

**BEFORE THE WASHINGTON STATE  
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of	)	
	)	DOCKET UE-060181
AVISTA CORPORATION, d/b/a	)	
AVISTA UTILITIES,	)	ORDER 03
	)	
For Continuation of the Company's	)	ORDER APPROVING
Energy Recovery Mechanism, with	)	SETTLEMENT AGREEMENT
Certain Modifications	)	
.....	)	

1 ***Synopsis:** The Commission finds that the modifications to Avista's Energy Recovery Mechanism proposed by the parties in their Settlement Agreement, including reduction of the so-called deadband from \$9 million to \$4 million, a 50/50 sharing for excess power costs or power cost savings between \$4 million and \$10 million, and a 90/10 sharing beyond the \$10 million threshold, result in improvements to the mechanism that are in the public interest.*

2 **PROCEEDINGS:** On January 31, 2006, Avista Corporation (Avista) filed its Petition for continuation of the company's Energy Recovery Mechanism (ERM), with certain modifications. The filing satisfies a condition established in the Commission's Order 05, "Approving and Adopting Settlement Agreement with Conditions," entered on December 21, 2005, in Avista's most recent general rate proceeding, Docket Nos. UE-050482 and UG-050483. In Order 05, we required Avista to file a petition on or before January 31, 2006, to initiate further review of the ERM.

3 **SETTLEMENT:** The parties filed a Settlement Agreement on June 7, 2006. The parties propose to resolve most issues associated with the ERM in this proceeding with a few issues deferred for consideration in Avista's next general rate proceeding. The parties filed joint testimony on June 12, 2006, supporting the Settlement Agreement. The Commission conducted a settlement hearing on June 15, 2006.

4 **PARTY REPRESENTATIVES:** David J. Meyer, Avista VP and Chief Counsel, Spokane, Washington, represents his company. S. Bradley Van Cleve, Davison Van Cleve P. C., Portland, Oregon, represents Industrial Customers of Northwest Utilities (ICNU). Irion Sanger and Matthew W. Perkins, Davison Van Cleve P.C., also filed appearances for ICNU. Simon J. ffitch, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of Attorney General. Gregory J. Trautman, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff ("Commission Staff or Staff").<sup>1</sup>

5 **COMMISSION DETERMINATIONS:** We find that the modifications the parties propose to make to the ERM via the Settlement Agreement filed in this proceeding result in improvements to the original power cost adjustment mechanism established in Docket No. UE-011595 during 2002. We conclude that it is in the public interest for the Commission to approve and adopt the Settlement Agreement as filed and without condition.

## MEMORANDUM

### **I. Background and Procedural History**

6 The Company's Energy Cost Recovery Mechanism (ERM) was established pursuant to a Settlement Stipulation (ERM Stipulation) between Avista, Staff, Public Counsel, and ICNU, adopted by the Commission on June 18, 2002, in the Fifth Supplemental Order in Docket No. UE-011595. On January 31, 2006, the Company filed its Petition for continuation of the ERM, with certain modifications, together with supporting testimony. The filing satisfied a condition in the ERM Stipulation, as well as a condition established in the Commission's Order 05, "Approving and Adopting Settlement Agreement with Conditions,"

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<sup>1</sup> In formal proceedings, such as this case, the commission's regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as any other party to the proceeding. There is an "ex parte wall" separating the commissioners, the presiding administrative law judge, and the commissioners' policy and accounting advisors from all parties, including staff. RCW 34.05.455.

entered on December 21, 2005, in Avista's most recent general rate proceeding, Dockets UE-050482 and UG-050483. In paragraph 177 of that order, the Commission required Avista to file a petition on or before January 31, 2006, to initiate further review of the ERM.

- 7 After analysis of the filing, and the pre-filing of testimony by Staff, ICNU, and Public Counsel, all parties commenced discussions for purposes of resolving or narrowing the contested issues in this proceeding in a settlement conference held April 26, 2006. The parties' discussions resulted in the Settlement Agreement filed by all parties on June 7, 2006, now before us for decision.

