

|   |  |   |
|---|--|---|
| 1 | BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION |   |
| 2 | COMMISSION   |   |
| 3 | THE WASHINGTON UTILITIES AND                       | ) |
|   | TRANSPORTATION COMMISSION,                         | ) |
| 4 |  | ) |
|   | Complainant,                                       | ) |
| 5 |  | ) |
|   | vs.  | ) |
| 6 |  | ) |
|   | AVISTA CORPORATION d/b/a                           | ) |
| 7 | AVISTA UTILITIES,                                  | ) |
|   |  | ) |
| 8 | Respondent.  | ) |

DOCKET NO. UE-011595  
 Volume No. IV  
 Pages 145-252

-----

9

10 A hearing in the above matter was held on

11 June 12, 2002, at 9:10 a.m., at 1300 South Evergreen

12 Park Drive Southwest, Olympia, Washington, before

13 Administrative Law Judge DENNIS MOSS, Chairwoman

14 MARILYN SHOWALTER, Commissioners RICHARD HEMSTAD and

15 PATRICK OSHIE.

16 The parties were present as follows:

17 THE WASHINGTON UTILITIES AND TRANSPORTATION

18 COMMISSION, by JONATHAN THOMPSON, Assistant Attorney

19 General, and DONALD T. TROTTER, Senior Assistant

Attorney General, 1400 South Evergreen Park Drive

Southwest, Post Office Box 40128, Olympia, Washington

98504; telephone, (360) 664-1189 (Trotter)

20 THE PUBLIC, by ROBERT W. CROMWELL, JR.,

Assistant Attorney General, 900 Fourth Avenue, Suite

21 2000, Seattle, Washington 98164-1012; telephone, (206)

464-6595.

22 AVISTA CORPORATION, by DAVID J. MEYER,

23 General Counsel, East 1411 Mission Avenue, Spokane,

Washington 99202; telephone, (509) 495-4316.

24 Kathryn T. Wilson, CCR

25 Court Reporter

1                   INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES,  
2           by S. BRADLEY VAN CLEVE, Attorney at Law, Davison  
3           Van Cleve, 1000 Southwest Broadway, Suite 2460,  
4           Portland, Oregon 97205; telephone, (503) 241-7242.

5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

0147

1

---

2

INDEX OF EXHIBITS

3

---

4

EXHIBIT:

MARKED:

ADMITTED:

5

10

153

6

11

153

7

12

153

8

13

153

9

14

153

10

15

152

153

11

16

153

153

12

17

250

251

13

14

15

16

17

18

19

20

21

22

23

24

25

0148

1                                   P R O C E E D I N G S

2                   JUDGE MOSS: Good morning, everyone. We are  
3 convened this morning for purposes of a hearing  
4 concerning the proposed settlement stipulation that has  
5 been filed in this matter, which is styled Washington  
6 Utilities and Transportation Commission against Avista  
7 Corporation doing business as Avista Utilities, Docket  
8 No. UE-011595.

9                   We will take appearances momentarily, and  
10 then we will have some remarks from the Chair. I  
11 understand that there will be no opening statements  
12 from counsel, so we will then call and swear our  
13 witness panel, and they are already seated, and I might  
14 remark that I appreciate the name tents that you all  
15 have provided. That makes the task of the court  
16 reporter much easier.

17                   We will look at the premarked exhibits, and I  
18 imagine those will be introduced into the record by  
19 stipulation. There are a couple of other exhibits to  
20 discuss, and then we will proceed into our narrative  
21 testimony and our other business, so lets begin with  
22 the appearances, and we'll start with the Company.

23                   MR. MEYER: Thank you, Your Honor. The short  
24 form of appearance, David Meyer on behalf of Avista.

25                   MR. VAN CLEVE: Brad Van Cleve on the behalf

0149

1 of the Industrial Customers of Northwest Utilities.

2 MR. CROMWELL: Robert Cromwell on behalf of  
3 the public counsel section of the attorney general's  
4 office.

5 MR. THOMPSON: Jonathan Thompson and Don  
6 Trotter on behalf of Commission staff.

7 JUDGE MOSS: Madame Chair?

8 CHAIRWOMAN SHOWALTER: Before we begin, I  
9 want to compliment everyone. It is clearly a  
10 remarkable achievement to present a settlement  
11 agreement of this type. It is clear from reading the  
12 agreement and the supporting documents that you've  
13 given a great deal of thought and care to balancing all  
14 of your interests and proposing a document. So  
15 regardless of how the rest of the proceeding goes,  
16 congratulations on that.

17 I'm sure you understand though that the  
18 commissioners need first to understand what is in the  
19 agreement to make sure that it means what you think it  
20 means, and then what does that mean. Most importantly,  
21 we have an independent responsibility to determine that  
22 this settlement agreement is in the public interest,  
23 and so I hope that our learning curve will catch up  
24 with yours by the end of this session.

25 In particular, the supporting documents that

0150

1 you have provided are very, very helpful. In the past,  
2 we sometimes receive settlements that are simply that,  
3 a settlement, and we are left more or less to guess at  
4 what the basis for it is or to guess or to ask at the  
5 prehearing conference. I think the contribution of  
6 your statements in support of the settlement has really  
7 helped us come up to speed, at least partially, on what  
8 it entails, so I want to compliment you on that as  
9 well.

10 JUDGE MOSS: With that, by prior arrangement,  
11 the witnesses have been called and are seated. We have  
12 Mr. Norwood and Mr. Eliassen for Avista, and Mr. Elgin  
13 for Commission staff, Mr. Schoenbeck for the Industrial  
14 Customers of Northwest Utilities, and we have  
15 Ms. Kimball for Public Counsel, and that constitutes a  
16 panel representing all the parties in the proceeding.  
17 Let me ask that all of you rise and raise your right  
18 hand.

19 (Witnesses sworn.)

20 JUDGE MOSS: With our witnesses impaneled,  
21 let's proceed to the matter of the exhibits. We had a  
22 prehearing conference yesterday, and we premarked a  
23 number of exhibits: No. 10, which is the settlement  
24 stipulation, and we reserved No. 11 for public comments  
25 to be presented by Public Counsel. When would that be,

0151

1 Mr. Cromwell?

2 MR. CROMWELL: Your Honor, I spoke to  
3 Mr. Sweeny this morning. We've communicated or we've  
4 conveyed down the e-mails and letters that we received  
5 both by correspondence we sent out by Monday, and I  
6 brought some more down this morning.

7 I think Judge Mace's instruction at the  
8 public hearing had been that the public comments were  
9 to be filed by close of business yesterday. I can,  
10 when I go back to my office either this afternoon or  
11 tomorrow morning, confirm if there were anymore that we  
12 received that I did not see. Sometimes the mail cycle  
13 is a little slow, but what I would intend to do is  
14 submit down for consideration and inclusion into the  
15 record anything we may have received by five o'clock  
16 yesterday. I can either ask Mr. ffitch to bring that  
17 down or send it by mail. I would hope you would have  
18 it by the end of the day tomorrow.

19 JUDGE MOSS: So you plan to submit a single  
20 packet by tomorrow then?

21 MR. CROMWELL: That would be my expectation.  
22 Mr. Sweeny and I will try to coordinate and put  
23 everything into one bundle.

24 JUDGE MOSS: Let's do that. Exhibit 12 is a  
25 prepared statement by Mr. Norwood, and 13 is a prepared

0152

1 statement by Mr. Eliassen. We discussed yesterday the  
2 staff memorandum that was filed in support and made the  
3 observation that in its present form, it constitutes  
4 argument by Counsel, but Staff indicated that it was  
5 agreeable to the idea of my putting to the witness for  
6 staff whether you, Mr. Elgin, would be willing to  
7 subscribe to the factual statements contained in the  
8 memorandum as your testimony in the proceeding so that  
9 that might be a matter of record, and would you be  
10 willing to do that?

11 MR. ELGIN: Yes, Your Honor.

12 JUDGE MOSS: You did, in fact, participate in  
13 the formulation of that document and are familiar with  
14 the factual statements contained therein.

15 MR. ELGIN: That's correct.

16 JUDGE MOSS: That has been marked as 14.  
17 I've been handed this morning and have distributed to  
18 the other members of the Bench and the parties all have  
19 what's been marked as Exhibit 15 now, which is the  
20 parties' written responses to Bench Request Nos. 3, 4,  
21 and 5. Let me ask you, Mr. Meyer, should I identify  
22 that as an Avista exhibit, or was that something the  
23 panel is offering as a unit, in which case I'll mark it  
24 as a Bench exhibit?

25 MR. MEYER: It should be an Avista exhibit;



0153

1 although, we did share this with the other panel  
2 members before the start of the session.

3 JUDGE MOSS: 16 is an exhibit that's  
4 entitled, "Annual Variability of Prosym Model Run Power  
5 Supply Costs." That's No. 16. It was handed up this  
6 morning. I understand Mr. Norwood will refer to that  
7 in connection with some of his testimony today.

8 MR. MEYER: That's right. That will assist  
9 in responding particularly to Item 7 of the Bench  
10 request.

11 JUDGE MOSS: Are there any other exhibits  
12 that we need to mark? Apparently there are not. I'll  
13 ask if there is any objection to any of the exhibits I  
14 have identified? Hearing none --

15 MR. CROMWELL: No objection, but just to  
16 clarify, Exhibit 15 is an illustrative exhibit not a  
17 factual.

18 JUDGE MOSS: Thank you. Hearing no  
19 objection, these exhibits will be admitted as marked.  
20 There are two other pieces of paper floating about the  
21 room or hopefully now secured in front of witnesses and  
22 counsel. One of these is a compilation of the Bench  
23 requests that were issued by the Commission several  
24 days ago in a tabular format, and I'm holding that up  
25 so everybody can see that they have the right document.

0154

1           This is something that we've provided for  
2 your convenience and our convenience, and my  
3 understanding is that the parties will be responding  
4 orally from the Bench and that they have perhaps  
5 divided up the responsibilities among themselves. I  
6 will ask as we do that this morning that you keep us  
7 apprised of where you are in terms of the questions so  
8 we can make careful notes and have a good record on  
9 that.

10           The other piece of paper that was distributed  
11 this morning is a set of tables, and they are variously  
12 labeled Scenario 1, 2, 3, etcetera, and these relate to  
13 the Bench Request 3, at least, perhaps 4 and 5 as well,  
14 and may provide a useful basis for further development  
15 of the record, and we will discuss that prospect in  
16 connection with our discussion of the various Bench  
17 requests to which they relate, so I'll just put that  
18 aside for the moment, and we will get back to that at  
19 the appropriate point in time. Anything further before  
20 we go on to the testimony?

21           MR. ELGIN: I just wanted to make sure that  
22 in adopting the factual underpinnings of the staff  
23 memorandum that that would include the errata sheet  
24 that corrected the amounts on Page 5 of the memorandum.

25           JUDGE MOSS: Good point, Mr. Elgin. It was

0155

1 my intention that that be so, and indeed, I should  
2 point out that Mr. Thompson for the staff distributed  
3 this morning a revised memorandum, and my understanding  
4 is that this revised version includes only those errata  
5 changes; is that correct?

6 MR. THOMPSON: That's correct. I would also  
7 add in addition to Mr. Elgin this morning, Mr. Schooley  
8 and Mr. Buckley are also available to answer questions  
9 on behalf of staff.

10 JUDGE MOSS: We will call them and swear them  
11 if we need to.

12 MR. MEYER: One final procedural comment so  
13 the commissioners are aware how we are going to present  
14 our prepared remarks. We have exhibits consisting of  
15 prepared statements of Mr. Norwood and Mr. Eliassen.  
16 They do not intend to read those verbatim but to  
17 highlight certain portions of those. Once Mr. Norwood  
18 has done that and Mr. Eliassen has done that, we plan  
19 then on having Mr. Norwood address specifically the  
20 Bench request items on the ERM, as well as any other  
21 questions. So that was how we were handling our part  
22 of this.

23 JUDGE MOSS: Did other witnesses have opening  
24 narrative testimony?

25 MR. ELGIN: No, Your Honor.

0156

1 MR. SCHOENBECK: No, Your Honor.

2 JUDGE MOSS: We are ready to hear from you  
3 Mr. Norwood, so proceed at your own pace keeping in  
4 mind the court reporter's agility.

5 MR. NORWOOD: Thank you, and I know that you  
6 have a copy of my opening statement, as Mr. Meyer  
7 indicated. I will just highlight a few items in my  
8 opening remarks here. At the outset, I would like to  
9 express my appreciation to the other parties in the  
10 case for their cooperation and their commitment to  
11 working through the issues in this case. I think what  
12 we ended up with was a good balance of the interests of  
13 the parties in this stipulation that you have before  
14 you. My statement also mentioned the thoroughness of  
15 the staff memorandum in that they provided a good  
16 summary of the stipulation itself, as well as their  
17 review of the case that we filed to the Commission.

18 The stipulation is a critical component of us  
19 moving forward as a company, to restore the financial  
20 health of the Company as we continue to provide service  
21 to our customers. The stipulation, I believe, does  
22 strike a good balance within the stakeholders. I've  
23 mentioned our customers and that the stipulation, if  
24 approved, would provide for no further rate adjustment  
25 coming out of this case. There is a continuation of

0157

1 the prior rate impact mitigation measures for an  
2 additional period of time, and also this will increase  
3 the opportunity for the Company to move toward a return  
4 to investment credit rating.

5 As to our investors, approval of the  
6 stipulation would provide a further indication of the  
7 regulatory support for the utilities in this state,  
8 which I believe is important from the investment  
9 community perspective. It would resolve all remaining  
10 issues before the commission in this case regarding  
11 prior costs incurred as well as ongoing costs of  
12 providing service to our customers. There have been a  
13 number of filings that we've made over the past year,  
14 and I'm not going to go into detail on those. The  
15 surcharge filing be the prudence petition that would  
16 get filed, the accounting order that was granted in  
17 December, the interim rate relief that was provided in  
18 March, and then the general rate case that is pending  
19 before you now.

20 I would also like to express appreciation to  
21 the commission for the timely response to all of the  
22 filings that we have provided and put before the  
23 commission, and that is what has brought us to this  
24 point of resolving the remaining issues in this case,  
25 and if the stipulation is approved, as I indicated, it

0158

1 would resolve the remaining issues at issue before the  
2 commission.

3           As far as the benefits itself of the  
4 stipulation, as I indicated, there would be no further  
5 increase to customers' rates from this stipulation in  
6 this case apart from a minor adjustment to Schedule 25.  
7 The existing 31.2 percent rate increase that is in  
8 place since October of 2001 would continue, and I  
9 believe that provides a balance of the two competing  
10 objectives of getting the Company healthy over time  
11 while also recognizing the impact on customers, so that  
12 provides a balance of those two objectives.

13           Attached to my statement, there is a  
14 schematic which shows the changes in rates that have  
15 occurred since October, and in that schematic, you can  
16 see the 25 percent adjustment, the surcharge that was  
17 put in place in October, 2001. That 25 percent  
18 surcharge was put into place to begin to recover the  
19 deferred power costs. Then in March of 2002, the  
20 interim increase of 6.2 percent was also added, and  
21 that revenue was provided to cover the ongoing costs of  
22 operating the Company.

