington Water Power. The largest increase ever approved was $32 million, in Cause U-83-26, a case in which the Company's request for interim relief was denied, when the Kettle Falls and Colstrip generating projects entered rate base.

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The table below provides the background for this comparison:

Year[2]	Docket	Amount Requested	Amount Granted
1981	U-80-13	$25,262,000	$17,667,000
1982	U-81-15	$21,115,000	$20,174,000
1982	U-82-10	$20,736,000	$13,397,000
1984	U-83-26	$45,862,000	$32,230,000
1985	U-84-28	$22,952,000	$ 2,253,000
1986	U-85-36	$23,971,000	$14,152,000
1987	U-86-99	$33,900,000	$15,527,000
2000	UE-991606	$25,250,000	($3,406,000)
2001	UE-010395	$87,387,000	

23. As is evident, this request is about twice as large as the U-83-26 request. If granted, it would be almost three times as large as the amount allowed in U-83-26. All of the above proceedings were general rate cases, with a reasonable amount of time for discovery, cross-examination, preparation of testimony, hearings, and preparation of briefs.

24. The sheer magnitude of Avista's request constitutes rate shock, by almost any definition. Elgin Direct, Ex 451-T, p 16, line 2; Tr. 582, lines 7-25; Tr. 598, lines 8-13. A 37% rate electric increase is almost unprecedented for an investor-owned utility in Washington. As public witnesses testified on September 10, and as reflected in written comments in Ex. 7, when combined with dramatic increases for natural gas customers last winter the impact would be sudden and severe as eastern Washington enters another winter season, already experiencing the effects of recession.

25. Staff witness Elgin, when asked if the Staff proposal for a 32% rate increase likewise would result in rate shock, replied: "Unfortunately it does, yes." Tr. 593. Staff, however, has made no proposal to the Commission in its testimony for the mitigation of rate shock created by

[2] Prior to 1980, total annual revenues were less than the requested increase in this case.

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its proposal. Tr. 593. Avista has made no mitigation proposal either. Notwithstanding the lack of such proposals, the Commission has an obligation to consider means of mitigating any rate shock that would result from an order in this case. Tr. 583, 598.

26. As this brief will discuss, Public Counsel recommends against the grant of interim relief. If relief is awarded, however, Public Counsel's alternative recommendation, that the Commission only grant a surcharge of 14.1%, avoids the rate shock which would result from the Company or Staff proposals. It also ensures that, even with a cost-based allocation of the allowed increase, no customer class will get nearly as a large an increase as the Company requested.

III. EVALUATION OF AVISTA'S REQUEST FOR EMERGENCY RELIEF

A. There Are Many Serious Deficiencies In The Company's Case

1. There are real questions of prudence.

27. There is no question that Avista has spent very significant sums of money on power purchases in recent months, and committed to additional such purchases in the future. Witness Schoenbeck referred to these as "very untimely and possibly imprudent" power purchases. Schoenbeck Direct, Ex. 651-T, p. 6. Many of the "deal tickets" are in the record. Mr. Norwood's testimony includes a graph showing the current market value of this power. Exhibit 103, p. 7. Just comparing two of Avista's transactions – Deal Ticket Nos. 2008 and 2021 - shows that the company paid huge premiums -- as much as ten times the value of the power it is currently receiving. Ex. 109C.

28. The relationship between Avista Utilities, the petitioner here, and Avista Energy, the unregulated marketing subsidiary of Avista Corporation, raises very serious questions. Avista's 2000 Financial Report shows that Avista Utilities lost $1.37 per share in the year 2000, while Avista Energy earned $3.54 per share. Ex. 161, p. 55. It is at least curious that two parts of the same company could have such radically different results trading in the same power market. One possible interpretation is that every time a "good" deal came in the door, it was routed to the

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unregulated entity, and every time a "bad" deal was struck, it was assigned to the utility. There certainly has been no opportunity in this expedited proceeding to examine this question, but it demands much closer scrutiny.

29. The important questions of prudence must not be pre-judged. First, any surcharge amount must be subject to refund, based on the outcome of the general rate case and prudence reviews. Second, there must be enough time provided for the review for it to be meaningful. Public Counsel strongly differs with Staff witness Elgin's suggestion that this review can be completed in three months. Tr. 565. We have, therefore, proposed that, should any rate surcharge be allowed in this proceeding, it be implemented for a period of 15 months, until December 31, 2002. This will allow for resolution of both the prudence review and general rate cases in an orderly and complete fashion.

2. Unregulated subsidiaries are a major cause of Avista's financial problems.

30. During its recent history, Avista (and WWP) has engaged in a great deal of diversification into areas unrelated to providing utility service. It is fair to conclude that the great bulk of these funds came from the utility and its ratepayers. Mr. Eliassen testified that the Company has not issued any stock since the early 1980s, so it certainly does not appear to have come from investors. Tr. 253. Indeed, Mr. Eliassen stated at the hearing that the investments in subsidiaries by the corporation, which is the utility, totaled at least $131 million between 1989 and 2000. Tr. 726-728. He referred to this as "internal cash generation." Tr. 726. At the same time as the Company has taking cash out of the utility, and putting it into these unregulated ventures, the investment community has become more and more concerned about these ventures, and reflecting that concern in its ratings of Avista Corporation.

31. Public Counsel/ICNU witness John Thornton made a thorough analysis of the rating agency opinions about Avista. Thornton Direct, Ex. 601-T, pp. 3-12. His Exhibit 604 contains complete copies of the rating reports he cites in his narrative testimony. Mr. Thornton points out that as early as 1998 rating agencies were expressing concern:

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> WWP has already placed increasing emphasis on inherently riskier nonregulated business activities, mainly those of Avista Energy. (Standard and Poors, August 18, 1998), Ex. 601-T, p. 4
>
> Management is demonstrating somewhat less conservative financial strategies from a fixed income investor's perspective. (Moody's, July 15, 1999), Ex. 601-T, p. 5).
>
> The downgrade is based on increasing business risk through investments in unregulated subsidiaries..." (Duff and Phelps, August, 13, 1999), Ex. 601-T, p. 5.
>
> The lower ratings reflect Avista's aggressive growth strategy that emphasizes the inherently riskier nonregulated businesses…(Standard and Poors, August 23, 1999), Ex. 601-T, p. 6.