23           Also in March, there was a reallocation of  
24 the existing 25 percent surcharge where 5 percent of  
25 that went to cover the ongoing operating costs so that

0159

1 at this point this time, prior to this stipulation of  
2 the 31 percent in place, 11 percent is covering ongoing  
3 operating costs, and 20 percent is being used to  
4 amortize deferrals. The last part of this schematic  
5 shows that if the stipulation is approved, beginning  
6 July 1, 19.3 percent would be used to cover ongoing  
7 operating costs, and 11.9 percent of the total 31.2  
8 would be used to continue to amortize the deferral  
9 balance over time.

10 As to other benefits, I had mentioned the  
11 continuation of rate impact mitigation measures. Those  
12 are outlined in the stipulation itself. As a part of  
13 that, the Company has agreed to increase the  
14 contribution to Project Share from 50,000 a year to  
15 \$150,000 until the defer balance reaches zero. The  
16 energy recovery mechanism is a very critical component  
17 to the stipulation itself. Lack of a mechanism such as  
18 this has been consistently identified by the financial  
19 rating agencies as a concern.

20 Just as a brief overview of the mechanism  
21 itself, we basically each month will compare the actual  
22 power supply costs with the base power supply costs  
23 that would be approved in this case. To the extent  
24 that the differences between actual and the base costs,  
25 of those differences, the Company would absorb or

0160

1 benefit from the first nine million of those  
2 differences on an annual basis. To the extent that the  
3 differences would exceed nine million, if it exceeds  
4 nine million, 90 percent would be deferred for later  
5 rebate or recovery to customers, and as was mentioned  
6 earlier, we do have some examples that I'll walk  
7 through a little later to show you how that would  
8 operate under different scenarios.

9 In summary then, as I mentioned, approval of  
10 the stipulation would resolve all the remaining issues,  
11 including dealing with the prior costs incurred as well  
12 as the ongoing costs of providing a service to our  
13 customers. It would provide a sound foundation for the  
14 Company going forward to move toward regaining its  
15 investment credit rating. We believe the stipulation  
16 does provide a fair and balanced resolution to the  
17 issues and that the stipulation is in the public  
18 interest, and we have requested that the commission  
19 approve the stipulation in a time frame that would  
20 allow us to implement it on July 1 of this year. Thank  
21 you.

22 JUDGE MOSS: Before we go on to Mr. Eliassen,  
23 if you will look at Page 6 of your prepared statement,  
24 which is now Exhibit No. 12, Mr. Norwood, it caught my  
25 eye in the first full paragraph, third line, that you



0161

1     parenthetically refer to 12.9 percent, and I believe  
2     the correct figure is probably 11.9 percent, and I  
3     wanted to make sure our record was clear on that.

4             MR. NORWOOD: You are correct.

5             JUDGE MOSS: We can turn to Mr. Eliassen now.

6             MR. ELIASSEN: I too would like to express my  
7     appreciation to all parties for their cooperation and  
8     the commitment that's made this settlement possible,  
9     and the timeliness is probably one of the most  
10    important things. To deal with all the issues that  
11    have been faced by this company and the commission and  
12    by all of our customers in a timely manner is really  
13    critical for us. I appreciate that.

14            I believe the settlement proposal today is  
15    really a key step in providing the opportunity for the  
16    Company to return to financial health. We all know the  
17    record of what we've gone through for the last 12 or 18  
18    months, but I believe at this point in time, we have  
19    made significant progress, especially in the last nine  
20    months, in being able to return this company to  
21    financial health.

22            The regulatory action and support received  
23    today by the Company has been critical as a part of  
24    this progress. The surcharge that we implemented last  
25    fall was critical in providing cash flows that have

0162

1 been necessary for the Company to return to health this  
2 year. In addition, the subsequent orders, the  
3 settlement in March, among others, are additional  
4 positive steps that have allowed us to continue to  
5 rebuild the financial strength of the business.

6           Based on where we've been able to come to  
7 date, we have now renegotiated our bank lines, and  
8 while we lost three banks from our existing credit line  
9 totaling some 75 million dollars, we were able to add  
10 new banks to the line based on what we had accomplished  
11 in the last 10 to 12 months and now have received  
12 approval of a credit line of 225 million dollars going  
13 forward.

14           We've also renegotiated our accounts  
15 receivable line. We've increased it from 90 to 100  
16 million dollars; although, we had to move it to a  
17 different bank and a different provider, but again,  
18 actions by regulation by this commission and by the  
19 Company have made that possible. But even these  
20 actions that we are talking about today have not yet  
21 made it possible to return the Company to  
22 investment-grade credit rating, at least on its  
23 unsecured debt, and changing that outlook in the credit  
24 rating depends in large part on the resolution of the  
25 final issues before us today in the general case.

0163

1           So the settlement proposal today addresses  
2 the final key factors that we need to resolve: The  
3 additional revenue requirement to recover our actual  
4 ongoing costs of providing service. The settlement  
5 provides that there would be no additional write-offs,  
6 which is an assurance that we are not going to be  
7 further reducing our equity ratio and increasing our  
8 debt ratio. The settlement provides recovery of  
9 remaining deferred power costs, and finally, and  
10 perhaps most important of all of these, the energy  
11 recovery mechanism is viewed as a significant positive  
12 step in the recovery for credit quality going forward.

13           The ERM, as proposed, provides better  
14 stability and the opportunity for the Company to have  
15 more predictable cash flows and earnings as we go  
16 forward; thus reducing risk associated with exposure to  
17 unpredictable power markets in the future. That is  
18 critical to our credit in the future as well.

19           Overall, the proposed settlement will bring  
20 us much closer to being able to demonstrate the  
21 business risk profile of this company is returning to  
22 where it was three to four years ago, and that's  
23 important too in returning the Company to an  
24 investment-grade credit profile. To date, Standard and  
25 Poors has issued a fairly positive statement about the

0164

1 proposed settlement. In conversations with Moody's and  
2 Fitch, they have reiterated similar comments that are  
3 positive.

4 We still have work to do. The Company will  
5 continue to focus on continuing to control costs both  
6 with O and M and capital. We've continued a hiring  
7 freeze. We continue to evaluate the viability of a  
8 need to issue additional common stock, and we will  
9 continue to work with rating agencies to talk about the  
10 business risk profile and what we are doing with the  
11 settlement to return the Company to a higher financial  
12 profile for a stronger financial profile. Again, I  
13 want to thank the Commission and all parties for their  
14 timely actions in supporting the settlement we have  
15 before us today. Thank you.

16 JUDGE MOSS: With that, I believe the plan is  
17 to begin addressing the various questions that were put  
18 out in the form of Bench requests, so Mr. Norwood, we  
19 are back to you.

20 MR. NORWOOD: If I may, I would like to start  
21 with the series of questions related to the energy  
22 recovery mechanism, which begins on Question No. 3. I  
23 don't know if I need to reread the questions. What I  
24 would like to do is refer to Exhibit 15 in responding  
25 to Questions 3, 4, and 5, and I think in preparing this

0165

1 exhibit and looking at this exhibit, I think it may  
2 help in responding to the work sheets that were handed  
3 out relating to different scenarios around the  
4 mechanism itself.

5           On Example 1, it's labeled at the top, "Nine  
6 Million Dollar Band Not Exceeded, No ERM Deferrals."  
7 This scenario is run assuming that nine-million-dollar  
8 band is not exceeded, and if I could just walk you  
9 through January as an example of how the mechanism will  
10 work. You can see at the bottom, Line 1 is actual net  
11 expense for January, and as was pointed out earlier,  
12 these numbers are for illustrative purposes only. Line  
13 2 is the authorized net expense, which would be the  
14 base power supply cost that would come out of this rate  
15 proceeding, and that would be the numbers that are  
16 attached to Attachment 1 to the settlement stipulation.

17           Line 3 shows the change in that expense,  
18 actual versus authorized, and that number \$1,526,000  
19 and Line 4 is the Washington portion of that system  
20 number, which is two-thirds of Line 3. Line 5 then  
21 shows the cumulative change in the expense, and because  
22 that difference between actual and authorized is less  
23 than nine million, you can see that Lines 6 and 7 are  
24 zero. There would be no deferral on the Company's  
25 books for that month.

0166

1           As we progress across the year, Line 5, you  
2 can see that the balance does not exceed nine million  
3 dollars for the calendar year, period. At the end of  
4 December, you can see that the balance is \$4,587,000.  
5 Because it's less than nine million, the Company in  
6 this case would have absorbed the 4.5 million.  
7 Beginning in January the following year, the balance  
8 would be reset at zero, and you would start the  
9 calculation toward the band again.

10           CHAIRWOMAN SHOWALTER: Before we leave that,  
11 it's set again at zero. How does this interact with  
12 the beginning 115-million balance?

13           MR. NORWOOD: Good question. Any deferrals  
14 that would be made in any of these months would be  
15 added to the deferral balance that's there, and in this  
16 particular case, there would be no addition or  
17 subtraction to the existing deferral balance. So when  
18 I say restart the 4.5 million, you see in December,  
19 those numbers don't touch the deferral balance. None  
20 of those dollars are deferred because it didn't exceed  
21 the nine-million-dollar band, so when I say "reset," we  
22 are resetting the tracking that we are doing to keep  
23 track of whether it exceeds the nine million or not.

24           CHAIRWOMAN SHOWALTER: So this Exhibit 15  
25 only deals with the ERM. It doesn't show the spillover

0167

1 into the deferred balance, or maybe it would if it  
2 reached nine million but it doesn't here.

3 MR. NORWOOD: We will get to an example where  
4 it does spill over into the deferral balance, but for  
5 this case, there would be no additions or subtractions.  
6 What we would see with a deferral balance is a  
7 continual reduction from the surcharge that's in place  
8 to amortize it.

9 Then on Page 2 is a second example, and in  
10 this case, you can see that the nine-million-dollar  
11 band is exceeded during part of the year, but then  
12 costs decline to the point where at the end of the  
13 year, you actually don't have a net deferral, so I'll  
14 walk through that also. Similar calculations, so if  
15 you look at Line 5, we progressed all the way through  
16 until June where you can see on Line 5, the balance is  
17 \$9,528,000. Because the cumulative balance exceeds  
18 nine million, we would take 90 percent of the amount  
19 that exceeds the nine million, which is 528,000, and we  
20 would defer 90 percent of that, which is shown on Line  
21 6, \$475,000. So we are only deferring 90 percent of  
22 the amount that exceeds the nine-million-dollar band.

23 Then you can see the cumulative amount that  
24 moves across. In September on Line 4, you can see that  
25 the actual costs are actually less than the authorized,

0168

1 which means you are going in the other direction, in  
2 the rebate direction, so to speak. By November, you  
3 can see that on Line 5, the total cumulative difference  
4 between actual and authorized is \$7,459,000. Because  
5 that's less than the nine million, you've actually had  
6 deferral entries in the opposite direction to where  
7 your cumulative balance on Line 7 is zero.

8 Then in December, you can see that the  
9 cumulative balance of Line 5 is \$6,268,00. Because the  
10 total is less than nine million, there would be no  
11 deferral for that year, and again, beginning in January  
12 of the following year, you would reset to zero in  
13 accumulating your dollars plus or minus the band of  
14 nine million.

15 CHAIRWOMAN SHOWALTER: I want to make sure I  
16 understand. The operation of the ERM alone exceeded  
17 the nine-million-dollar band. Therefore, 90 percent of  
18 the excess becomes a deferral entry, but am I right  
19 that by the end of the year because it went back down  
20 under the band, does nothing get kicked over into the  
21 deferral account?

22 MR. NORWOOD: That's correct. What we saw  
23 was we had some deferrals in the surcharge direction,  
24 but then the costs reversed and you actually saw  
25 deferrals in the rebate direction, so at the end of the



0169

1 year, you actually had no incremental deferrals for  
2 that period of time.

3 CHAIRWOMAN SHOWALTER: So you track the  
4 excess of the dead band, but you don't do anything  
5 about it until after the end of the year, at which  
6 point you see is it or isn't it an accumulative basis  
7 for one year or above the nine million?

8 MR. NORWOOD: What we would do is each month,  
9 as indicated here, in June, we would actually make an  
10 entry to the deferral balance of 475,000. As we  
11 progress to the next month, then we would determine do  
12 we do an entry, and if so, was it positive or negative,  
13 and what we saw is in September, there is a negative  
14 entry of \$41,000, which reduces the cumulative balance.  
15 We reduce it again in October and then reduce it again  
16 in November.

17 CHAIRWOMAN SHOWALTER: Maybe this is a  
18 different way to put it. Is there only one deposit  
19 into the deferral account after an annual examination,  
20 or are there deposits into the deferral account as they  
21 occur month to month, but they might build and then  
22 they might go back down, which way?

23 MR. NORWOOD: There are deposits each month  
24 to the extent it exceeds the nine-million-dollar band,  
25 but it can go both ways, and that's part of the purpose

0170

1 of this mechanism and this balancing account is to let  
2 the pluses and minuses offset each other over time. In  
3 this particular case, the minuses offset the pluses by  
4 the end of the year.

5 CHAIRWOMAN SHOWALTER: So the excess either  
6 way does go into the deferral account. It's just that  
7 you only take stock of what is in that deferral account  
8 every year; is that right, once a year?

9 MR. NORWOOD: It's a calendar-year band of  
10 nine million, so another way to look at it is even  
11 though we might have entries in and out during the  
12 year, at December, if the total difference is less than  
13 nine million, then there would be no net increase for  
14 that calendar year period.

15 CHAIRWOMAN SHOWALTER: That is to say, let's  
16 say as of December, there is eight million dollars more  
17 in the deferral account. Starting January, you forget  
18 about that eight million?

19 MR. NORWOOD: You mentioned the deferral  
20 account, but if it's an eight-million-dollar difference  
21 between actual and authorized, then nothing would go  
22 into the deferral account, and January would start at  
23 zero again accumulating toward the nine-million-dollar  
24 band.

25 CHAIRWOMAN SHOWALTER: I think I understand

0171

1 the mathematics of it, but I'm a little unclear on the  
2 mechanics of it. Are these amounts going into the  
3 deferral account on a monthly basis?

4 MR. NORWOOD: Yes. To the extent they exceed  
5 the nine-million-dollar band, they would go into the  
6 deferral account.

7 CHAIRWOMAN SHOWALTER: So to the extent they  
8 exceed the nine-million-dollar band, they do go into  
9 the account. So if at December it was a positive,  
10 let's say two million dollars, all of which got in  
11 there because it was above the nine-million-dollar band  
12 in the month that it got in there, then what happens to  
13 that two million dollars?

14 MR. NORWOOD: That two million would remain  
15 in the deferral account; that's correct.

16 CHAIRWOMAN SHOWALTER: What is done with that  
17 two million, that depends on whether before or after  
18 the time period at which you can trigger the 10 percent  
19 surcharges.

20 MR. NORWOOD: That's correct. Until the  
21 existing balance goes to zero, then there wouldn't be  
22 any further changes up or down in rates. Once the  
23 existing deferral balance goes to zero, then this  
24 trigger mechanism would kick in, and the deferral  
25 balance would have to accumulate up to the 27.8 million

0172

1 before it would trigger a new rate adjustment, and  
2 that's shown on the next example. Perhaps this will  
3 answer questions that we've been discussing here.

4 On Page 3, this is an example where we exceed  
5 the band fairly quickly and also hit the  
6 27.8-million-dollar trigger, and again, this is after  
7 the existing balance goes to zero and we start the  
8 trigger mechanism. In January, you can see that the  
9 difference is 4.3 million dollars on Line 5. In  
10 February, the balance exceeds the nine million, so you  
11 would defer 90 percent of that 176,000.

12 Throughout the year then on Line 7, you can  
13 see the balance accumulate -- this is adding to the  
14 deferral balance -- is accumulating to the point to  
15 where in December you hit the 27.8-million-dollar  
16 figure. At that point in time, then that would trigger  
17 a filing by the Company to seek a 10 percent rate  
18 adjustment up or down, depending on which way the  
19 numbers go, and then you would pull that amount out of  
20 the deferral balance and it would be recovered from  
21 customers over a 12-month period.

22 CHAIRWOMAN SHOWALTER: So in this particular  
23 instance, would we be reviewing this year in April of  
24 the following year?

25 MR. NORWOOD: We would make an annual filing

0173

1 prior to April on the actual entries that were made.  
2 The way that trigger mechanism would work is if, for  
3 example, we were to hit the 27.8 million in August,  
4 then we would file in August and seek an adjustment to  
5 rates, and that's the purpose of the trigger is once it  
6 gets to a certain level, then we request an adjustment  
7 to take care of that balance. The filing that we make  
8 again prior to April 1 of each year would be to review  
9 the entries that were made for that prior calendar year  
10 period.

11 COMMISSIONER OSHIE: Will the trigger  
12 mechanism be affected by the deferral account? In  
13 other words, while there is a deferral plus deferral  
14 balance, will the trigger mechanism be implemented or  
15 could it be implemented under the terms of the  
16 stipulation?

17 MR. NORWOOD: Under the stipulation, the  
18 expectation is that the trigger mechanism will not come  
19 into play until the existing deferral balance goes to  
20 zero. Once the existing balance goes to zero, then we  
21 would make a filing to zero out the existing surcharge  
22 in place, and at that point, you would start to  
23 accumulate a new deferral balance plus or minus, which  
24 then would be subject to the trigger.

25 COMMISSIONER OSHIE: So under your Example 3

0174

1 then, any of the positive balances under Line 7 would  
2 just be added to the deferral account.

3 MR. NORWOOD: That's correct.

4 CHAIRWOMAN SHOWALTER: But I'm a little  
5 confused. When you said you could come in in August,  
6 if you hit the 27-million trigger -- is that the  
7 number?

8 MR. NORWOOD: 27.8.

9 CHAIRWOMAN SHOWALTER: If you hit that  
10 trigger in August, why is it that you come in instead  
11 of waiting the full year to find out what happened?

12 MR. NORWOOD: Again, this is assuming that  
13 we've already gone to zero on the existing balance.  
14 The intent of the trigger mechanism was to say once you  
15 get to a level, you probably need to do something  
16 positive or negative. But we've also indicated in the  
17 stipulation that if you get to August and you have  
18 reached the trigger of 27.8 million, if projections  
19 show that the numbers are going to go the opposite  
20 direction, we may file with the Commission and ask the  
21 Commission to not implement anything plus or minus  
22 because there is an expectation it may go the other  
23 way, or there may be another rate adjustment that's in  
24 place, and we may want to time whatever rate adjustment  
25 is here with the other one because they may go in

0175

1 opposite directions, and there may be opportunity to  
2 offset them. So it's those kinds of considerations we  
3 look at once the trigger is reached.

4 CHAIRWOMAN SHOWALTER: Can you just point out  
5 in the settlement stipulation itself the sentence or  
6 two where this operates?

7 MR. NORWOOD: I believe it's on Page 8 at the  
8 end of the first paragraph there: The Company may,  
9 depending on the circumstances, propose a different  
10 effective date to minimize the number of rate changes  
11 to customers.

12 It's that full paragraph beginning at the  
13 bottom of Page 7 that talks about the actual mechanics  
14 of the trigger mechanism. That's all I have in terms  
15 of actual operation of the mechanism itself in  
16 responding to Questions 3, 4, 5.

17 CHAIRWOMAN SHOWALTER: Then I think in that  
18 case, it might be helpful to go through these. We have  
19 eight scenarios, and I'm not sure all of them have been  
20 addressed in your exhibits. My biggest concern is what  
21 happens if things are really bad, if there is a drought  
22 and a west-coast-wide market failure, so things are  
23 just getting bad, bad, bad, somewhat similar to a year  
24 ago or two years ago. What kind of shape will the  
25 Company be on in or what will this deferral balance

0176

1 look like, and what, if anything, can be done about it,  
2 either before or after the deferral balance has gone to  
3 zero?

4 MR. NORWOOD: If we can go to Example 3, and  
5 what can we can do is tack on the extreme event you  
6 are talking about. If the example in Example 3, if we  
7 have a 100-million-dollar issue, for example, instead  
8 of a 30-million-dollar situation here, what would  
9 happen is the Company would --

10 MR. MEYER: I'm sorry. I think Mr. Norwood  
11 is referring to Page 3 of Exhibit 15, not your Scenario  
12 3.

13 MR. NORWOOD: Yes, it is Page 3 of Exhibit  
14 15. In this case, if you had a 100-million-dollar  
15 situation, then it would operate just as is shown here,  
16 and that is the first nine million would be absorbed by  
17 the Company. There would be a 90 percent deferral for  
18 any amount above that, and once you hit the  
19 27.8-million trigger, we would file with the Commission  
20 to adjust rates.

21 If the balance continues to grow, then it  
22 would be up to the Company then to come to the  
23 Commission to say that we have an extreme extraordinary  
24 situation and request the appropriate relief at that  
25 point in time, but that would be outside of this ERM



0177

1 mechanism. It could be done in the context of a  
2 general rate case or request for some kind of emergency  
3 relief.

4 CHAIRWOMAN SHOWALTER: Is a way to put the  
5 situation is that this settlement stipulation does not  
6 in and of itself provide for that extraordinary  
7 situation in the sense that it only provides for one  
8 surcharge at a time? Once the trigger is met, it  
9 doesn't really allow for the absorption by the  
10 ratepayers of greater costs than the one-time trigger  
11 at any point in time; am I right on that?

12 MR. NORWOOD: It would require a separate  
13 filing by the Company to deal with any further costs.

14 CHAIRWOMAN SHOWALTER: One of my questions  
15 is, does that mean this agreement is broken, or does  
16 the agreement itself provide for the possibility that  
17 there could be an extraordinary situation or a worse  
18 situation than the agreement is capable of handling,  
19 are we going to get arguments that you can't do this  
20 because the agreement doesn't provide for it, or we  
21 just can't do it without have a hearing on the subject?

22 MR. CROMWELL: I think Mr. Elgin wants to  
23 address the point as well. I think from our  
24 perspective, what we tried to do in structuring how the  
25 ERM works is using historical hydro data, try to create

0178

1 a mechanism that would limit the number of events  
2 customers would experience, whether positive or  
3 negative, so that the fluctuations would be less  
4 extreme in terms of the customer experience on their  
5 bill. Obviously, you could have the 100-year drought  
6 and that sort of situation.

7 I think the other factor that gave us a  
8 degree of comfort with this structure is that when  
9 Coyote Springs 2 comes on line, the Company will have  
10 excess resources available, and our hope would be that  
11 if we were again in that type of situation that the  
12 Company's excess resources would allow it to go to  
13 market, and by selling power be able to offset what  
14 would otherwise be a very rapidly decreasing deferral  
15 balance, and again, that's where the nine million --

16 We've been talking in the three scenarios in  
17 Exhibit 15 about excess costs, which is certainly what  
18 we all expect in the next few years, but the other flip  
19 side of the coin would be that the Company were able to  
20 sell into a very high-priced market with relatively  
21 lower cost resources and be able to pay down that  
22 deferral or offset it to the degree that the way the  
23 band works is it's symmetrical.

24 CHAIRWOMAN SHOWALTER: I guess your answer  
25 gets at the issue of whether that worst-case scenario

0179

1 is likely to occur as distinct from what happens in the  
2 agreement if it occurs, but I take it you are saying  
3 that you think there are circumstances today that may  
4 be different than yesterday, meaning a year ago or two  
5 years ago, that make it less likely that in Avista's  
6 case, it will get into the situation it got into. Is  
7 that what you are saying?

8 MR. CROMWELL: Yes. I think it would be more  
9 appropriate for Mr. Eliassen and Mr. Norwood to address  
10 the Company's resource and what they would expect. I  
11 think our expectation is that in the near term, the  
12 Company will be long, as we say, and will by virtue of  
13 that available resource be in a more protected position  
14 than it was a year and a half ago.

15 CHAIRWOMAN SHOWALTER: But just to pin you  
16 down a little more, Page 7 of the agreement, the Item C  
17 says, "On or before" -- and I emphasize "before," --  
18 December 31, 2006, Avista will make a filing with the  
19 Commission --"

20 MR. CROMWELL: I'm sorry, Your Honor. We may  
21 have different pagination. Where are you?

22 CHAIRWOMAN SHOWALTER: It's entitled, "ERM  
23 review filing December 2006." It says, "On or before  
24 December 31, 2006, Avista will make a filing with the  
25 Commission that will allow interested parties the

0180

1 opportunity to review and propose changes to the ERM."

2           Do you agree that if things, as Mr. Meyer  
3 would say, go fubar, that this line allows the Company  
4 to come in, let's say, 2004, and trigger a review by  
5 this commission of how the ERM is working?

6           MR. CROMWELL: I would perhaps state it a  
7 little differently based upon my understanding and our  
8 perspective in the settlement negotiation. This clause  
9 was agreed to between the parties, from our  
10 perspective, but it was more to provide a check. All  
11 the parties structured the ERM in a way that addressed  
12 the concerns that the parties had about different  
13 aspects of the Company's financial picture and what  
14 it's likely to be for the next few years.

15           It's our perspective that the ERM is  
16 fundamentally not structured as a PCA as this  
17 commission has announced the criteria for a PCA in  
18 prior orders. We view the December 2006 review as an  
19 opportunity for this commission and the parties to  
20 examine the ERM. It would be our expectation that the  
21 parties to this case would be very likely talking  
22 during the late summer and fall of 2006 about what the  
23 Company, if it wishes to have changes in the ERM, we  
24 would be discussing those. If it wishes to have a more  
25 explicitly hydrocentric PCA structure, then we would be

0181

1 talking about that.

2           What we were interested in doing is having a  
3 very explicit review of how this is working in the  
4 2006, 2007 time frame, and that's because I think the  
5 experience of the last few years has taught us that we  
6 are never as good at predicting the future as we think  
7 we might be.

8           CHAIRWOMAN SHOWALTER: I concur with that.

9           MR. CROMWELL: Thank you. I think that  
10 furthermore that without assuming any result in the  
11 piece in the Puget Sound Energy rate case, which also  
12 has a settlement stipulation pending, if for purposes  
13 of argument, we assume that Puget Sound Energy has some  
14 form of PCA on a going-forward basis in place, that  
15 about 2006, this commission will have a foundation of  
16 information. You will have a record of experience with  
17 different structures with different companies and how  
18 they've worked in fact, and at that point, I think that  
19 we will all be better educated about how these  
20 mechanisms are working and what might be most  
21 appropriate at that time.

22           CHAIRWOMAN SHOWALTER: Mr. Cromwell, you  
23 haven't answered my question, and you actually answered  
24 the prior question. My questions are not interested in  
25 what the expectations of the parties are either as to

0182

1 how things will play out or how the market will play  
2 out. What I'm interested in is the operation, the  
3 legal operation of the language of the settlement  
4 stipulation in the worse-case scenarios. Under stress,  
5 how does this agreement work? It's very important for  
6 me to understand that, because under stress, prior  
7 settlement agreements have not worked out very well,  
8 and we need to understand just what happens when things  
9 go bad, because the party adversely affected is going  
10 to come in and say, "Well, that's not what we meant,"  
11 as we've heard these arguments before, and so what is  
12 important is not what people mean or hope or expect.  
13 What's important is how does the language operate?  
14 What does it permit or not permit?

15 My question to you is, is the Company  
16 entitled to come into this commission a year from now  
17 and say to us, "This ERM isn't working very well. We  
18 don't like it." Does this sentence permit that?  
19 Obviously at any time, a party can come in and cause  
20 the Commission to modify the agreement, but I'm asking,  
21 does this agreement itself permit a review of its  
22 terms? It seems to me it does, but that's the question  
23 I want to ask of you because I think you are the party  
24 that would probably be coming in and saying, "This  
25 isn't what we hoped would happen. We hoped the

0183

1 ratepayers would not experience any more than a 10  
2 percent trigger once a year or at any one time, and now  
3 the Company wants to change the terms. So what is the  
4 answer?

5 MR. CROMWELL: I think the answer to your  
6 question is there is nothing in this settlement  
7 agreement that precludes the Company from making other  
8 filings in the future. I think that our perspective on  
9 the merit of those filings I would leave to that  
10 possibility. I think it is, and I hope I've answered  
11 your question by saying there is no lockout, for  
12 example, in this settlement, as maybe by contrast, the  
13 ongoing PacifiCorp rate plan has a very specific period  
14 in it. There is no such period in this agreement.

15 That obviously was a concern for us during  
16 negotiations, and it was certainly something discussed.  
17 I think that the resolution you see before you in this  
18 stipulation, and again, I will result to the old saw  
19 that it is an integrated document, and looking at all  
20 of its terms, there was certainly a trade-off in  
21 various aspects of this agreement.

22 One of the trade-offs from our perspective  
23 was the lack of that type of lock-out period. It was  
24 my understanding that their view of how the investment  
25 community would view that type of provision was very

0184

1 negative, and I'll just leave it to Mr. Norwood to  
2 elaborate or Mr. Elgin.

3 MR. ELGIN: I would like to take a shot at  
4 your question. As I understand it, you were talking  
5 about the extreme variations. The ERM is designed to  
6 deal with the expected normal variability of hydro. If  
7 you look at Exhibit 16, this was the prosym modeling of  
8 the water records that the Company has, and the ERM is  
9 a mechanism designed to deal with those variations in  
10 hydros and the expenses on the Company, and this is a  
11 modeling of that.

12 From Staff's perspective, this settlement  
13 agreement does not deal with extraordinary  
14 circumstances that we dealt with in 2000, 2001 period  
15 that gave rise to the existing deferrals. In my mind,  
16 those were emergency situations, and if you think about  
17 it as a pancaking, you have the general rates, the  
18 ERM's on top of that to deal with this kind of hydro  
19 variability that everybody expects in terms of the most  
20 likely scenarios under the hydro variability that we  
21 have experienced and the kind of prices that we have  
22 experienced, but under extraordinary circumstances  
23 where the Company is exposed to two hundred million  
24 dollars of power costs that are not reflected in rates,  
25 we know what that does to their balance sheet, and we



0185

1 think this settlement would provide for the Company to  
2 come in under those emergency circumstances as another  
3 way to deal with those extraordinary circumstances.

4 This settlement does not deal with those  
5 conditions. It just can't. Those impacts and costs  
6 are too big, and we have to deal with that on the cases  
7 and the circumstances as they arise, and this is how  
8 staff would view this settlement operation, the  
9 operation of this settlement document.