32. In May 2000, Standard and Poor's quite explicitly noted the negative effect of the unregulated ventures on the otherwise stable and low-risk utility business:

> The ratings of Avista are based on the company's consolidated average business profile, which reflects *the utility's low-risk hydroelectric operations, competitive electric rates, and moderate rate needs*. These strengths are tempered by the company's participation in the inherently risky and nonregulated energy trading business through Avista Energy... (Standard and Poors, May 9, 2000), Exhibit 601-T, p. 7. (emphasis added).

33. All of these analyses took place before the runup in market energy prices which began at the end of May, 2000, and before any of the power cost deferrals were authorized. It is simply beyond any reasonable question that the unregulated operations have increased the risk exposure of the company and have caused the company's downgrades.

34. The Company's assertion that the utility operations are responsible for its rating downgrades is simply not supported by the record. First, the rating agencies, cited above, have all said that the unregulated operations are riskier, and that this is affecting the ratings. Second, most of the downgrades took place in 1999 and early 2000, long before there were power cost problems at the utility. As reference to the company's Financial Report shows, the downgrades started in 1999, when the utility was still earning strong returns. Exhibit 161, p. 55.[3] In the face of such evidence, at the close of the evidentiary hearing, Mr. Eliassen maintained his categorical

[3] Poor returns for Avista Information and Technology and Avista Ventures are also reflected in this exhibit.

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assertion that non-regulated activities of Avista have "nothing whatever to do with Avista Corp's current financial difficulties." Tr. 750. His testimony strains credulity, particularly when Mr. Ely, Chairman, President, and CEO of Avista, testified just the day before "risker non-regulated ventures" that were "still a concern"of rating agencies like Standard and Poor's. Tr. 183, listing Avista Energy and other subsidiaries. Tr. 182-184.

35. Staff did not have time to investigate or provide testimony on how non-regulated operations affected Avista Utilities' financial situation. Schooley Direct, Ex. 401-T. Staff agreed, however, that these operations would ultimately impact any recommendation in this case, Tr. 589, and that if the adverse financial situation were entirely a result of unregulated operations, the company should not be granted any interim relief whatever. Tr. 590.

3. Avista has already been compensated for below-average hydro conditions.

36. The Company's rates, set in the last rate case, were designed to collect "average" power costs, based on a 60-year water study that the Company prepared. This study included dry years like 1937 and 1988. Ex. 651-T, p. 13. A part of the current problem is that conditions are even drier than the most extreme year included in the average.

37. The Commission has previously heard testimony, however, on why it is crucial that surcharges not be allowed in dry years if it includes those dry years in the average upon which rates are based. Docket U-88-2363-P, First Supp. Order, p. 6. It stated in that order that:

> It might be better to develop more fully the criterion for emergency rate relief to compensate for drought conditions at the time that they occur. Id., p. 10.

The Commission has not, since that comment was made, engaged in such an exercise, and has continued to base rates on multi-year water averaging. All of the most recent 40 years of the water record were included in the average upon which rates were based in the last Avista general rate case. Docket UE-991606, Third Supp. Order, p. 44.

38. Witness Schoenbeck correctly noted that if the company has already been compensated, through use of the 40-year water study, for taking the risk down to the level of drought reflected

in that study, it would be double-counting to reimburse that risk a second time. Unfortunately, the Company has been deferring power costs based on the average power cost, not the low end of the range. Mr. Schoenbeck calculated that the current deferral is overstated by $25,584,000 because it inappropriately assumes that the Company should be compensated a second time for the risk already included in its base rates. Ex. 561-T, p. 13.

39. Accordingly, the Commission should remove the $25.6 million from the deferral amount if it ultimately allows cost recovery of any portion of the deferral balance. In addition, Public Counsel recommends that this adjustment be included in determining the amount of a surcharge, if any, allowed in this phase of the case.[4]

4. Financial Risk Adjustment

40. The Commission has previously ruled that any form of power cost recovery mechanism that compensates companies for drought risk should be accompanied by an adjustment to the cost of capital. Clearly, a company which can shift all or a part of the drought risk to ratepayers is a lower-risk company than one that cannot. The Commission recognized this when it re-examined Puget's Energy Cost Adjustment Clause (ECAC) in 1988:

> If no such downward adjustment [in the cost of capital] can be demonstrated by the parties in the next general rate case, then the Commission will have to seriously question the ECAC's raison d'etre." Cause U-81-41, Sixth Supp. Order p. 20.

The Commission has reiterated this on several occasions. When Avista requested a PCA in 1988, the Commission rejected it stating:

> Any power cost adjustment clause involves a regulatory tradeoff between the goals of rate stability and earnings stability. Earnings stability benefits a company and its stockholders, while ratepayers seek stable rates. If, through establishment of a PCA, a company receives the advantage of earnings stability, some of that benefit must be passed on to ratepayers to compensate for enduring rate instability. U-88-2363-P, First Supp. Order, p. 10.

[4] At the August 9 open meeting when Avista's deferral was initially considered, Staff emphasized that one important issue to be addressed in determining whether recovery of the deferred costs was appropriate was "What is a 'normal variation' in power supply costs? " Ex. 504, p. 2. Public Counsel and ICNU also raised the need to determine "normal fluctuation" in costs before allowing any recovery. Id., pp. 3, 5.

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The Commission reiterated this when ordering the termination of Puget's ECAC in Cause U-89-2688-T, Third Supp. Order, p. 14, and again when rejecting Avista's proposed PCA in its most recent rate case, where it stated:

> Mechanisms that simply shift risk from shareholders to ratepayers without compensating benefits do not meet this objective. UE-991606, Third Supp. Order. p. 52.

The company's request is actually for something even more favorable to the company than a PCA, but there is no adjustment for the cost of capital provided whatsoever, in disregard of the requirement previously imposed and reiterated by the Commission.

41. If the Commission allows a surcharge, subject to refund, it should be with the explicit recognition that the recoverable amount to be determined in the Prudence / General Rate Case process would be net of the cost of capital adjustment appropriate for a Company that has a mechanism to recover retroactively its excess power costs. Further, this is a crucial reason why the Commission should cut off the deferral at 6/30/01, as recommended by the Staff – to make it extremely clear that the Company is not receiving a long-term PCA mechanism of any kind. *See* Tr. 580-581 (Elgin: equivalence of deferral and PCA, issue unresolved).

5. By historical standards, Avista's financial condition is not so severe as it asserts.

42. Avista been in financial difficulty before, and has filed previous requests for emergency rate relief, not all of which have been granted. *WUTC v. Washington Water Power*, Dockets U-77-53, Second Supplemental Order; U-80-13, Second Supplemental Order; Fourth Supplemental Order, U-83-26. Mr. Eliassen was a witness in both the 1980 interim rate request (granted, in conjunction with a pending general rate case) and the 1983 interim rate request (denied, in conjunction with a pending general rate case). During cross-examination, Public Counsel asked Mr. Eliassen to compare the company's current financial condition to that in 1983. He testified that that current situation is "significantly worse today." Tr. 256. This assertion does not appear to comport with the facts.

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43. Comparing some of Avista's financial indicators from the "nuclear construction" era to those in the current situation provides a useful perspective on Avista's current claims regarding the severity of its distress. The record contains the Company's Financial and Operating Report from 1984, which includes summary statistics for the ten years preceding, Ex. 155, as well as the Company's 2000 Financial Report, Ex. 161. The following table takes figures from the two exhibits to provide a comparison.

	2000	**1984**	**1983**	**1982**	**1981**	**1980**
Net Income (millions)	$91.6	$65.9	$67.7	$59.4	$46.3	$29.6
AFUDC as % of Net Income	4.5%	46%	58%	38%	33%	29%
Market-to-Book Ratio	134%	82%	87%	92%	76%	70%
Coverage Ratio w/o AFUDC	2.32%	2.02%	1.59%	2.36%	2.30%	1.98%

See Ex. 155, p. 2 (coverage, market-to-book), p. 6 (AFUDC, shares issued); Ex. 161, p. 29 (AFUDC), p. 55 (market-to-book).

44. It is clear from this data that the company is in better financial condition now than it was then. Income is higher. AFUDC is lower (meaning that earnings are cash, not accrual of interest). Market-to-book ratio is dramatically better than in the earlier era. The facts simply do not support Mr. Eliassen's assertion. In 1983, when the Company was denied interim rate relief, it was in a significantly more adverse situation than it is today. As Mr. Elgin acknowledged in his cross, WWP in 1983 was an $800 million dollar company with a $200 million investment in problematic nuclear construction at the WNP-3 and Skagit plants which had not yet been ruled on by the Commission. Tr. 600. By contrast, Avista today is $1.5 billion company, with an investment (deferral) at issue in this case of comparable size (projected to be $200 million). The former company situation would seem to be of much greater concern to the financial community. Tr. 600-601. [5]

[5] Mr. Schooley's additional comment that fixed charge coverages are not met even though they improve appears to be based on the portion of Mr. Peterson's exhibits that assumes no financing.

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6. Avista's financial problems are short-term in nature.

45. Notwithstanding the breadth of company claims of distress, the record reveals only one problem with the Company's financial indicators, as is apparent from a review of Mr. Peterson's table showing the Estimated Fixed Charge Coverage Ratio. Exhibit 201, p. 1. Assuming the financing that the Company plans to do, it has only a single quarter where it has a problem, the fourth quarter of 2001. In fact, by the middle of 2002, the Company's coverage ratio reaches a level higher than anytime in the 1980 - 1984 era. Mr. Schooley also points out that the problem with fixed charge coverage ratio will turn around quickly and begin to improve. Ex. 401-T, p. 18, lines 2-6. As Mr. Schooley noted, as recently as June 30, 2001, "the Company did not appear to be experiencing an actual emergency." As of that date, coverage ratios complied with applicable financial ratio covenants. Ex. 401, p. 12, ll.17-19. The company has, at worst, a short term problem for which a short term solution is needed.

7. There is little reliable evidence regarding the specific expectations of Avista's "bankers" or "Wall Street."

46. Throughout its written testimony and cross-examination, Avista has made frequent references to the demands and expectations of its bankers and Wall Street. For the most part, these figures are unidentified, and their asserted views and opinions uncorroborated. The Commission should give little weight to this form of hearsay support for the Avista filing and should rely instead on the objective and factual evidence in the record in reaching its determination. Indeed, the only direct evidence of the views of the Wall Street rating agencies are the reports which show that the principal concern of Wall Street is the unregulated activities, not the power cost deferrals. Ex. 604.

8. Avista improperly recommends the continuation of the deferral.

47. Public Counsel concurs with the Staff recommendation that, if relief is granted, the deferral should be terminated for the reasons stated in Mr. Elgins's direct testimony. Ex. 541-T,

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pp. 21-23. Avista has clearly abandoned the terms of the Settlement Stipulation upon which the extension of the deferral were based.

B. Avista Has Provided Evidence Of Financial Difficulty, But Does Not Meet The Test For A Surcharge Or For Interim Relief.

1. Avista's request does not qualify it for a surcharge.

48. Avista's petition for a surcharge does appear to constitute a request for rate treatment for a specific type of expenditure, a single element of cost of service – power supply costs. Beyond this description, however, it falls short of the requirements for a surcharge in several two respects.

49. First, a significant portion of the costs sought to be recovered is neither actual, nor reasonably known and measurable. Deferral costs after July 2001 are projected rather than actual.

50. Second, surcharges are typically dependent on a prior finding of prudence. No such finding has occurred here, as Avista acknowledges. Since no such prudence determination has been made, it is not possible for the Commission to accurately determine if these were costs over which the company had little or no control.

51. Third, surcharge requests are not to be employed for "stopgap" financing purposes. Yet, Avista has expressly and repeatedly characterized this request as one designed to address interim financing needs.