10 CHAIRWOMAN SHOWALTER: Supposing that the  
11 settlement itself and the mechanism is pretty good for  
12 the standard fluctuations up and down. How does the  
13 Company decide and how do the parties respond to what  
14 is or isn't an emergency situation? Obviously, if  
15 things get bad, they start by going beyond the  
16 nine-million-dollar band. They get up to 27 million,  
17 which may or may not be before the deferral balance has  
18 gone to zero, and then they keep getting worse, and at  
19 some point, you decide that things are so bad, you have  
20 to come in and change the operation of this. But of  
21 course you don't know, as we didn't know two years ago  
22 when we thought, well, the deferral balance will go  
23 down to zero. This plan will work out, and then of  
24 course it didn't work out, and we all watched it not  
25 working out, so...

0186

1           MR. ELGIN: I think the critical factor  
2 becomes the Company's ability to borrow on reasonable  
3 terms. I think that is in a nutshell of all the  
4 measurements you have out there, and if you recall in  
5 the initial interim case, that was the fundamental  
6 question. What was the impact on those costs on the  
7 ability of the Company to raise capital in external  
8 markets, and what was the amount of relief necessary to  
9 provide the coverages so that the Company could  
10 continue to fund those expenses and continue to  
11 discharge its public service obligations, so I think in  
12 my mind, that would be the critical test that we would  
13 look at, and we would recommend that the Commission  
14 would view as a way to look at the circumstances under  
15 those situations.

16           CHAIRWOMAN SHOWALTER: Thank you for that  
17 answer. I've taken a lot of time. Go ahead.

18           COMMISSIONER HEMSTAD: The original question  
19 that the Chair asked was where is the language in this  
20 document, and I assume we are looking at that. The  
21 language might have read, Prior to December 31, 2006,  
22 Avista may, but not later than December 31, 2006, it  
23 will make a filing with the Commission to review. In  
24 the kind of extremist circumstances being described, I  
25 take this language to mean that the Company can come in

0187

1 and say that it's not working by the language here  
2 itself. Is there any disagreement with that?

3 MR. NORWOOD: I would just like to clarify my  
4 understanding of the agreement here, and that is the  
5 language that's here dealing with the December of 2006  
6 filing, the intent was to do a check-in at that point,  
7 see what's working and what's not and do a  
8 modification.

9 As to other filings that may be made, we did  
10 discuss that there is no lock-out period. We do have  
11 the opportunity to come in for a general rate case, and  
12 if things do go awry -- there are extreme extraordinary  
13 circumstances -- we're not precluded from coming in to  
14 make a request there, and so that that's upper level,  
15 and it would be up to us to demonstrate that there is  
16 relief that's necessary.

17 Some context there around would we come in  
18 would we not, if you look at the dollar amounts  
19 involved here -- you have a nine-million-dollar band,  
20 which is a Washington jurisdictional share. A 10  
21 percent rate adjustment would be appropriately 28  
22 million, so that would be a total of 37 million dollars  
23 on a Washington jurisdictional basis.

24 If you gross that up to a system basis, then  
25 you are a little over 50 million dollars is the amount

0188

1 of variation and cost that you could experience and  
2 still be able to deal with it in a one-year period. If  
3 it went to a 100-million-dollar variation, which is a  
4 very extreme event, that would be spread out over a  
5 two-year period. So this goes to, number one, Avista  
6 has positioned itself to be in an equal even to long  
7 position to deal with these variations in costs, and I  
8 believe the mechanism does provide for handling fairly  
9 significant variations in cost, and then the third step  
10 is there is no preclusion from filing a general case,  
11 or if things do go awry to come in and seek further  
12 relief.

13 CHAIRWOMAN SHOWALTER: I think what it  
14 amounts to is that this sentence serves possibly two  
15 different purposes. One may be the purpose that the  
16 parties intended, which is things not go beyond 2006  
17 without a review, but it also, I think, serves the  
18 purpose of allowing an earlier review if conditions  
19 warrant without having to necessarily bring something  
20 outside the terms of this agreement.

21 COMMISSIONER HEMSTAD: That was a question.

22 MR. NORWOOD: The answer is yes.

23 COMMISSIONER OSHIE: I took it as a  
24 statement, but that's fine.

25 CHAIRWOMAN SHOWALTER: Commissioner Hemstad

0189

1 took it as a question. I thought we had confirmation  
2 from Mr. Cromwell that my statement was correct, that  
3 the Staff, Mr. Cromwell, and ICNU are the people I  
4 would like to hear from most on that question, because  
5 I think it's in the case where the Company comes in and  
6 wants to change things that there could be resistance  
7 from the parties, and that resistance can take the form  
8 of procedural arguments, which is what I'm asking  
9 about, or the merits, which I'm not asking about.

10 MR. CROMWELL: I can tell you that our  
11 perspective on the language of 4 sub C was that it  
12 served the purpose we've discussed in terms of  
13 establishing a review at that period. We had not  
14 intended it to be an explicit statement that the  
15 Company is not precluded. We simply understood,  
16 perhaps from the tenor and the content of the  
17 discussions, that there was nothing in this agreement  
18 that precluded the Company from making another filing,  
19 and again, getting back to we clearly cannot predict  
20 the future as well as we hope we can.

21 There are many things out there that could  
22 affect this company's performance, and only a range of  
23 those or a subset of those are under anyone's control  
24 in this state, so I think it's true to say we do not  
25 view anything in this stipulation agreement as a

0190

1 procedural matter preventing the Company from coming in  
2 and requesting emergency relief under the standard this  
3 Commission has announced or from filing a general rate  
4 case based on other circumstances. We can hypothesize.  
5 I know the Noxin Dam in Montana is an issue that's come  
6 up.

7           Obviously, if the Company suddenly lost a  
8 significant percentage of its generation resources,  
9 whether through that or the Columbia goes, something  
10 happens, terrorists blow up all the dams and they are  
11 gone, things could happen that we could not predict and  
12 wouldn't attempt to predict in the context of this  
13 settlement stipulation, so there is nothing that  
14 precludes the Company from trying to address that  
15 extreme type of circumstance.

16           MR. SCHOENBECK: I agree with everything  
17 Mr. Elgin has said. When disagreement was being  
18 discussed, it was certainly within the box of  
19 variability as defined by Exhibit No. 16. There would  
20 be nothing to preclude the Company to come in with a  
21 filing if there was extraordinary circumstances, and at  
22 that time, I expect you would be hearing arguments if  
23 the circumstances exceeded the variability we saw  
24 within Exhibit 16, but that was certainly the horizon  
25 of variability that people were analyzing when this

0191

1 agreement was established.

2 CHAIRWOMAN SHOWALTER: I think we've gotten  
3 the only answers you are going to give, and I think  
4 this commission can interpret this language as it sees  
5 it, and if you have a disagreement with that, bring a  
6 petition to review, but I point out that Part C has two  
7 sentences, and one is about making the filing to review  
8 the ERM and the other is that Avista has the burden of  
9 demonstrating it's in the public interest. There is no  
10 extraordinary relief requirement, no PNB criteria. It  
11 simply is a provision that allows review on a public  
12 interest standard.

13 COMMISSIONER OSHIE: A statement made by  
14 Mr. Norwood, I want to make clear what the terms of the  
15 amortization period might be, because you had said, I  
16 believe, that if the amount was in the range of 100  
17 million that those costs would be spread over two  
18 years, and there is a question in the agreement as to  
19 if the trigger is reached and it's pulled, and let's  
20 just give it a number. Let's say the trigger amount is  
21 in excess of 50 million.

22 The question is, over what period, and I  
23 guess my own interpretation of the agreement is that it  
24 would be up to the Company to present to the Commission  
25 an amortization period. Now, the agreement at least

0192

1 contemplates that the deferral period will end or the  
2 deferral account will be fully amortized by 2006, so if  
3 there is a serious and unexpected event, or a better  
4 example, if the trigger is pulled, in the Company's  
5 mind, what would be the amortization period? I'm sure  
6 it depends on how much it is, but maybe you can give  
7 some examples, Mr. Norwood.

8 MR. NORWOOD: What is in the stipulation is  
9 that if the trigger is reached, and again, we are going  
10 after the deferral balance goes to zero, and I might  
11 add there my understanding is what we've been talking  
12 about is the projection is the balance should go to  
13 zero by sometime in 2007 is what we've been discussing,  
14 but with regard to the trigger itself, if the trigger  
15 is reached, we would make a filing, and what we have in  
16 the stipulation is that the 27.8 million would be  
17 spread over a 12-month period.

18 If we have a circumstance where the balance  
19 is much greater than 27.8, then you get into dealing  
20 with this on a case-by-case basis, as Mr. Elgin pointed  
21 out, and that is, is there some reason or circumstance,  
22 whether it be financial or otherwise, which would cause  
23 us to need to come in and ask for some further relief  
24 in addition to that 10 percent, and one possibility is  
25 to spread it out over a longer period of time, ask for



0193

1 further relief, and again, I think it goes to,  
2 depending upon the circumstances at the time, we deal  
3 with it on a case-by-case basis.

4 JUDGE MOSS: Let me follow up on that. I  
5 want to be sure the record is clear on this. Based on  
6 your response, Mr. Norwood, it sounds to me that the  
7 27.8 million is acting not just as a threshold but also  
8 as a ceiling, and that if, for example, the Company  
9 experienced a 40-million-dollar balance at the end of a  
10 given year, the Company might elect to write off the  
11 excess 12.2 million, or the Company might elect to make  
12 a filing before this commission and say, "We've got  
13 12.2 million dollars out here that we need to recover  
14 somehow." Help me understand.

15 MR. NORWOOD: The way the mechanism is set up  
16 is that once you reach that threshold, we would make a  
17 filing, and the filing would request a rate adjustment  
18 of that 27.8, a 10 percent adjustment. The remaining  
19 balance would continue to remain in the account, with  
20 the hearing charge that's addressed in here, until it  
21 either rises to another trigger or is offset by further  
22 deferrals.

23 JUDGE MOSS: So let's say the 27.8 is reached  
24 in October and you make the filing. A 10 percent  
25 surcharge is put in place. The balance continues to

0194

1 grow through the balance of the year to 40 million, for  
2 the rest of the year, 40 million, but then you zero it  
3 out on January 1.

4 MR. NORWOOD: No. The deferral balance  
5 wouldn't be zeroed out. When we are talking about  
6 zeroing out accounts -- we need to step back here for  
7 just a minute. On the nine-million-dollar band, to the  
8 extent that the differences stay below the nine  
9 million, then each January, you start again to  
10 accumulate toward the band of nine million. Once you  
11 get into deferrals, once dollars go to the deferral  
12 account, they stay there. The only way they come out  
13 is you recover them through some rate adjustment or  
14 they are offset by deferral in the opposite direction.

15 CHAIRWOMAN SHOWALTER: I think maybe the  
16 question is, let's say you reach 27 million in October.  
17 We have a surcharge in place, and then by the following  
18 March, it has reached 27 million dollars again.

19 MR. NORWOOD: We would not make a filing in  
20 that instance. We would continue to carry that because  
21 we already have a 10 percent in place. Once that drops  
22 out, then there may be a filing to continue that 10  
23 percent to recover another 27.8 million, and it's only  
24 if the balance gets out of control or very large that  
25 then we would consider some other filing to deal with

0195

1 on a case-by-case basis any further relief we needed as  
2 a company.

3 JUDGE MOSS: Let me return to my prior  
4 example with one more follow-up question. I'm going to  
5 change my numbers. We've reached 27.8 in October, and  
6 the Company makes a filing for the 10 percent  
7 surcharge, and then the balance continues to accumulate  
8 in a positive direction, but in this example only to  
9 the point of 8.9 million. That would be zeroed out.  
10 In other words, if the overall balance at the end of  
11 the year, putting aside the surcharge filing, would be  
12 36.7, that would be 27.8 as to which you filed the  
13 surcharge recovery.

14 MR. NORWOOD: Let me repeat that back to you  
15 and make sure we are on the same page, and that is, if  
16 we do trigger in October the implemented 10 percent  
17 rate adjustment, we would be collecting that 27.8  
18 million. Every January, we do start over again on  
19 accumulating towards that band of nine million, and it  
20 is true that if during that year it stays below nine  
21 million, there would be no further increase to the  
22 deferral account.

23 CHAIRWOMAN SHOWALTER: But if during in  
24 November, December things got bad and went above by  
25 five million dollars, there would be five million

0196

1 dollars that would kick over into the deferral account.

2 MR. NORWOOD: 90 percent of that would be;  
3 that's correct. So it's a calendar year band of nine  
4 million. Once you hit it and you continue to go all  
5 the way through December, then you would continue to  
6 make deferral entries to the deferral account.

7 CHAIRWOMAN SHOWALTER: But only if it were  
8 above nine million.

9 MR. NORWOOD: That's correct.

10 CHAIRWOMAN SHOWALTER: This gets back to my  
11 first question, separating the ERM tracking from what  
12 goes into the deferral account, which happens on a  
13 monthly basis, but only if the amounts are over nine  
14 million.

15 MR. NORWOOD: That's correct. So you have  
16 two levels. The ERM tracking, once the numbers go  
17 beyond nine million, then you start getting into the  
18 second level, and that is making deferrals to the  
19 account during each calendar year period.

20 MR. CROMWELL: Would an analogy be helpful,  
21 Judge Moss? There is different ways to try and  
22 visualize this. Maybe the metaphor is a fountain. I  
23 think one way to think about this is you've got two  
24 basins, one sitting above another, and the one at the  
25 top can hold nine million cups of champagne, and the

0197

1 one at the bottom can hold a lot more than that. So  
2 essentially, when the Company has above normal costs,  
3 that first basin starts to get filled up, and that's  
4 the nine-million-dollar basin, and when more than that  
5 gets poured into it, it flows into the one underneath  
6 it, and that's the deferral account.

7 Now, if the Company starts having off-system  
8 sales, then that's a cup coming in and taking water out  
9 of the basin, and it will start scooping from the  
10 bottom, and then it will start scooping from the top,  
11 and every year, Mr. Norwood takes that top basin and  
12 hucks it out, but that bottom basin might still have  
13 some champagne in it, and that's the going forward, and  
14 when that bottom basin fills up again and gets 27.8  
15 million cups of champagne in it, he will scoop that  
16 out, and the customers get to drink that, but there may  
17 well be more champagne in that basin. Does that help  
18 at all? That's how the mechanism works, I think.

19 CHAIRWOMAN SHOWALTER: But the bottom tray  
20 can be very, very deep. It can get deeper and deeper  
21 until somebody decides what to do about it.

22 MR. CROMWELL: Very much true. I think the  
23 concern, of course, is that that bottom basin, I think  
24 in Judge Moss's hypothetical of 40 million, and you  
25 take the 27.8 out, you've still got that 12-something

0198

1 sitting there floating, and that will carry on to the  
2 next year, and again, the nine-million-dollar bowl gets  
3 put back in place. The Company starts filling it up,  
4 and it's only when it drips over and starts --

5 CHAIRWOMAN SHOWALTER: The question was, it  
6 can spill from the top to the bottom every single month  
7 if it's over nine million at the top.

8 MR. NORWOOD: That's correct.

9 JUDGE MOSS: Furthermore, the 27.8 million is  
10 not removed from the balance at the time the Company  
11 files to recover that cost on a 10 percent surcharge  
12 over 12 months. In other words, that deferral account  
13 balance is amortized over that 12 months, so once you  
14 reach 27.8, you are going to stay over nine million  
15 dollars in the deferral account balance going forward  
16 until you have amortized for eight or nine months.  
17 Assuming zero changes from that point forward, you are  
18 going to have a nine-million-dollar balance in that  
19 account until 18 million dollars has been amortized.

20 MR. ELGIN: I would say it's collected.  
21 Amortization, you are collecting the money. You are  
22 not amortizing anything, so I think that may be a  
23 mischaracterization. The surcharge goes into effect.  
24 The Company now through the surcharge mechanism  
25 collects revenues which go to offset that cost that is

0199

1 on now their balance sheet, so they have now not  
2 recognized an expense, the power supply cost. Under  
3 the mechanism, they are allowed to book it as a  
4 regulatory asset.

5           Now the surcharge goes into effect. Now  
6 there is a source of revenues to match the expense, and  
7 that's how the mechanism operates, so that the idea is  
8 at any one time, the amount of revenue they could  
9 collect from ratepayers in terms of a surcharge is 10  
10 percent. That's the trigger, so that's when you have  
11 the connection between revenues under the surcharge and  
12 the expense that they now will recognize and take it  
13 off their balance sheet, and that's the critical where  
14 the rubber meets the road, where the rates reflect now  
15 the expense, and so when you were talking about  
16 amortization, it was like you were getting the other  
17 side of the coin, and that's how the revenues are  
18 attempting to match that item of expense, and I think  
19 Page 3 of Exhibit 15, you can see it there.

20           You see under that hypothetical you have  
21 the 20 -- let's just say that that is the trigger, 27  
22 million, for purposes of the response. Now the Company  
23 could file, and now the surcharge would remain in  
24 effect and the Company would now begin to collect the  
25 revenues to recover this element of cost.

0200

1           Now at the end of the year, depending on what  
2 might happen further, they would actually now close the  
3 account for that year and book it on their balance  
4 sheet, and now the idea would be that this surcharge  
5 would match that amount that they booked at that  
6 calendar year, and now we start the process anew. It's  
7 a fresh slate, and we begin starting in January and  
8 February calculating monthly deferrals to see what  
9 would be now the increment or decrement to that  
10 referral amount. So let's say hypothetically now we go  
11 to good hydro and it goes minus. That would work to  
12 offset this plus the revenue that would be collecting.

13           So I think that's how the mechanism works is  
14 trying to match the revenues and when the surcharge  
15 goes into effect and what the Company has booked on its  
16 financial statements for deferred power supply expense,  
17 and that's the critical thing of how the ERM works, and  
18 that's why Wall Street likes it, because now the  
19 mechanism says, Here's the revenue. Here's the  
20 expense, and there is recovery, and it is timely, and  
21 that's the critical thing that Wall Street wants out of  
22 these ERM's for the utilities in terms of their  
23 discussions about the mechanism. That's what they are  
24 looking for.

25           I don't know if that's helpful, but it's



0201

1 really that matching of the revenues under the  
2 surcharge with those expenses that they have not  
3 recovered yet.

4 CHAIRWOMAN SHOWALTER: But that's only the  
5 case for the first 27 million dollars over the band; is  
6 that correct?

7 MR. ELGIN: That's correct, at any one time.

8 CHAIRWOMAN SHOWALTER: And only after the  
9 deferral balance has reached zero.

10 MR. ELGIN: Only after what we've set up  
11 under the prior deferred mechanism goes to zero; that's  
12 correct. I don't mean to keep switching in papers, but  
13 in the Staff memorandum on Page 2, Item 5, that was a  
14 critical thing in our mind that the stipulation had to  
15 do was to provide an orderly way for the Company's  
16 financial statements to transition from the deferred  
17 accounting mechanism to the ERM and how those two  
18 mechanisms synced up, because we are doing it in the  
19 middle of the year, and on an ongoing basis, we dealt  
20 with the prior amounts and recognizing the stream of  
21 revenues to recover those and what amounts and how the  
22 mechanism in the future would match the revenues to the  
23 items of expense that the Company would incur for power  
24 supply, and we had to design it this way to have the  
25 two things link up and have that smooth transition

0202

1 between the extraordinary circumstance and the deferred  
2 mechanism and now the ERM that's going forward. I hope  
3 that helps you understand one of the things that the  
4 settlement does is put those two items together.

5 COMMISSIONER OSHIE: Mr. Elgin, just as an  
6 example then, if the present deferral account would  
7 double, and, say, over the next three years, it would  
8 still be recovered -- so it's never gotten to zero.  
9 There has never been a trigger pulled, but the recovery  
10 of that surcharge amount would be as stipulated but  
11 between the parties, which is 11.9 percent; is that  
12 right?

13 MR. ELGIN: That's correct.

14 CHAIRWOMAN SHOWALTER: I guess I'm not  
15 understanding that very much. It seems to me that if  
16 things just continue to build, it's a recoverable, but  
17 it would not actually be recovered because you will  
18 never be able to get to the point at which you could  
19 start recovering because your prior recovery would be  
20 in operation.

21 MR. ELGIN: Yes. You've identified one of  
22 the things about this that's the possibility. You do  
23 have a circumstance where that Schedule 93 surcharge  
24 could continue for some period of time. We hope not.  
25 Under our best guess, under normal hydro and normal

0203

1 power supply, we've made some informed judgments about  
2 when that would go to zero, but yes, you are correct.  
3 That could happen, and we hope not, but it's possible.

4 CHAIRWOMAN SHOWALTER: One question is why is  
5 or isn't Wall Street concerned about this scenario that  
6 we are laying out? We are kind of laying out bad-case  
7 scenarios, which is not unrealistic because we do know  
8 they happen, so why isn't Wall Street asking you these  
9 same questions, or do they seem to be satisfied.

10 MR. ELIASSEN: My observation is you have a  
11 future Standard and Poors, if you would like one, given  
12 the questions you've asked, because the questions  
13 you're asking are the ones that Wall Street asks, and  
14 while they don't dig into the details as we have here  
15 today, I think that there is a comfort from two things.  
16 One, the Company's operations are appreciably different  
17 today than they were two years ago, and one of the  
18 things we talked to Wall Street about, and especially  
19 rating agencies but also analysts, are that we've  
20 actually tapped to a large extent the amount of adverse  
21 impact power supply conditions can have on the Company  
22 by building plant in the last 18 months, and that's  
23 been critical for us.

24 So we are managing now going forward to  
25 minimize the impact of wild fluctuations and pricing,

0204

1 and we are hoping, of course, we don't see that kind of  
2 fluctuation again in the future. So we really have  
3 quite a cap on it from operations in terms of what the  
4 volatility of the Company can be, another reason why I  
5 think we are reducing the risk profile of the Company  
6 substantially.

7           That coupled with this kind of mechanism now  
8 that allows us then to recover fluctuations in hydro  
9 and in gas for turbines, and when we model it, as  
10 Mr. Norwood did by going back and looking at the last  
11 40 years or 60 years, whatever it was, given our  
12 current resources and when we look at the kind of  
13 volatility we might experience, we feel pretty  
14 comfortable we are working out a much more manageable  
15 range of costs.

16           So we really do explain the fact that we've  
17 got two things working for us here. Strong regulatory  
18 mechanisms that allow us to not have costs get away  
19 from us and not be recoverable at all, and then how we  
20 are operating the Company is different, so we really do  
21 manage the range of availability, and those two things  
22 together have been the kinds of answers that we've  
23 given.

24           Obviously to Mr. Cromwell's point, we can't  
25 predict the future, but we've taken a lot of the

0205

1 uncontrolled variability out of the Company's expense  
2 going forward, even under adverse hydro, even  
3 mechanisms we have in place today or will have with the  
4 settlement.

5 JUDGE MOSS: I think this would be a  
6 convenient moment for us to take our morning recess.

7 CHAIRWOMAN SHOWALTER: Before we do, I sense  
8 that we have probably covered conceptually the  
9 scenarios in 1 through 8, but I do think it would be  
10 helpful to have them filled out, and it would be  
11 helpful if all the parties agree as to how they are  
12 filled out, because if you don't agree, we are in real  
13 trouble because it means we don't understand, we don't  
14 agree on how it works, but I don't think we need to  
15 take more time to do it unless anybody else feels that  
16 they want to go through the scenarios, but it would be  
17 sufficient for me to get the answers to the exam  
18 question. Maybe it could be a Bench request.

19 JUDGE MOSS: We can make it in the form of a  
20 Bench request that the parties can work among  
21 themselves to decide who will fill in the blanks in the  
22 scenarios that were passed out this morning, so we will  
23 do that, and we'll take a 15-minute recess.

24 (Recess.)

25 JUDGE MOSS: I've had some off-the-record

0206

1 conversations concerning our process this morning, and  
2 while the Bench may have some remaining questions, and  
3 Mr. Norwood may have some additional comments  
4 concerning the subjects we've been discussing, he also  
5 is prepared to respond to the remaining questions under  
6 the topic energy recovery mechanism, and then I  
7 understand that it's been suggested that we will simply  
8 go through the list of questions, and others will have  
9 responses to some of them, and the Company will perhaps  
10 supplement those responses as well.

11           Before we turn back to you, Mr. Norwood, to  
12 walk through some of the remaining questions, I want to  
13 see if there are any other questions, follow-up from  
14 our discussion before the break, and then seeing  
15 indications of no, I have just one that relates back to  
16 some subject matter that I wasn't quite clear on.

17           If in a given year the balance reaches 27.8,  
18 so a surcharge is implemented to recover that cost, we  
19 talked in terms of the two basins in Mr. Cromwell's  
20 metaphor. If the amount in the upper basin during the  
21 balance of the year is less than the  
22 nine-million-dollar band, does it spill over into the  
23 other basin at the end of the year, or what happens to  
24 that if it's less than nine million dollars?

25           MR. NORWOOD: Let me talk through two

0207

1 situations to make sure we are clear. If you are into,  
2 let's go back to the example of October, you hit the  
3 27.8 million. You file the change rates and you begin  
4 recovery of the 27.8 million. If during that year  
5 you've already exceeded the nine million, which you  
6 would have because you've triggered, then you would  
7 continue to defer dollar amounts that may exceed the  
8 authorized expenses in November or December, so you  
9 would continue to add to the balance. Those dollars  
10 would stay in there until they are recovered at some  
11 future date or offset by other deferrals in the  
12 opposite direction, but once you cross over into a new  
13 year, then you do reset to zero just the tracking of  
14 the ERM changes at zero, and then only if you exceed  
15 the nine million would you then further add to the  
16 balance in that calendar year.

17 JUDGE MOSS: Thank you. That clarifies it  
18 for me.

19 CHAIRWOMAN SHOWALTER: Does that mean that  
20 you clean out the top trough at the end of December  
21 31st every year?

22 MR. NORWOOD: That is correct, but just the  
23 top trough.

24 CHAIRWOMAN SHOWALTER: I think it was a  
25 helpful metaphor.

0208

1           JUDGE MOSS: Now then, with that, I think we  
2 can turn back to you, Mr. Norwood, to sort of walk  
3 through the balance of the questions to the extent they  
4 haven't been answered.

5           MR. NORWOOD: Thank you. Question No. 6,  
6 what is the basis for the nine-million-dollar figure, I  
7 think each of us probably ought to respond to what our  
8 rationale reasoning was for the nine million. From our  
9 perspective, it was a negotiated number, and I think  
10 there was an effort by the parties to try to reach a  
11 balancing of the sharing of costs and risks between  
12 customers and the Company.

13           From our perspective, we took into  
14 consideration the variation of costs that we might  
15 expect to see in the future in determining that band,  
16 forward fuel contracts and other costs we were aware of  
17 on a going-forward basis. We considered the frequency  
18 of rate adjustments that may occur with that band and  
19 also took into consideration the fact that the band  
20 together with the 90/10 sharing above the band provides  
21 an incentive for the Company to make decisions that are  
22 in the best interest of the Company and its customers.

23           As to Question No. 7, I guess I would respond  
24 to that in terms of the exhibit, I believe it's No. 16,  
25 the bar chart, showing variation in power costs. It



0209

1 was that type of analysis that we looked at in terms of  
2 what is the expected variability that we might  
3 encounter to the future with the operation of that  
4 mechanism. Question No. 8, I believe we responded to  
5 this. The answer is yes. Question No. 9 -- we covered  
6 that also -- is yes.

7 CHAIRWOMAN SHOWALTER: Can we go a little  
8 more slowly as we are reading to ourselves what the  
9 question is?

10 MR. NORWOOD: Yes. On Item No. 10,  
11 statement in the stipulation the Company may, depending  
12 on circumstances, propose a different effective date,  
13 as I explained earlier, to the extent that we can time  
14 a rate adjustment to coincide with another one, we may  
15 choose to do that, and also if we see that the  
16 projections show that numbers may move in the opposite  
17 direction, we may talk to the parties and request that  
18 possibly, for example, an adjustment not be made if we  
19 think the adjustment is going to go into the opposite  
20 direction.

21 Item 11, we've talked about this to some  
22 degree also in that December 2006 filing. The intent  
23 of that filing is to provide an opportunity for all  
24 parties and the Commission to look at the operation of  
25 that mechanism, to review it, and to determine whether

0210

1 there should be changes to the mechanism on a  
2 going-forward basis. It could be continued as is. It  
3 could be modified, and it could be terminated, but  
4 there shouldn't be a presumption going in that it's  
5 going to be terminated.

6 CHAIRWOMAN SHOWALTER: But it does expire.  
7 "Sunset" usually means it expires unless revised, but  
8 this doesn't expire. It's just reviewed.

9 MR. NORWOOD: That's correct. It's an  
10 opportunity for all parties to review and propose  
11 modifications.

12 CHAIRWOMAN SHOWALTER: So I would take the  
13 answer to the question is no, there is not a rebuttable  
14 presumption. There is a burden to -- well, maybe it is  
15 a rebuttable. If you fail to carry a burden -- that's  
16 an interesting question. It would still be in place.

17 MR. NORWOOD: With the mechanism in this  
18 case, it's up to the Company to continue that  
19 continuation of that mechanism. It is in the public  
20 interest, and is with many of the filings, mechanisms,  
21 tariffs that we have in place, at any time they can be  
22 reviewed by the Commission, and basically, it's up to  
23 us to demonstrate in that filing that it is in the  
24 public interest going forward, but there shouldn't be a  
25 presumption that it's going to terminate that point.

0211

1 On Item No. 12, the reference to --

2 CHAIRWOMAN SHOWALTER: I'm sorry. I'll just  
3 point out, it's a little bit confusing. I think the  
4 sentence is on Page 7 says -- I'm looking under sub  
5 C -- "Avista will have the burden of demonstrating it  
6 is in the public interest that the ERM should continue  
7 or be modified."

8 It's a funny thing, because normally, you  
9 would expect to see expiration of something, and then  
10 the Company would have the burden to say that no, it  
11 should continue or be modified. We have the second  
12 half of the equation here, but we don't have the  
13 default that it expires unless you've met this burden.

14 MR. ELGIN: What the parties meant by this is  
15 the evaluation of the ERM as it is operating today or  
16 under the sum, it would be evaluated, so the parties  
17 anticipate the parties will come forward with a filing,  
18 and then we anticipate that if they don't carry their  
19 burden, and whatever the Commission at that point  
20 chooses in that proceeding, there would be an order  
21 either terminating or modifying or whatever on the  
22 basis of that record would continue for this company.