52. For these reasons, Public Counsel submits that, as filed, Avista's request does not present a sufficient basis for a surcharge under existing criteria. Staff witness Elgin also raises questions as to whether the request qualifies, while concluding that the petition "fits best" in the surcharge category, rather than as interim relief. Ex. 451-T, pp.15-17.

2. Avista's request does not meet the standards established by this Commission for interim relief

53. There are major gaps in the *PNB* analysis conducted in this case. The initial and chief fault lies with Avista, the party with the burden of proof. The company's initial filing stated

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only that it was consistent with the Commission's "previously articulated criteria." Ely Direct, Ex. 50-T, p. 9, line 25- p.10, line 1. The criteria were not stated. In response to Staff discovery, Avista identified the *PNB* criteria as the applicable standard, Ex.52. On cross examination, Mr. Ely acknowledged that the *PNB* standard governs. Tr. 167-168. Not only did Avista's testimony fail to identify these criteria, Avista failed to provide an "explicit, systematic analysis of those criteria." Schooley Direct, Ex. 401-T, p. 10

54. The sparseness of the company's case has in turn made analysis and case preparation very difficult for other parties, including Commission Staff. Staff witness Schooley observed, for example, that "[t]he Staff has done the best it can to respond to the issues in this compressed time frame." Id., p. 12, lines 4-5.

55. Staff ultimately concluded, after reviewing the *PNB* test, that some interim relief was warranted. Staff's own review was incomplete, however. With regard to the important fourth *PNB* criterion – the review of financial indices - Mr. Schooley, the chief witness for Staff's surcharge recommendation, acknowledged his own analysis of financial indices turned on a single factor, the fixed charge coverage ratio. This was "[t]he one factor [he] was able to analyze in the time available." Schooley Direct, Ex. 401-T, p. 22, lines 18-20. He and Staff did not have time to analyze other factors, such as market-to-book ratio, trends in rate of return, earnings per share, or other interest coverages, all factors which the Commission has previously stated are important in interim relief cases. Tr. 658-659; *cf*. *WUTC v. Washington Water Power,* U-80-13, Second Supp. Order, at 5.

56. Mr. Schooley's point by point review of other *PNB* criteria hardly paints a compelling picture of Avista's compliance with the standards for relief. Indeed, it is difficult to reconcile the ultimate Staff recommendation for a surcharge with the underlying review of the applicable criteria in Staff's testimony.

1. Hearing Requirement. As noted above, Mr. Schooley observes that the compressed time frame has rendered analysis difficult. Ex. 401-T, p. 12, lines 1-5.

2. Actual Emergency. Mr Schooley did not state an opinion as to whether an actual emergency exists. He does state that no emergency existed prior to June 30, 2001 and that Avista provided evidence of "one failed liquidity criterion." Id., p. 12, lines 17-21. He does not conclude that denial of relief would lead to gross hardship or inequity, and, in fact, notes that if relief were denied and Avista had to issue higher cost debt, "Avista has not shown that higher cost debt is more or less cost effective than the 37 %, surcharge it has requested." Id., p. 22, lines 9-16.

3. Rate of Return Not Determinative. Mr. Schooley notes that rate of return is low per Avista reports, if the deferred power costs are included, but renders no opinion on whether or how this should be considered.

4. Review of All Financial Indices. As discussed above, only one was reviewed. While Mr. Schooley testified that financing the Coyote Springs II project was the "main reason" for problems with Avista's fixed charge ratio, his testimony did not take into account possible improvements in the ratio that would result from a full or partial sale of the plant. Tr. 656-657, 660-661.

5. Impending Disaster/Clear Jeopardy. Mr. Schooley merely recites Avista claims, and notes his conclusion that certain financial covenants will not be met without additional revenue. He does not expressly conclude that there is an impending disaster that places ratepayers and shareholders in clear jeopardy. Id., p. 21, lines 10-16.

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6. Regulation in the Public Interest. Mr. Schooley does not treat this as a separate criterion, instead apparently arguing that if the other criteria are met, relief is in the public interest. In particular, he mentions specifically the second (actual emergency/gross inequity) and fourth (financial indices) criteria as determinative.

Other factors.

57. Mr. Schooley lists Avista's claims of need for immediate and short term financing but appears to have done no independent analysis of them.. Ex. 401-T, p. 14, lines 1-8. He does not make a recommendation on this criterion, but does conclude that Avista had provided no evidence to demonstrate that the projects were still viable and cost effective Id. lines 9-11. Likewise, no detailed analysis was done of whether the company had any ability to generate sufficient capital from internal sources to finance its construction needs, Tr. 659. *See, citation* (explaining that this is an aspect of the *PNB* analysis). Avista, in Staff's view, has not demonstrated that all elements of its ongoing construction budget are necessary for it to carry out is obligations as a public service company. Tr. 603-605.

58. As noted above, Avista's request for interim relief is made outside the context of an interim rate case. The important reasons why this requirement exists have been noted above. The Commission should not establish the dangerous precedent here that companies can obtain interim relief from their customers without at the same time opening up their books and initiating a general case.

59. Finally, those portions of Avista's filing that seek recovery of projected deferrals by means of a surcharge are clearly a PCA "in disguise." The request does not meet the requirements for a PCA established by the Commission and reaffirmed in the most recent Avista rate case. The request does not make an adjustment to cost of capital, nor is limited to weather related changes.

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60. For the foregoing reasons, there is ample basis for this Commission to conclude that Avista has not met its burden of proof to justify approval of either a surcharge or interim relief. Public Counsel recommends that the Commission therefore deny the request. As discussed elsewhere in this brief, there is also evidence in the record that Avista has other sources of funding available other than its ratepayers. Neither Avista nor Staff have made the kind of strong showing which should be required to impose an increase of this size and impact on the company's ratepayers.

3. Avista has presented some evidence of financial difficulty.

61. As discussed above, Avista's case has many flaws and weaknesses. The company has provided some evidence that it is facing financing difficulty. While the company's actual financial situation is much better than it was during the nuclear construction era, the California crisis has apparently made the financial community skeptical, and the Company is having difficulty issuing securities. Staff witness Schooley has reached the conclusion that the Avista will fail to meet its fixed charge coverage ratio, warranting relief in Staff's view.