23 The idea is that the Company would make an  
24 affirmative showing of what the ERM in terms of the  
25 specifics and how the mechanism would operate in its

0212

1 continuation, and we would have some proceeding to  
2 determine what would happen, but the answer to the  
3 question is no, there is no sunset, so implied in this  
4 is that something will continue, but what that will be  
5 will be the outcome of that proceeding is what we had  
6 in mind.

7 CHAIRWOMAN SHOWALTER: So the important thing  
8 is that first there will be a proceeding; second, that  
9 at a minimum, Avista has the burden of going forward  
10 with evidence, and then they are instructed to go  
11 forward. They are supposed to carry a burden. Only  
12 it's a little unclear what happens if they don't carry  
13 it. It's up to the Commission at that point, because  
14 at that point, we've had a whole proceeding about it  
15 and decide.

16 MR. ELGIN: Yes, that's correct.

17 MR. NORWOOD: Question No. 12 refers to the  
18 carrying charge and the question of whether it's  
19 short-term, long-term, and the answer there is it is  
20 the overall weighted cost of debt, including both  
21 short-term and long-term debt. No. 13, the answer is  
22 no. We've discussed that. The Company would not be  
23 precluded from seeking further relief.

24 No. 14, in this particular case, the Company  
25 files Commission basis reports each year, and in those

0213

1 Commission basis reports, we normalize the operating  
2 costs of the Company that will produce a normalized  
3 return, rate of return or earnings for the Company.  
4 That can be compared then against the authorized  
5 return. In that analysis, the nine-million-dollar band  
6 would not affect that calculation.

7 Another way to look at this is you can also  
8 compare the actual results for the Company with those  
9 authorized by the Commission. In that case, to the  
10 extent we had adverse conditions, higher power costs,  
11 that we would absorb the first nine million, and the  
12 absorption of that nine million would be reflected in  
13 the comparison of the actual results to the authorized  
14 results.

15 CHAIRWOMAN SHOWALTER: I'm not sure I  
16 understood. Tell me if this is right or wrong. The  
17 nine million dollars simply occurs. You absorb it, or  
18 you gain it outside of the authorized rate of return?  
19 In other words, the authorized rate of return assumes  
20 that additional above or below benefit or cost?

21 MR. NORWOOD: The authorized return is set at  
22 a level. Basically, our rates and the revenues we are  
23 collecting are coming in such that we have the  
24 opportunity to earn that return. To the extent that  
25 costs are higher than expected, revenues don't cover

0214

1 that additional amount, and we would absorb the first  
2 nine million, so if we absorb an additional nine  
3 million than what we are collecting in rates, then our  
4 actual return would be lower than our authorized  
5 return.

6 CHAIRWOMAN SHOWALTER: So it doesn't affect  
7 the authorized rate of return. You just wouldn't  
8 receive your authorized rate of return.

9 MR. NORWOOD: That's correct. Item 15,  
10 implications of the pro rata 4.5-million-dollar band is  
11 as simple as 2002 is a half a year, July to December,  
12 '02, so it's half of a band of nine million dollars.

13 JUDGE MOSS: Will it also be the amount  
14 that's considered on a monthly basis for August,  
15 September and so forth?

16 MR. NORWOOD: The way it will work is, for  
17 example, if costs in July are three million dollars  
18 more than authorized, we will absorb that three million  
19 dollars. We will continue to absorb until you reach  
20 the 4.5 million, even if it's in the second month.  
21 Once you hit that 4.5, anything beyond that 90 percent  
22 will be deferred until December.

23 CHAIRWOMAN SHOWALTER: So your upper trough  
24 for this half a year is only half as big.

25 MR. NORWOOD: That's correct, and as soon as

0215

1 you fill the trough, it doesn't matter whether it's  
2 September or October. Once you fill the trough, you  
3 start to fill the other one.

4 No. 16, how the trigger amount would be  
5 spread among rate schedules and the stipulation be --  
6 any rate adjustment that would be proposed would be  
7 spread among the schedules on a uniform percentage  
8 basis, and within the schedules, for example, Schedule  
9 1, a residential rate, which has a number of different  
10 rate blocks, that adjustment would be made on a uniform  
11 cents-per-kilowatt hour within the schedule.

12 CHAIRWOMAN SHOWALTER: Looking at Page 8 of  
13 the settlement stipulation, the first full paragraph,  
14 it's the first sentence that says "The trigger amount  
15 will spread on a uniform percentage basis, and then  
16 it's the second sentence you must have just explained.

17 MR. NORWOOD: That's correct.

18 CHAIRWOMAN SHOWALTER: I'm not sure I get it.

19 MR. NORWOOD: Between the schedules, for  
20 example, Schedule 1, 11, 21, it will be uniform  
21 percentage, but within Schedule 1, a residential class,  
22 there are three different rate blocks. The more you  
23 use, the more you pay, so that the rate adjustment to  
24 those would not be a uniform percentage to each of  
25 those blocks. You would take the overall cents per

0216

1 kilowatt hour off that schedule, and it would be equal  
2 for each of those rate blocks.

3 CHAIRWOMAN SHOWALTER: I don't know if this  
4 is realistic or not, but if it's half a cent, than each  
5 rate block would increase by one-half a cent in terms  
6 of rate.

7 MR. NORWOOD: Yes. I'm assuming Brian with  
8 kick me if I'm wrong.

9 CHAIRWOMAN SHOWALTER: He was nodding his  
10 head.

11 MR. NORWOOD: We are on 17, and it is true,  
12 the answer is yes. The Company will file to zero out  
13 that rate schedule when it goes to zero, and that, in  
14 essence, would be a compliance filing with the  
15 stipulation. With that then, perhaps we can go to  
16 No. 1 and go through the ones we haven't covered yet.

17 CHAIRWOMAN SHOWALTER: It actually might help  
18 if you would read the question simply so we aren't  
19 reading it ourselves when you are giving us the answer.

20 MR. NORWOOD: Okay. I think Mr. Elgin is  
21 going to cover No. 1.

22 MR. ELGIN: Question 1 asks, What is the  
23 pro forma revenue requirement, 278 million or  
24 282,490,000 or some other amount.

25 The difference between the two numbers has to



0217

1 do with general tariff schedules and total revenues  
2 that the Company receives. The 278 million is the  
3 revenue figure for general tariffed rates. The  
4 282,490,000 number includes a special contract and  
5 revenues that the Company revises under its  
6 conservation tariff rider, so that's the difference  
7 between those two, and the revenue deficiency that we  
8 are recommending in the stipulation is on the basis of  
9 that number, 278 million, those revenue figures, for  
10 278 million, general tariffed revenues.

11 CHAIRWOMAN SHOWALTER: So is a way to think  
12 of this is that 278 million is the general revenue  
13 requirement, and those two additional things, the  
14 special contracts and tariff rider can take care of  
15 themselves?

16 MR. ELGIN: That's correct.

17 JUDGE MOSS: Thank you, Mr. Elgin. Are we  
18 ready for No. 2 then?

19 MR. NORWOOD: No. 2, the question is, What  
20 portion of the proposed 19.3 percent general increase  
21 in retail rates represents fixed costs associated with  
22 new power plants; for example, Coyote Springs, Kettle  
23 Falls. The answer here is the fixed costs or the  
24 revenue requirement associated with the fixed cost is  
25 approximately 17 million dollars. That includes

0218

1 depreciation, the return on the investment, and fixed  
2 O and M costs.

3 CHAIRWOMAN SHOWALTER: So what proportion of  
4 the 19.3 percent, what is the 19.3 percent absolute  
5 amount?

6 MR. NORWOOD: That would be just slightly  
7 over seven percent of that 19.3 percent. I think  
8 Mr. Elgin has No. 18.

9 JUDGE MOSS: Mr. Elgin, No. 18.

10 MR. ELGIN: The question is, Is the retail  
11 revenue adjustment an attempt to insure the Company  
12 neither over nor underrecovers fixed costs. The answer  
13 is no. Is this basically what is generally called  
14 decoupling, and the answer is no. If you would like a  
15 bit more explanation, I would be happy to go into that,  
16 what the revenue adjustment mechanism is designed to  
17 do.

18 JUDGE MOSS: I think that would be helpful.

19 MR. ELGIN: It's primarily a design to  
20 account for load growth and also make sure that the  
21 Company bears in its actual results of operations the  
22 traditional variations of temperature. So the idea is  
23 to adjust the deferral by the amount that the Company  
24 recovers through load growth on its system, and then to  
25 the extent that temperature affects power supply costs,

0219

1 it's to adjust the deferral for that impact as well.

2           So imbedded in the calculation of any  
3 deferral is the retail revenue adjustment figure, so  
4 that's what it's designed to do. It's designed to make  
5 sure the Company does not book costs to the deferral  
6 that would otherwise recover due to load growth or  
7 variations in temperature, and it's symmetrical both on  
8 the upside and the downside.

9           JUDGE MOSS: The idea then is to make the  
10 mechanism sustainable over a period of time without  
11 having to modify it.

12           MR. ELGIN: That's correct, and it's also an  
13 explicit acknowledgment. The first power cost  
14 mechanism the Commission implemented, it was the Puget  
15 Sound Power and Light's ECAC (phonetic), and there were  
16 significant issues regarding the overrecovery of fixed  
17 costs under the ECAC mechanism, and it's an attempt to  
18 deal with that issue so that it's not insuring over or  
19 underrecovery. That's why I answered no to that  
20 question, but it's designed to deal with the phenomenon  
21 of load growth and how the Company recovers costs when  
22 its load grows, and what's the impact on those variable  
23 power supply expenses that are part of the ERM.

24           JUDGE MOSS: Who has No. 19?

25           MR. ELGIN: I think I've answered 19. I'll

0220

1 go ahead and read it: Is the retail revenue adjustment  
2 independent of the nine-million-dollar ERM band, and  
3 it's imbedded in that calculation. Then the second  
4 part, Is that as well the retail revenue adjustment  
5 affect the energy cost deferral balance in the years  
6 that the ERM is within the nine-million-dollar band.

7 Again, it's imbedded in the calculation of a  
8 deferral, so to the extent that the Company recovers  
9 costs through load growth and it affects power supply  
10 costs, the ERM adjusts the deferral amount which  
11 impacts the nine-million-dollar band.

12 MR. NORWOOD: If I might add, the answer is  
13 no to the last part.

14 MR. ELGIN: Question 20 is under the heading  
15 "rate design," and I might add that Question 20 is  
16 related to the response that Mr. Norwood gave in  
17 Question 16. 20 asks specifically, Were the base  
18 revenues quote the Commission is asked to approve  
19 developed using the methodology Ms. Knox employed in  
20 prefiled Exhibit No. TLK-2, Part 1, Page 2, Line 17?  
21 Yes.

22 Do the base revenues remain at the same  
23 revenue-to-cost ratios, and that is related to Question  
24 16, and the answer is yes. For rate spread purposes,  
25 because we are allocating the amount on uniform

0221

1 percentage or revenues between schedules or rate  
2 spread, you maintain the same revenue-to-cost ratios  
3 for rate design purposes. Since it's millage -- it's  
4 uniform cents per kilowatt hour -- there are no rate  
5 design issues as part of this stipulation. So the rate  
6 design stays the same, and the rate spread maintains  
7 existing revenue-to-cost ratios from that  
8 cost-of-service study.

9 CHAIRWOMAN SHOWALTER: Do you see 20-A there?  
10 That was added.

11 MR. ELGIN: Right, so since the answer is  
12 yes, then there is no need to answer "A," because the  
13 answer -- we are maintaining those.

14 CHAIRWOMAN SHOWALTER: This is my question,  
15 so I just need to understand it better, and in our last  
16 rate case, we did not revise, or generally, we didn't  
17 revise the allocation among classes because we said the  
18 cost study was not good enough, and we anticipated that  
19 in the next rate case, there would be a cost study,  
20 which would be basis to go towards unity, which we  
21 acknowledge we needed to do. So what I don't  
22 understand -- you may have given the answer just now,  
23 but I don't understand what we are doing about getting  
24 towards unity in this settlement agreement.

25 MR. ELGIN: We are not doing anything more

0222

1 with respect to moving towards unity. We are  
2 maintaining the same revenue-to-cost relationships that  
3 were identified in Ms. Knox's exhibit.

4 CHAIRWOMAN SHOWALTER: I don't understand  
5 what those are. In other words, let's say compared  
6 to-- when was our last rate case with our order?

7 MR. ELGIN: 1999 case.

8 CHAIRWOMAN SHOWALTER: At that point, we  
9 didn't make progress toward a reallocation that would  
10 get closer to unity or closer to classes carrying their  
11 costs. We did express a desire to do that, so I don't  
12 understand whether we have or haven't made progress,  
13 and if we have not, why not.

14 MR. NORWOOD: We have, and if I might  
15 represent, in the Company's filing, we had proposed a  
16 uniform percentage spread which does move each of the  
17 schedules closer to unity, and what the stipulation  
18 incorporates is the uniform percentage, which does, in  
19 fact, move the schedules closer to unity, so we are  
20 making progress.

21 CHAIRWOMAN SHOWALTER: How much progress, if  
22 you can characterize it.

23 MR. NORWOOD: That would be a Brian  
24 Hirschhorn question. We can provide that in one way or  
25 the other.

0223

1                   CHAIRWOMAN SHOWALTER:  Why doesn't he come  
2 forward?

3                   JUDGE MOSS:  We can swear Mr. Hirschhorn and  
4 see if he has anything to add.

5                   MR. MEYER:  May I suggest we go on and answer  
6 the other questions and return to this one after he's  
7 reviewed some materials?

8                   JUDGE MOSS:  That sounds like a good  
9 suggestion, so we'll return to this question in a  
10 moment when the prospective witness has an opportunity  
11 to review his work papers.

12                   MR. NORWOOD:  21, regarding the reference to  
13 a future rate proceeding, does this reference refer  
14 only to a general rate case, or does it encompass other  
15 types of proceedings in which the Company's rates might  
16 be adjusted, and the answer here is that it could  
17 encompass any number of filings, including a general  
18 rate case or some other separate filing.  I think  
19 Mr. Elgin has No. 22.

20                   MR. ELGIN:  Question 22 asks, The interim  
21 settlement stipulation stated that the cost of debt and  
22 preferred trust securities for the purposes of  
23 calculating the pro forma interest expense will be  
24 determined in Avista's general rate case.  Has this  
25 been done, and if so, where is it reflected in the

0224

1 settle agreement.

2           It has been done, and it's reflected in --  
3 I'll refer you to Page 11, Section 4, Sub A, the  
4 calculation and the Staff's review of the Company's  
5 revenue requirements, and this is also related to our  
6 response to Question 1. The overall rate of return is  
7 9.72.

8           JUDGE MOSS: Give us a minute, Mr. Elgin.

9           MR. ELGIN: It's in the staff memo, revenue  
10 requirements overall.

11           JUDGE MOSS: I think everybody is there now.

12           MR. ELGIN: It's the second paragraph in our  
13 review, and when we put together the results of  
14 operations to determine what is the Company's  
15 Washington pro forma revenue requirement, we used 9.72  
16 percent as the overall rate of return, which includes  
17 the stipulation, which agreed to the return on equity  
18 and the capital structure and updated the cost of debt  
19 and preferred securities, so it's imbedded in our  
20 acceptance of that figure for purposes of revenue  
21 requirements.