62. The financial situation is primarily of Avista's own making, a result of unregulated ventures and of untimely power purchases which have drained its cash flow. The company's large construction program for Coyote Springs II is creating a challenge. Borrowing enough money to finish the project is not assured. Public Counsel submits there is substantial evidence in this record that there are numerous options available to the company which would not require a rate adjustment. These are addressed in the next section of the brief. If the Commission nevertheless finds that a rate surcharge should be a part of the package of solutions, we also propose methods for the imposition, collection, and accounting for such a surcharge.

IV. ALTERNATIVES TO SURCHARGES FOR CONSUMERS

A. Avista and Its Shareholders Must Be Part of Any Solution

63. Avista cannot expect ratepayers alone to bear the costs associated with its high-cost purchases. Avista's request actually provides the company the sort of inequitable result it could

never hope to achieve after a full review of its general rates, its PCA request, and the prudence of its deferred costs. Not only does it recover 100% of its excess power costs, but it also gets double-recovery of the portion of hydro risk for which it has already been granted rate treatment. Not only would it get a rate of return based on a company without a Power Cost Adjustment, but it also would get full recovery of deferred power costs. Such an outcome would violate fundamental tenets of regulatory policy. Any resolution of this situation must involve a fair allocation of burdens to the company and its shareholders.

B. Operating and Capital Budget Cuts

64. The company has already taken an important step to ease its financial situation by cutting its capital and operating budget. These cuts total some $57 million, and are mostly deferrals of capital items. Ex. 30, Tr. 170. While we have not examined these cuts in any detail, it does not appear that customer service quality is at great risk, so the Company has probably chosen areas to cut which will not seriously affect customers.

65. This cut in the budget creates a corresponding reduction in financial pressure, and the company's rate surcharge should be reduced by the amount of savings it has identified. The company testified, however, that it had not considered these cuts in computing its request. Tr. 170, although today they are a part of the company's financial plan. If it no longer needs this $57 million for its operations in the next 15 months, then ratepayers no longer need to provide the funding.

66. Simply by subtracting this reduced funding requirement from the requested rate increase Avista's request is cut almost in half. *See* Appendix A, "Second Approach". Over the twelve months October 1, 2001 through September 30, 2002, these savings amount to $40 million, which would reduce the Company's original purported "need" for $87 million down to $47 million.

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C. Part of Coyote Springs II Should Be Sold

67. The biggest problem facing the Company is the financing to complete the Coyote Springs power plant in Oregon. Schooley Direct, Ex. 401-T, p. 18, lines 8-10. This plant is much bigger than any other Company power plant, requiring significant construction funds. It would create operational problems for the company that will require additional funds to address. Mr. Ely testified that Avista has explored sale options, Tr. 154-156 , and acknowledged that a sale would improve the fixed charge ratio.

68. The company's estimated financial requirements are overwhelmingly for Coyote Springs Eliassen, Ex. 150-T, p. 2; Peterson, Ex. 200-T, pp. 1-2; Ex. 404C. Mr. Ely testified that Coyote Springs would be three times as big as any other single resource on the Avista system, and that this would cause operational challenges because of the reserve requirements the Company must carry for its largest generating unit. Tr. 202. Mr. Norwood confirmed that there is still some work to do to manage the cost exposure associated with having such a large generating unit on a system as small as Avista's. Tr. 387. Mr. Ely testified that suspension of construction activity at Coyote Springs II was an option that could be considered, although he expressed reservations. Tr. 178.

69. Coyote may well be too expensive in terms of power supply. Mr. Norwood testified that the cost of the output of Coyote Springs will be $45 - $50 per megawatt-hour,. Tr. 375, and that the current price at which a forward purchase can be made for five years is $37 - $40 per megawatt-hour, Tr. 376. Therefore, a sale of all or a portion of Coyote Springs, and a purchase of needed energy on a long-term contract, would result in lower power supply costs for Avista over the next five years.

70. The evidence is compelling that a portion of Coyote should be sold. The plant is the basic source of the company's financial pressure. It is too big. It creates operational problems for the company, and it costs more than the value of the power it produces. Mr. Ely himself expressed similar sentiments:

> One of the things we may look at is should we sell part of that output to somebody else so we're not so reliant on specifically one plant and maybe buy part of another plant to take and fill the rest of the need, and that way you don't have this one incident taking megawatts basically out of your load and having to backfill on it. Tr. 203.

The record strongly supports a conclusion that selling a portion of Coyote would reduce financial needs, reduce risk to the Company, and reduce its power supply costs in the next few years.

D. Sale of Subsidiaries Must Be Considered As An Alternative.

71. Ratepayers are being asked to bail the utility out of its current predicament. If any such "bail out" is ordered, however, a part of the solution must be the sale of the risky subsidiaries, largely created with the profits from utility operations, which have contributed significantly to the current financial problems. Mr. Ely indeed testified that the company has already begun this undertaking, Tr. 158-159, 165, 182-184, and that the equity in the subsidiaries is approximately $200 million. Tr. 159. Public Counsel recommends that the Commission condition any grant of rate relief in this proceeding on a covenant of the company to sell its unregulated operations no later than December 31, 2002, the ending date we recommend for a rate surcharge.

72. This will have two effects; first, it will bring equity back to the utility that was inappropriate diverted to other uses. It is undisputed that the utility needs more equity. *See e.g.* Thornton Direct, Ex. 601-T, p. 12 , line 12. Second, it will make the utility's financial ratings stronger in the long run, by disposing of these volatile and uncertain business lines. The fact that Avista Energy is currently profitable should make it possible to sell this business for a significant premium – helping to offset the damage to the utility's financial operations that these risky business have posed in recent years.

73. We believe that this is an important condition of ratepayer support for the Company in this situation. The Commission must make divestiture a condition of rate relief.

E. The Utility Can Borrow From Avista Energy

74. Avista's response to Bench Request No. 3, now designated Ex. 3, suggests a further option for Avista beyond ratepayer surcharges. Exhibit 3 is the cash flow statement for the utility and the subsidiaries. It shows that while Avista Utilities has only $12 million cash on hand, Avista Energy has over $200 million of cash on hand, mostly consisting of trading profits it has made in the past year – the precise period when Avista Utilities paid so much for power and lost money. Mr.. Eliassen testified about the prospect of Avista Energy "dividending up" some money to the parent utility. Tr. 728. It seems equally reasonable that the company could consider a loan from Avista Energy to the utility to address its financial needs.

75. Because we recommend that any rate relief be conditioned on the sale of the unregulated subsidiaries, Avista Energy would presumably have no need for this $213 million in cash on hand. Since this would revert to the parent upon sale of the subsidiary, there should be no problem with treating this as a loan in the meantime. It would give the utility the cash it needs to complete the portion of Coyote Springs that is prudent to retain, without having to reach out to the skeptical financial community.

F. There Are Other Alternatives To Raise Capital

76. In addition to those discussed above, the company has other alternatives available to it to raise capital if it does not get the requested rate surcharge. All were acknowledged by company witnesses, though not necessarily with enthusiasm. They include:

- Sale of transmission or distribution properties. Ely, Tr. 180
- Issuance of common stock below book value, as the company did consistently between 1978 and 1984. Eliassen, Tr. 260, *see* Ex.. 155, p. 6.
- "Bailout financing." Ely Tr. 187.
- Suspending the dividend. Ely, Tr. 179 – 180.
- Issuing stock dividends instead of cash dividends. Ely, Tr. 356.

77. Finally, it is of no little significance that Avista Corporation has to date not sought or supported any refunds in the Federal Energy Regulatory Commission (FERC) case established for the Pacific Northwest. *Puget Sound Energy v. All Jurisdictional Sellers*, FERC Docket No. EL01-10-000. Tr. 379-380. Avista Corporation is participating in that case on behalf of both the utility and the marketing subsidiary, Avista Energy. Tr. 380. These entities are not similarly situated, however. The utility is a net purchaser in the wholesale market, Tr. 381, who could stand to obtain refunds for the excessive power costs it has incurred, the same costs for which it here seeks recovery. Tr. 382-383. Avista Energy, on the other hand, had a very profitable year 2000, earning over $165 million. Exhibit 122C.[6] Under these circumstances, Mr. Norwood acknowledged on cross-examination that the company is "seeking relief from our customers" rather than pursue refunds in the federal proceeding. Tr. 382.

G. Requiring Avista To Resort To Other Options To Solve Its Financing Needs Does Not Interfere With The Company's Management Of Its Affairs.

78. Avista has many options. Raising rates through a huge surcharge, the biggest rate increase in company history, is simply not an acceptable option. Disturbingly, the company has proposed this as the sole solution to its problems. Fundamental fairness, and the public interest, requires that if ratepayers are to support the company in this time of financial stress, the shareholders must also sacrifice. Yet, the company has shown little willingness to date in these proceedings to look realistically at other options besides rate increases. The Commission need not require the company to undertake any specific alternative, but by limiting the scale of relief it provides to a level that is fair to ratepayers , it can leave to management discretion the appropriate means for raising capital from other sources such as those discussed here. Both Mr. Ely and Mr. Elgin acknowledged this point at the hearing. *See*, Tr. 187-188 (Ely); Tr. 599-600 (Elgin).

[6] On cross-examination waived confidentiality as to this data from the exhibit. Tr. 753.

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V. RATE DESIGN

79. The Company has proposed increasing all rates by a uniform percentage. Hirschkorn Direct, Ex. 300-T, p. 2. This has the effect of surcharging both power supply costs, which are the subject of this proceeding, and distribution costs, which are not. Staff, on the other hand, has proposed a uniform cents/kwh surcharge.

80. Mr. Hirschkorn testified that every other interim rate increase he was aware of had been imposed on a uniform cents/kwh basis. Tr. 454. Mr. Hirschkorn further testified that on a cost of service basis, a uniform cents/kwh surcharge would be more appropriate, stating:

> I would not argue that from a cost causation standpoint, a uniform cents per kilowatt hour would be a more appropriate way to apply the surcharge. Tr. 466.

81. The unfairness of the company proposal is shown in sharp relief by the impact on street lighting customers. These customers would get a $.05/kwh rate increase – more than the total rate currently paid by residential and industrial customers. This is the mathematical result of applying a surcharge on not only the power supply costs, but also the distribution costs and the lighting fixture costs. Both Mr. Ely and Mr. Hirschkorn testified that the distribution and lighting fixture costs are not at issue in this proceeding. Tr. 185 (Ely); Tr. 464 (Hirschkorn). These distribution and lighting fixture costs should not be surcharged; this is an energy supply problem.

82. In summary: previous surcharges have consistently been imposed on a cents/kwh basis; this is the method which is justified on a cost-causal basis; Staff has proposed a uniform surcharge both because it is cost-justified and because it is easier to track the recovery of the allowed surcharge amounts. Public Counsel recommends a uniform cents/kwh surcharge.

VI. PUBLIC TESTIMONY

A. Public Hearing in Spokane

83. The Commission held an evening hearing on September 10 in Spokane, Washington, to provide an opportunity for Avista customers to testify regarding the proposed surcharge. Over

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100 persons attended. Over forty persons provided oral statements and a number of written statements were also submitted.[7] Witnesses included small business people, large business owners, union workers, senior citizens, low-income and disabled residential customers, political leaders (including mayors and county commissioners), representatives of non-profit agencies, and large institutional customers.

84. A number of themes emerged from the testimony.[8] There was substantial testimony from many witnesses that Avista's proposed surcharge would impose tremendous hardship on senior citizens and low-income customers, forcing many to choose between paying for electricity and other necessities such as food and medicine. Several witnesses testified about the limited assistance available to low-income customers to pay utility bills. Witnesses from the Area Agency on Aging noted that many frail elderly and other citizens live on fixed incomes of around $1000 or less. They supported the alternatives offered by Staff and Public Counsel. Spokane Neighborhood Action Program testified regarding the drastic tradeoffs that seniors would face, while noting Avista's support for energy assistance and other programs.