22           CHAIRWOMAN SHOWALTER: Just so we can have a  
23 cross-reference over there to the settlement  
24 stipulation itself.

25           MR. ELGIN: Yes, ma'am. One second, please.



0225

1 It's on Page 3, and it's under Section 2, settlement  
2 stipulation, subparagraph 1, retail rates. It's in the  
3 second paragraph.

4 CHAIRWOMAN SHOWALTER: Read the lines.

5 MR. ELGIN: "The parties agree that the  
6 revenues increases authorized and implemented since  
7 October 1st, 2001, representing an overall increase of  
8 73,914,000, or approximately 31.2 percent, will be  
9 allocated effective July 1st, 2002 as follows:  
10 45,722,00, or approximately 19.3 percent, to base rates  
11 to reflect the resolution of the Company's general  
12 revenue requirement request.

13 CHAIRWOMAN SHOWALTER: So you are saying that  
14 imbedded in that 45 million 7 figure is an overall  
15 return of 9.7 percent?

16 MR. ELGIN: 9.72 percent.

17 CHAIRWOMAN SHOWALTER: Then you said that's  
18 contained in the Staff memorandum at Page 11, but  
19 where?

20 MR. ELGIN: I'm saying that in our acceptance  
21 of this revenue deficiency, and on Page 11, the second  
22 paragraph, "Staff investigated the Company's proposed  
23 general retail revenue increase of 45,722,000, which  
24 leads to total pro forma retail revenues of 282,490,00  
25 (Washington.)

0226

1                   CHAIRWOMAN SHOWALTER:  So it's not on this  
2  paper, but you are saying to us today that that 9.72  
3  went into the calculation of the number.

4                   MR. ELGIN:  That's correct, and Question 23  
5  asked to confirm that the ROE is as per the settlement,  
6  the prior settlement of 11.16 percent, and the 9.72  
7  percent overall rate of return does reflect that ROE  
8  and the agreed-upon capital structure from that  
9  settlement.

10                  JUDGE MOSS:  From that settlement or from  
11  that proceeding?

12                  MR. ELGIN:  From the settlement of the  
13  interim case in this proceeding.

14                  (Pause in the Proceedings.)

15                  JUDGE MOSS:  No. 24?

16                  MR. ELGIN:  I will read the question:  What  
17  is the public policy purpose of preventing the Company  
18  from entering commodity transaction with Avista Energy  
19  (until the energy cost deferral balance goes positive.)

20                  For myself to answer it, I would ask for  
21  clarification in terms of what is it -- this was  
22  something that was part of, from my perspective,  
23  something the parties talked about in the context of  
24  the settlement, but in terms of how to specifically  
25  respond, I asked for clarification for myself of the

0227

1 question.

2 MR. NORWOOD: If I may offer from the  
3 Company's perspective in responding to this question.  
4 As we were in negotiations, this issue was raised, and  
5 we recognized as a company that the review of  
6 transactions between the corporation and its  
7 subsidiaries requires closer scrutiny.

8 It requires closer scrutiny than for other  
9 transactions, so for purposes of this settlement, the  
10 Company agreed until the deferral balance goes to zero  
11 to simply not enter into further commodity transactions  
12 on electric and gas side that relate to the electric  
13 operations, and therefore, there wouldn't be further  
14 transactions that would go into the ERM until that  
15 deferral balance goes to zero.

16 CHAIRWOMAN SHOWALTER: Is the prohibition  
17 related to the ERM and deferral account, or is it  
18 simply at a time period that coincides with the  
19 deferral balance going to zero?

20 MR. NORWOOD: It's a time period that  
21 coincides. Once the balance goes to zero, then this  
22 provision would no longer apply.

23 CHAIRWOMAN SHOWALTER: I understand that, but  
24 is it a convenient time period, or is there something  
25 inherent about the deferral balance and the deferral

0228

1 balance going to going to zero which could be affected,  
2 I suppose, by these trades. You don't have to say what  
3 the public policy purpose is, but what are the factors  
4 at issue. What are people worried about, if anything,  
5 or is it that there needs to be a time-out so that  
6 people can take a better look at the subsidiary  
7 relationship, and this is a convenient time-out.

8 MS. KIMBALL: I don't know if this will  
9 address the specific timing issue, but in terms of a  
10 public policy concern, our concern is certainly one of  
11 self-dealing. We were extremely concerned when the  
12 natural gas transaction between Avista Utilities and  
13 Avista Energy, and what I would say is that this  
14 provision is something that the parties were able to  
15 reach agreement on in terms of attempting to address  
16 some of those concerns.

17 CHAIRWOMAN SHOWALTER: So almost like a  
18 little sanction, in your mind? Maybe not in the  
19 operation of the settlement agreement.

20 MR. CROMWELL: I wouldn't use that  
21 characterization. I think in our view, a lot of what  
22 the ERM does is allocate costs between shareholders and  
23 ratepayers in a way that produces a result that is  
24 reflective of where the parties were able to get to  
25 agreement on a possible outcome of litigation of the

0229

1 underlying facts regarding a number of transactions  
2 that the Company entered into, specifically long-term  
3 gas contracts and concerns that we had about certain of  
4 those contracts. Some were with third parties. Some  
5 were with Avista Energy.

6 We had a range of concerns about those  
7 transactions, and one of the concerns we had was with  
8 the potential for self-dealing between Avista Utilities  
9 and Avista Energy. We were willing in part to settle  
10 on these terms because this provision that we are  
11 discussing in Question 24 creates a decreased risk to  
12 ratepayers of the possibility, the possibility of  
13 self-dealing occurring while we are still paying off  
14 the existing deferral balance, until that deferral  
15 balance gets to zero.

16 We are not taking a position regarding the  
17 underlying facts, but to our mind, this was a way of  
18 decreasing the risk to ratepayers of any possibility of  
19 self-dealing during the period when ratepayers are  
20 still paying off deferrals that reflect transactions  
21 between Avista Utilities and Avista Energy.

22 MR. NORWOOD: This issue was discussed in  
23 negotiations. It was raised. The Company did  
24 voluntarily offer to go ahead and agree to this  
25 provision of not entering into any further transactions

0230

1 during the time period that the balance was greater  
2 than zero.

3 CHAIRWOMAN SHOWALTER: Actually, the question  
4 itself should have been the deferral balance is  
5 negative rather than positive, shouldn't it?

6 MR. NORWOOD: Yes.

7 JUDGE MOSS: I guess I would like to follow  
8 up on Chairwoman Showalter's question though in the  
9 sense that she put it to you whether this is sort of a  
10 time-out, if you will, an opportunity to have some time  
11 to address this sort of problem, and the manner in  
12 which you described it, to return to perhaps not so  
13 colorful but metaphor nonetheless, this is sort of a  
14 mop-and-bucket approach to the potential for a leaky  
15 sink as opposed to addressing the more fundamental  
16 questions of affiliate transactions.

17 Is there any plan or prospect or idea -- the  
18 other side of the coin is that the best deal out there  
19 might be a deal between Avista Energy and Avista  
20 Utilities for a block of power or gas. We wouldn't  
21 necessarily want to preclude that, so is the underlying  
22 issue being addressed for further discussion,  
23 collaboration?

24 MR. CROMWELL: Frankly, I think the provision  
25 that we came up with, from our perspective, it was a

0231

1 way of providing us assurance that we wouldn't have to  
2 get into affiliate transaction issues during the annual  
3 review process that we will be having if the  
4 stipulation is adopted over the next few years, so that  
5 when we are doing that 90-day review and we are looking  
6 at what the Company proposes for addition into the  
7 deferral and recovery, we are not having to spend a  
8 chunk of time drilling down and doing discovery on who  
9 was talking to who and did someone in Avista Energy  
10 used to be at Avista Utilities. Was there some  
11 communication or essentially short dealings for those  
12 type of transactions that we would then feel that we  
13 should argue some degree of disallowance for.

14           This takes what could be a very contentious  
15 and otherwise fact-driven and painful for all involved  
16 inquiry off the table, in essence, while we are still  
17 paying off that deferral. It allows us to focus,  
18 again, from our perspective, on the merits of what the  
19 Company is putting in and not have to think about that  
20 there is some possibility that these transactions were  
21 proper. It narrows the scope of inquiry, I suppose  
22 would be the simplest way to put it, and to get back to  
23 the fundamental, it decreases the risk to ratepayers of  
24 any possibility of self-dealing during this deferral  
25 period.

0232

1                   MR. NORWOOD:  If I may add, you mentioned the  
2 word "problem."  I don't think that there is a  
3 conclusion there was a problem, but by not entering  
4 into these transactions, it just reduces the amount of  
5 effort that goes into reviewing these types of  
6 transactions, so we have agreed not to do that for this  
7 period of time.

8                   JUDGE MOSS:  All right.

9                   MR. MEYER:  We now have Mr. Hirschhorn  
10 available.

11                   JUDGE MOSS:  If you would rise and raise your  
12 right hand.

13                   (Witness sworn.)

14                   JUDGE MOSS:  You are going to return us to  
15 20(A), I believe.

16                   MR. HIRSCHKORN:  Yes.  What I'll try and do  
17 here is make sure I understood the question first, and  
18 the question refers to an exhibit that was prepared by  
19 Ms. Knox and a comparison of the revenue-to-cost ratios  
20 by individual service schedule at both current rates  
21 and proposed rates.

22                   There is two different measurements that  
23 we've looked at in this case in terms of analyzing  
24 revenues versus costs for individual service schedules.  
25 One takes a look at all costs and how all costs are



0233

1 allocated across schedules. The one that I kind of  
2 zero in on in my testimony just looks at the rate of  
3 return produced by each individual service schedule.  
4 The rate of return is just a component of total costs.

5 Our original proposal in this case was to  
6 spread the proposed revenue requirement on a uniform  
7 percentage basis to all schedules. When you look at  
8 the result of spreading the revenue requirement on a  
9 personal basis, on a revenue to total cost basis, it  
10 really doesn't change the resulting result in terms of  
11 revenue to cost.

12 When you look at how it affects the rate of  
13 return for those schedules by spreading the revenue  
14 requirement on a uniform-percentage basis, it actually  
15 moves the rate of return closer to unity, because  
16 again, the rate of return is just one component of  
17 total costs. So we are moving the rate of return  
18 closer to unity, but because that rate of return is  
19 such a small component of total costs, it really  
20 doesn't affect those ratios, and that's what the  
21 question went to in this case was revenue to cost.

22 On Page 12 of my prefiled testimony, which  
23 I'm sure you don't have in front of you, I do have a  
24 table that shows the relative rates of return by  
25 schedule under current rates versus the rates the

0234

1 Company proposed in this case. For the majority of our  
2 schedules, we're between 20 to 50 percent away from  
3 unity on a rate-of-return basis. As we proposed in  
4 this case, spreading the revenue requirement on a  
5 uniform-percentage basis would move those relative  
6 rates of return about 20 to 30 percent towards unity.  
7 So if you look at the difference between the rates of  
8 return and unity, it moved those rates of return 20 to  
9 30 percent towards unity.

10 CHAIRWOMAN SHOWALTER: But only on the  
11 component of rate of return, which is what percent or  
12 what proportion of the total picture?

13 MR. HIRSCHKORN: I don't know exactly. I  
14 would guess probably -- well, rate of return. I'm  
15 guessing about 10 percent in terms of total costs.

16 CHAIRWOMAN SHOWALTER: So for 10 percent of  
17 the picture, we moved 30 percent towards unity? Is  
18 that a way to put it?

19 MR. HIRSCHKORN: Yes, in terms of revenue  
20 compared to total costs. I wanted to add that because  
21 what has been agreed to in the stipulation is on a  
22 uniform-percentage basis, the results, when you look at  
23 the revenue requirement in the stipulation, will make a  
24 similar movement towards unity in terms of rate of  
25 return, so we are moving towards unity as a result of

0235

1 the stipulation. Granted, probably not as much as we  
2 could if rate design and rate spread were more of a  
3 contested issue in this case, but we are making some  
4 movement.

5 CHAIRWOMAN SHOWALTER: One of my concerns is  
6 it's evident from the room that there is no one here  
7 specifically representing the commercial class, and am  
8 I right or wrong that that's the class that is most out  
9 of whack?

10 MR. HIRSCHKORN: Small commercial is the  
11 class that's most out of whack.

12 CHAIRWOMAN SHOWALTER: What I'm trying to get  
13 a grip on is --

14 MR. HIRSCHKORN: The rate of return under  
15 current rates is about 50 percent, 57 percent higher  
16 than our average rate of return. Under our proposed  
17 revenue requirement, that would move to about 43  
18 percent higher than average, so a reduction, if you  
19 will, from 57 percent above the average rate of return  
20 to 43.

21 Under the settlement, I would guess that  
22 would change by possibly two percentage points, so from  
23 a 57 percent above unity to about a 45 percent amount  
24 above unity. So it still is significantly above unity  
25 for the small commercial class but less than it is

0236

1 under current rates.

2 CHAIRWOMAN SHOWALTER: In our prior order in  
3 November 2000, the Fourth Supplemental Order, we said  
4 at that time, Avista's proposed electric rate spread  
5 would move each customer class one-third of the way  
6 toward unity. Then we went on to say that we didn't  
7 think the foundation for it was sufficient so we didn't  
8 do it. Was that one-third based on total cost of the  
9 piece, the 10 percent piece that you are talking about?

10 MR. HIRSCHKORN: It's based on the piece, the  
11 rate of return.

12 CHAIRWOMAN SHOWALTER: So does that mean that  
13 what we are doing, what you propose to do in the  
14 settlement is roughly comparable to what was proposed  
15 back in 1999, in ballpark terms?

16 MR. HIRSCHKORN: It's slightly less. It's  
17 not quite a one-third movement towards unity. It's  
18 between 20 and 25 percent.

19 CHAIRWOMAN SHOWALTER: But it is an  
20 apples-to-apples comparison.

21 MR. HIRSCHKORN: Yes, it is.

22 CHAIRWOMAN SHOWALTER: I think my most  
23 general question was, is there a piece of unfinished  
24 business left from the prior rate case that didn't  
25 quite get finished in this rate case, and as I

0237

1 understand it, your answer would be no, we did propose  
2 something similar in the prior rate case. We are  
3 resolving whatever we proposed in the prior rate case  
4 in this case, and this larger question of the larger  
5 costs and unity didn't get raised in either place. Is  
6 that correct?

7 MR. HIRSCHKORN: The Company proposed  
8 something different than a uniform-percentage spread in  
9 the last case, if I recall correctly. In this case, we  
10 were proposing a uniform-percentage spread because of  
11 the size of the increase, the prior increases taking  
12 all the factors into account. One thing we did want to  
13 accomplish in this case was making some movement  
14 towards unity, and a uniform-percentage basis actually  
15 does make some movement towards unity, so the Company's  
16 proposal in this case was a uniform-percentage basis.

17 CHAIRWOMAN SHOWALTER: I guess the question  
18 is if this settlement is approved, are we either being  
19 in the moment unfair to a class? Does this commission  
20 have a responsibility to look at the class allocation  
21 and say fundamentally, is it fair or not, or are we  
22 making progress or not, and if that's the case, do we  
23 need to set up another proceeding to keep working on  
24 this or not?