85. Many witnesses also raised questions about the justification for Avista's increase and about the accountability of Avista for creating its own problems. Frank Yuse of the Senior Legislative Coalition provided a list of reasons to reject the increase, including (1) Avista's poor business judgement and poor foresight in trying to capitalize on a risky market; (2) Avista's status as a private monopoly should place more risk on the shareholders and requires more protection for ratepayers who have no choice; (3) ratepayers are not responsible for the problem and should not be required to bail out the company; (4) the surcharge is too high, the largest ever, and is too extended; and (5) Avista executives are overpaid. Mr. Yuse also stated that the Staff recommendation was too high and suggested instead that a 12 percent surcharge over nine

[7] Written statements submitted at the September 10 hearing and subsequently have been included in the record as part of Exhibit 7 containing all written and email comments in the docket.

[8] This brief summarizes the testimony and comments, but does not attempt an exhaustive review of all the witnesses and points made. The hearing transcript and public exhibit provide a complete record of public response to the proposal.

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months would be more reasonable, with the rest from shareholders. These points were echoed by many witnesses.

86. Many large and small business owners raised questions about the increase, noting that regional business was already experiencing an economic downturn that would be exacerbated by the proposed level of increase. Wayne Andreesen, President of Inland Empire Paper, stated Inland was Avista's sixth largest Washington customer, that they had been in operation since 1911 and had a current workforce of 141 employees. He noted the recent reassurances about no need for a rate increase, and testified that the proposed surcharge would place Inland in jeopardy. He urged that any increase be kept to the bare minimum. Union workers from Inland's PACE Local also spoke about the impact on the plant and the ripple effect on the community of job losses, operating cutbacks, and rate increases on family budgets.

87. Robert Tenold, Chairman of the Board of Spokane Industries, testified to his serious concerns about the economic impact of the proposed surcharge, which would amount to an increase of $14,000 per month in Spokane Industry's electricity costs. Spokane Industries has 200 employees. Mr. Tenold asked the Commission to consider alternatives to the increase, including extension of the time to reduce the monthly impact, reactivation of Schedule 26 so that large customers could have options, and spreading more of the cost to other ratepayers through rate design.

88. A representative of Sacred Heart Medical Center spoke in support of the ICNU proposal for an 11.9 percent surcharge. Small business owners from a dry cleaning firm, a recycling company, and others all spoke of serious concern about the impact on their businesses.

89. County commissioners from Stevens and Whitman Counties raised concerns about the increase. Commissioner Delgado of Stevens County stated that he was opposed to any rate increase. He pointed out that Stevens County is already economically depressed with unemployment rates as high as 13 percent, ranking 38th of 39 counties in level of poverty in the state. Stevens County is about to experience a major blow on September 30 when Alcoa closes

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its NW Alloys plant. He expressed special concern for the impact on low-income, disabled and elderly residents.

90. A significant number of the witnesses who raised serious concerns about the justification for the increase, also expressed concern about the viability of the utility company, suggesting that the alternative was a smaller surcharge for a shorter period of time, as opposed to outright denial. A number of witnesses also spoke favorably about Avista's role in Spokane supporting community and social service activities.

91. The Mayor of Spokane, John Powers, and some business representatives spoke in favor of Avista's request, as did a representative from Whitman College. The thrust of the Mayor's comments was that it was in the community's interest to preserve Avista as a locally owned, managed and headquartered utility with a long history in Spokane and Eastern Washington. While he acknowledged the difficulties that some customers would face paying a surcharge, he argued that the rates were still reasonable by comparison with national and regional levels and that the short term sacrifice was worth it.

B. Written Testimony

92. In addition to the testimony provided on September 10, the Commission and Public Counsel have received substantial written comment. The record was closed on September 14 for purposes of receiving written comment. These comments have been incorporated into Exhibit 7 and submitted to the Commission.

93. As of the time of preparation of this brief on September 17, 2001, the Commission and Public Counsel had received, by Public Counsel's tally, 96 written comments (58 email and 38 letters). Of these 92 opposed the rate increase, or requested a lower amount of surcharge. Four supported Avista's request.[9] In addition, a number of petitions collected at Senior Nutrition Sites were provided expressing strong opposition to "a high rate increased by Avista."

[9] Because the record did not close until 5 p.m. Friday, September 14, and the time to finalize the public exhibit was limited, the actual tally may vary slightly. The exhibit speaks for itself as to the tally and positions expressed.

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VII. PUBLIC COUNSEL RECOMMENDATION

A. No Interim Relief Should Be Granted Without A General Rate Case

94. Avista's request in this case is troubling in many respects.

1. It has taken the unprecedented step of asking for interim relief without filing a general rate case, giving the Commission no context for the request, and asking the Commission to depart from sound regulatory practice and precedent.

2. A substantial portion of the request is simply a renewed attempt to obtain approval of the PCA mechanism rejected in the company's last rate case. The request violates the Commission's PCA requirements, being tied neither to weather-related factors, nor offering a adjustment to return on equity. Risk is clearly and dramatically shifted to ratepayers.

3. The request unquestionably creates rate shock.

4. The request comes only two months after a settlement in which the company assured the Commission, Staff, Public Counsel and its customers that it would not need to seek rate relief until 2003.

5. This rate request is the culmination of a series of steps involving the deferral of costs which, despite Commission orders reserving any decision on the merits, have effectively created a growing pressure on the Commission to overlook any questions of propriety of deferral or prudence of costs. By now asking for assurances about recovery for the benefit of "bankers" and "Wall Street," Avista places tremendous pressure on the Commission to simply determine when and how the deferred costs should be recovered, and thus to prejudge, or signal that it is prejudging, prudence and other issues. As Staff witness Mr. Lott testified, no regulatory asset was ever created by the Commission. Avista has improperly treated the deferral as if the Commission had done so.

6. The request is clearly overstated. It does not even take into account Avista's own acknowledged operating and capital savings. The company appears to categorically

reject any source other than ratepayer funding as a solution to Avista's problems. This failure to look at other options is fundamentally indefensible, particularly in view of the size and duration of the surcharge.

7. Much of the company's difficulty is of its own making. Its poor investment grade is largely the result of the risky ventures of unregulated subsidiaries. There are real questions as to the prudence of the deferred costs.