25 It's not in this agreement. I recognize

0238

1 that, but I think, speaking for myself, my expectation  
2 was we didn't really get to this in the last rate case,  
3 but we will get to it in the next rate case. Well,  
4 here we are at the next rate case, and it seems as if  
5 we've started going in the right direction, but perhaps  
6 not very far, so how long do you just let what appears  
7 to be, I think, an inequitable distribution or at least  
8 something that could be approved or allocation? How  
9 long do you let it go on, or am I kind of off base?

10 MR. ELGIN: Well, I would say there is two  
11 factors to consider. One is a lot of these costs are  
12 power supply related, and the way we've done it in the  
13 past, the rate design for power supply is millage,  
14 cents per kilowatt hour, and to the extent we don't  
15 adopt this here, it does move the classes that are  
16 above unity more towards unity by adopting something  
17 other than millage, so if you use uniform percent --  
18 now the question is the degree to which you want to  
19 move in that direction.

20 So you look at the surcharge, and that was  
21 allocated on percentage of revenues, not millage, and  
22 you look at this rate design, so to the extent that  
23 that mitigated the increases as opposed to a  
24 traditional kilowatt cents per hour, I think that  
25 helps. Is that enough? I think what the parties and

0239

1 what the Company has proposed in terms of this  
2 settlement, we think this is a fair result based on  
3 what the nature of these costs are and how it's spread  
4 to the customers, vis-a-vis how we would have done it  
5 in the past on a millage basis. So I guess that would  
6 be the comparison and the context to evaluate this rate  
7 spread proposal and what it does for class cost of  
8 service.

9 MR. SCHOENBECK: I certainly have testified  
10 many times, I think, rates should be a move towards  
11 cost of service as soon as practicable, and I think the  
12 fundamental problem I have with this particular  
13 situation is the overall increase has been so large for  
14 all the customers, basically a 31 percent increase.  
15 It's very difficult for me to request other customers  
16 to share even an additional burden above that level.

17 I also think there is a certain amount of  
18 equity that is achieved by using uniform percentage  
19 basis, as Mr. Hirschhorn and Mr. Elgin are pointing  
20 out. It does make some modest movement, but I don't  
21 think you can make a major movement because it would  
22 mean giving people a substantial increase above the 31  
23 percent already. So I think it's a timing issue, and  
24 the timing simply did not work out because the power  
25 costs were what they were and they are what they are.

0240

1           CHAIRWOMAN SHOWALTER: So this moves in the  
2 right direction in only a very small degree, but you  
3 are saying that it's not a good time to move in a  
4 larger degree because of the very high rate increases  
5 that would have to be incurred by some of the other  
6 classes. The time to do rate rebalancing, if that's  
7 the word, is when times are better.

8           MR. SCHOENBECK: That's right. Obviously,  
9 the best time it could happen in the gas industry in  
10 this state would be -- whenever gas decreases, there is  
11 significant movement towards cost-based margin rates,  
12 and that's the perfect time to do it, when everyone can  
13 get a potential decrease, but when every customer on  
14 average is already looking at a 31 percent increase,  
15 it's difficult to ask people to share even more pain  
16 than that, given the existing circumstances of the  
17 state.

18           MR. HIRSCHKORN: In fact, that's what we did  
19 in the last case that was filed with the Commission.  
20 We asked for or recommended a more significant movement  
21 towards unity because we were asking for a smaller  
22 increase. In this case with the surcharge that just  
23 went into effect and then the general case we have  
24 filed with the Commission, we didn't think it was  
25 reasonable to ask certain customer classes to pay



0241

1 substantially more than this overall percentage.

2 CHAIRWOMAN SHOWALTER: Assuming you are  
3 correct and this is not a good time to do anything more  
4 than is done, how do we set it up or do we set it up  
5 such that at a good time, we do do this because, of  
6 course, I suppose if things are working out, the  
7 Company simply doesn't come in, and the Company tends  
8 to come in for a rate increase when times are bad,  
9 which is not a good time to do the rate rebalancing.

10 MR. HIRSCHKORN: My opinion would be possibly  
11 a good time is when there hasn't been a significant  
12 change in rates probably for a couple of years, so the  
13 customers adjust to new rates, so to speak, and you can  
14 make a significant shift without adding to an already  
15 requested significant increase. That may be a  
16 reasonable time to look at that. If it's a  
17 rate-spread, rate-design case only, that may be a  
18 reasonable time to do it.

19 MR. SCHOENBECK: Another opportunity may be  
20 when the existing 11.9 percent surcharge balance goes  
21 to zero. That would be a good opportunity. When  
22 everyone has seen the 11.9 percent decrease to say,  
23 okay, should there be some tweaking so some people now  
24 get a two or three percent decrease and others might  
25 get a larger one.



0243

1 Boulder Park facility. It's a gas-fired facility in  
2 the Spokane Valley that consists of six reciprocating  
3 engines about four megawatts apiece, so it's about 24  
4 or 25 megawatts. The heat rate is about 9,000 BTU's  
5 per kilowatt hour, and I believe it's completed now.  
6 In this time frame plus or minus a few weeks, it's  
7 going to be on line.

8 COMMISSIONER HEMSTAD: Is that a peaking  
9 facility?

10 MR. NORWOOD: You can use it either way.  
11 Primarily, it would be peaking, and the bottom line is  
12 if gas costs, for example, are three dollars times the  
13 9,000 heat rate, it's about \$27 per megawatt hour as an  
14 operating cost. If wholesale market prices go beyond  
15 that, then you would run it and either use it to serve  
16 your load or you would sell it, and those revenues  
17 would be picked up in the ERM calculation.

18 The third facility is the Kettle Falls bifuel  
19 project, and it's basically an additional small  
20 combined-cycle unit. I can't remember exactly how many  
21 megawatts, but it's four to six megawatts that would be  
22 added to the existing Kettle Falls. We wouldn't waste  
23 facility. It's a way to actually basically capture the  
24 existing steam and complement the existing steam force,  
25 so it's basically a complementary addition to the

0244

1 Kettle Falls project, and I believe that one is  
2 completed now.

3 COMMISSIONER HEMSTAD: My other question is  
4 with regard to the 40-year hydro rolling average as  
5 against the 60-year not average but just the straight  
6 60-year period that is being used in your hydro model.  
7 This historically has been an issue that seems to be if  
8 not relitigated but continually litigated as to what is  
9 appropriate, and I had this from memory concluded that  
10 the 40-year device seemed to be an attractive solution,  
11 but now that's not being used, the 40-year rolling  
12 average, but now it's just straight 60 years. Could  
13 someone give me a bit more background on those choices  
14 and why the 60-year period was selected?

15 MR. NORWOOD: I guess this to some degree is  
16 we didn't resolve that issue in the discussions. The  
17 Company did propose the 60 years. We had extensive  
18 testimony in the prefiled case. Staff and the other  
19 parties looked at all of the numbers including that  
20 component. If I recall the Staff memo correctly, it  
21 says that it's part of the package deal to use what was  
22 filed in this particular case but doesn't indicate that  
23 that should be used to the future.

24 So to some degree, this is a settlement, a  
25 package of all the ins and outs, pluses and minuses, so

0245

1 I guess in my mind, we haven't resolved to the future  
2 whether it should be 60, 40, 50 or something different,  
3 for that matter.

4 COMMISSIONER HEMSTAD: So essentially, the  
5 debate is among engineers and technicians, or are there  
6 other policy implications as to which choice is made?

7 MR. ELGIN: From Staff's perspective, there  
8 are differences about it, but in litigation, our memo  
9 points out that we would have proposed, in the context  
10 of adopting an ERM, literally proposed something  
11 different, but for purposes of settling this case, we  
12 accepted the Company's normalized water study for 60  
13 years and is the basis for calculating the difference  
14 in costs under normalized conditions. We are not  
15 accepting that, and it is something that may come in  
16 the future is the best way we can describe it, but  
17 there are differences between a 40-year rolling average  
18 and 60-year water. There are differences.

19 COMMISSIONER HEMSTAD: So I guess I take it  
20 from this, this is an issue to be debated or fought  
21 about another day.

22 MR. ELGIN: Right.

23 COMMISSIONER HEMSTAD: I'm not suggesting I  
24 had a level of discomfort with that but so much as to  
25 understand what the implications of that choice may be.

0246

1           MR. ELGIN: In the circumstances of this  
2 case, the implications are, what is the baseline you  
3 use for calculating the nine-million-dollar band. So  
4 for purposes of this ERM mechanism and the  
5 nine-million-dollar dead band, Staff is comfortable  
6 with the baseline and the 60-year water for which that  
7 calculation is made.

8           It could very well be in 2006 when the  
9 Company makes its filing for the continuation of the  
10 existing ERM or something new or whatever, that issue  
11 of baseline and water could arise in that proceeding,  
12 but it's truly an issue related to the baseline, and  
13 there are differences, but in the context of going to  
14 an ERM or PCA or whatever you want to call it, what is  
15 the base and what do you do for water is a critical  
16 issue, and that's where we are at today on that.

17          MR. CROMWELL: I would concur with Mr. Elgin.  
18 I think our perspective is that the record you have  
19 before you is sufficient to make a public interest  
20 finding regarding the proposed stipulation, but by  
21 entering into the settlement, I don't think any party  
22 is committing to supporting in any other proceeding or  
23 in any other venue the methodology that the Company had  
24 employed in the aspects of its direct case, whether the  
25 40-year or cost-of-service study. We think there is a

0247

1 sufficient record before the Commission, but we are not  
2 committing ourselves vis-a-vis any particular  
3 methodology the Company may have employed in its  
4 prefiled case.

5 JUDGE MOSS: Other questions from the Bench?

6 CHAIRWOMAN SHOWALTER: I have some very small  
7 technical questions. One is on the settlement  
8 agreement bottom of Page 6, top of Page 7. This is the  
9 annual filing about how the ERM is doing, and it says  
10 the filing is on or before April 1st, and then it says  
11 there is a 90-day review period ending June 30th.  
12 Would I be right to say that the review period is 90  
13 days from the filing, so that if the filing occurred  
14 February 1st, it would be 90 days after that?

15 MR. CROMWELL: I think that was our  
16 understanding that there would be a 90-day review, and  
17 the dates that were provided were to set a deadline, so  
18 that by no more than roughly a quarter after the  
19 they've closed their books, they would have something  
20 before this commission and that the parties would have  
21 90 days too look at it.

22 CHAIRWOMAN SHOWALTER: Then on Page 9 makes  
23 reference to the comfort level of billing plan and  
24 continuing modification of program restrictions  
25 previously approved. I might have asked this question

0248

1 before when these were approved, but do these  
2 provisions comply with our rules? That is, the parties  
3 are not asking us to waive any rule; am I correct on  
4 that?

5 MR. CROMWELL: I believe that is accurate. I  
6 do recall this conversation during the presentation of  
7 the interim stipulation at the end of February. I  
8 think we checked the rules to make sure there wasn't  
9 any conflict in the rules, and I see other parties  
10 nodding, so I think my recollection is correct that we  
11 are okay in terms of rule compliance.

12 CHAIRWOMAN SHOWALTER: My last question is on  
13 the Staff memorandum, Page 8. The third paragraph on  
14 Page 8, which begins, "As explained..." on Page 6 and  
15 7, the second sentence there that begins, "This  
16 means..." Mr. Trotter, maybe you could just read that  
17 sentence to yourself.

18 Maybe there is something missing in it or  
19 maybe there is something I'm missing, but I can't  
20 understand it. I think we've covered the ground, but I  
21 don't know what it means or says.

22 MR. TROTTER: Mr. Elgin may be the best  
23 person to respond, but I think it intended to be a very  
24 too-compressed, too-concise statement of what we went  
25 through this morning on Exhibit 15, the three examples,



0249

1 and talking about no rate change occurs if the power  
2 costs that are tracked do not exceed the  
3 nine-million-dollar band. I think that's all we are  
4 intending to convey there in perhaps an ineptly-worded  
5 sentence.

6 CHAIRWOMAN SHOWALTER: I actually can't find  
7 a verb in this sentence.

8 MR. TROTTER: You are correct. There is an  
9 extra "and" there, the second line. That probably  
10 should be removed.

11 JUDGE MOSS: It should perhaps say,  
12 "balances, then no rate change occurs"?

13 CHAIRWOMAN SHOWALTER: Just scratch the "and"  
14 and put a comma after "balance", and that's what is  
15 meant to be said; is that right?

16 MR. TROTTER: I think it should read, "This  
17 means that if power supply costs tracks by the ERM but  
18 exceed the base costs for those amounts by less than  
19 nine million one year, no power costs are added to  
20 power cost deferral balances and no rate change  
21 occurs." So that's the "and" that needs to be deleted.

22 CHAIRWOMAN SHOWALTER: So the verb is "are  
23 added."

24 MR. TROTTER: I don't think we intended to  
25 say anything to contradict the presentation on Exhibit

0250

1 15, which is probably a lot more precise and a lot more  
2 numerical and perhaps a lot more helpful.

3 JUDGE MOSS: I will just comment in light of  
4 yourself effacing comment that the memo was very well  
5 written, I think, and helpful to the Commission.

6 CHAIRWOMAN SHOWALTER: It was, and that was  
7 the only sentence I didn't understand. Those are all  
8 my questions.

9 JUDGE MOSS: Any further questions from the  
10 Bench? Do the parties have anything else to be made of  
11 record in connection with the settlement stipulation?

12 MR. MEYER: We just have one piece of  
13 business, and that has to do with the work sheets, and  
14 we have done our analysis and have made copies for the  
15 other parties to review. In fairness, the parties are  
16 just going to need time just to check our calculations.  
17 I would suggest that be treated as a late-filed  
18 exhibit. Then the other parties can review it. Staff  
19 counsel has agreed they would submit this as a  
20 late-filed exhibit.

21 JUDGE MOSS: Let's treat it this way. We had  
22 24 Bench requests individually in this phase of the  
23 proceeding. What we will do is reserve Exhibit No. 17  
24 for the response to Bench Request No. 25, and this will  
25 be Bench Request No. 25, and without objection, we will

0251

1 simply make that of record when the responses have been  
2 reviewed by all parties and is furnished to us. Is  
3 that agreeable? Hearing no objection than --

4 MR. TROTTER: If I could have just one moment  
5 to talk to Mr. Meyer about what he handed us, because  
6 it may be a question that we have to ask you.

7 (Discussion off the record.)

8 MR. CROMWELL: I think I would only add we  
9 would want to review the numbers, but we wouldn't have  
10 any objection, but if there were some concern, we would  
11 talk about it with the Company before.

12 JUDGE MOSS: You would bring it to my  
13 attention, I'm sure. We will admit 17 under the  
14 conditions that I have described.

15 It appears there is nothing further for our  
16 record. I think the Chair has a few closing remarks,  
17 and then I will close our proceedings for the day.

18 CHAIRWOMAN SHOWALTER: Thank you very much.  
19 I made the opening remarks. I just wanted to say we  
20 had a lot of questions coming into this, as you can  
21 see, and you gave very responsive answers, and we  
22 appreciate it.

23 JUDGE MOSS: I thank you all for being here  
24 today and for helping us develop our record. The  
25 Commission will take the matter under advisement and

0252

1 issue its order in due course. With that, our record  
2 is closed. Thank you.

3

4 (Hearing concluded at 12:18 p.m.)

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25