95. For these and the other reasons set out in this brief, Public Counsel recommends that the Commission deny the current request for interim relief, and instead require the company to prove its need in the context of a full general rate case and an accompanying review of the prudence of deferred costs. As demonstrated above, Avista has available to it a range of options to address its financing problems pending a full rate and prudence review.

B. If the Commission Concludes Relief Is Warranted, Public Counsel Recommends A Reduced Amount of Surcharge With Conditions.

1. Public Counsel Alternative Recommendation and Options

96. Avista has provided evidence of financial problems. The Staff has recommended relief. In the event the Commission's review of the record leads to a conclusion that some relief is warranted, Public Counsel urges the Commission to tailor such relief narrowly, adhering to the following principles:

- Require the company and its shareholders to contribute to the solution.
- Relief should not prejudge prudence or other issues identified by the Commission in its prior order in this docket.
- Tie any relief to costs incurred prior to July 1. These costs are actual rather than projected.
- Treat the relief as a surcharge rather than interim relief, for the reasons set out in Mr. Elgin's testimony, and this brief.

Public Counsel Recommended Approach: Allow 1/2 of the Pre 6/30/01 Deferrals at This Time

97. This option would permit Avista to immediately begin recovering a sum equivalent to one-half of the amounts it deferred through 6/30/01, amounts which represent actual rather than

projected costs. Recovery of this amount is adequate to provide Avista with the funding it needs, taking into account other financing options, as reflected by the range of other alternatives set out in Appendix A. The only adjustment is that the level of deferrals is first adjusted for the level of hydro risk which was already embedded in permanent rates, as testified to by Mr. Schoenbeck. Therefore, the deferral balance at 6/30/01 of $109 million is reduced by $25.6 million, and the result divided by 2. We propose that if this option is chosen, a 15 month recovery period be allowed, as that would provide time for completing the Prudence Review and the General Rate Case before any additional surcharge is needed. This produces an annualized surcharge of $33.4 million, or a 14.1% surcharge.

98. As to accounting treatment, if the Commission concludes that the Staff recommendation is sufficient to address the concerns of the financial community, Public Counsel would support that option. Otherwise, surcharge revenues should be booked in the manner proposed by the company, but with the clear declaration that the amount is subject to refund, and that no determination as to prudence has been made. The surcharge should be collected on a single rate per kilowatt hour basis, as recommended by Staff, for the reasons set out in Section V (Rate Design) of this brief.

2. Other alternatives supported by the record establish that Public Counsel's proposal is in a reasonable range.

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Second Approach: Subtract Savings From Budget Cuts

99. Avista has reduced its capital and operating budget, and sold the Mint Farm power plant. These provide savings and revenues which offset the alleged need for $87 million in annual rate relief. This option subtracts the Company's estimated savings for the period October 1, 2001 - September 30, 2002, as well as the revenue received from the sale of Mint Farm, from the requested level of rate relief. This produces a residual amount of $45.3 million, which is a 19.1% rate increase. We believe that this is the largest number that can be supported by the record before the Commission.

Third Approach: Approve the Staff Recommendation, Less the Budget Cuts

100. Staff has proposed a $19.5 million three-month surcharge, of 32.6%. This was prepared prior to the budget cuts announced by Avista, and reflected in Exhibit 30. This amount should be reduced by the amount of the budget cuts, as the Company now has that amount of cash available to meet coverages. This produces a residual amount of $8.2 million, which would be a 13.7% surcharge over the period 10/1/01 - 12/31/01.

Fourth Approach: ICNU Proposal by Schoenbeck

101. Mr. Schoenbeck proposed that 100% of the pre-6/30/01 deferral amounts be allowed, but that offsets be applied based on the hydro risk adjustment he discusses, and an accelerated amortization of the PGE credit to reduce the amount required from rates. We do not support the underlying principal that 100% of the pre-6/30/01 balance should be recoverable. This option produces an annual surcharge of $28.3 million, or 11.9%.

Range of Surcharges

102. Public Counsel's recommendation and the three alternatives establish a range of appropriate surcharges of from 6.1 percent to 19.1 percent.

3. Conditions

103. General Rate Case. Public Counsel concurs in Staff's recommendation that any surcharge be coupled with a requirement that Avista immediately file a general rate case. Its proposal to file a case sometime in November creates undue delay. A general rate case is critical to enable the Commission to fully evaluate the company's cost of service, its overall revenue requirement, and its request for a PCA issue. The rate case should also incorporate the power supply case which the company is required to file under the Avista 1999 Rate Case Order and the order of May 23, 2001, in this docket.

104. Terminate the deferral. If any surcharge is granted, the Commission should concurrently terminate the deferral of any further power costs. Again, Public Counsel concurs in the

recommendation and supporting rationale of Staff. Elgin Direct, Ex. 451-T, p. 21, line 17 - p. 23, line 2.

105. Divestiture of subsidiaries. As discussed earlier in this brief, Public Counsel recommends that any surcharge be conditioned on Avista's divestiture of its unregulated subsidiaries.

VIII. CONCLUSION

106. While Avista has presented evidence of financial difficulty in this case, its showing falls short of establishing the basis for a surcharge or for interim relief under Commission precedent or appropriate regulatory methodology. This brief has detailed the many troubling aspects of this request which militate against the imposition of a surcharge, particularly one of this magnitude. In addition, there is significant evidence in the record that Avista has alternatives, other than a draconian increase of rates, to which it could resort to address its financial problems. Accordingly, the record provides the Commission a strong basis for the denial of Avista's request for relief.

107. In the alternative, should the Commission conclude that Avista has justified a need for emergency rate relief, Public Counsel recommends that the relief be provided in the form of a surcharge, in an amount not to exceed 14.1 %, over a period of 15 months. The surcharge should be conditioned on a requirement that a general rate case be filed, and that the company initiate a process to divest itself of its subsidiaries. The deferral of any further costs should be terminated. Finally, any surcharge should be subject to refund, dependent on the outcome of a careful review of the prudence of the deferred costs incurred by the company.

RESPECTIFULLY SUBMITTED this ____ day of September, 2001.

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