## II. Proposed Settlement

- 8 We attach to this order and here adopt by reference into the body of this order the full Settlement Agreement as filed on June 7, 2006. The key provisions of the Settlement Agreement include six modifications to the original ERM. The parties also propose to defer four issues for consideration in Avista's next general rate proceeding. The parties agree that all revisions to the ERM resulting from the settlement will be effective as of January 1, 2006, and will remain in effect until the conclusion of the review described in paragraph (H) of the Settlement Agreement, unless otherwise expressly provided. Paragraph (H) provides that Avista will initiate a filing not sooner than five years from the date the settlement is approved, to allow all interested parties the opportunity to review the ERM, and make recommendations to the Commission related to the continuation, modification or elimination of the mechanism.

- 9 The Settlement Agreement provides specifically as follows:

1. Deadband and Sharing Bands. The deadband<sup>2</sup> will be reduced from \$9 million to \$4 million. The Company and its customers will share on an equal basis any positive or negative differences between actual and base power supply costs between \$4 and \$10 million.

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<sup>2</sup> Under the ERM, Avista's power costs are measured against a baseline that is updated each year. The deadband is the annual net deviation in actual costs from the baseline that Avista either absorbs, in the case of net excess costs, or retains, in the case of net cost savings.

Avista will be responsible for 10% of any excess power costs greater than \$10 million with the customers bearing 90% of such excess costs and Avista will retain the benefit of 10% of all power cost savings greater than \$10 million with the customers taking 90% of the benefit. The deadband and sharing bands are based on costs accumulated over a calendar year period.

2. Transmission Revenues and Expenses. The current ERM tracks the variation in net power supply expense, including purchased power and fuel expense, less wholesale sales revenue. Under the Settlement, transmission revenues and expenses will be included in net power costs and expenses under the ERM. Accordingly, monthly variations in transmission revenues and expenses will be included in the monthly ERM calculations.

3. Transmission Fixed-Cost Component. - The ERM's retail revenue credit will include the fixed-cost component of transmission approved for inclusion in rates in the then most recent rate case. The current retail revenue credit, which reflects the average cost of production (power supply) embedded in retail rates, is \$32.89/MWh. Until changed, the addition of the transmission cost component of \$6.14/MWh results in a new retail revenue credit of \$39.03/MWh.

4. Long-Term Power Supply Contracts. For any new power contract, or any power contract that has been renewed or extended, with a term longer than two years and of more than 50 megawatts (MW), costs in excess of the lower of the average embedded cost of power supply determined in the then most recent rate case (currently \$32.89/MWh) or the average market rate during the contract (based on the average annual price of the Dow Jones Mid-Columbia Firm Index), will be excluded from actual power supply costs until the contract is incorporated in base rates pursuant to a general rate case. Such costs, if approved, would be recoverable only on a going-forward basis. The contracting of up to 50 aMW under Avista's current renewable energy RFP is exempt from this limitation.

5. Treatment of Major Plant Outages. If Kettle Falls, Colstrip 3 & 4, or Coyote Springs 2 fails to meet a 70% availability factor during the ERM review period, the Company must demonstrate that:

- The fixed costs set in rates were in fact incurred for the time the plants had an outage that reduced the availability factor below 70%.
- The outage was not the result of imprudent actions on the part of the Company.

The fixed costs for each of the plants include return on rate base net of tax, depreciation expense, and operation and maintenance expense not included in the net power costs and other production costs related to these plants. If the actual fixed costs are below the level used to calculate base rates, or the outage resulted from imprudent actions and some level of cost is disallowed, base rates will be adjusted to reflect the lower actual costs or the disallowed costs. No adjustment is necessary to the normal method of calculating the retail revenue credit and the same retail revenue credit factor will be used that would have been used absent such an event.

6. Brokerage Fees. Fees paid to third-party brokers who facilitate electricity and natural gas turbine fuel purchases and sales are a component of the Company's power supply expense and will vary from the amount embedded in rates. Monthly variations in brokerage fees will be included in the monthly ERM calculations.

10 The parties agree to defer until Avista's next general rate proceeding the following four issues:

1. The cost of capital impact of the ERM.
2. The prudence of the Company's hedging strategy for power purchases and purchases of gas used for power generation, on a prospective basis.
3. Consideration of the allocation of common costs related to the retail revenue credit.
4. Consideration of a production property adjustment.

### III. Discussion and Decision

- 11 In Avista's most recent general rate case, Dockets UE-050482 and UG-050483, the Commission approved a multi-party Settlement Agreement, subject to conditions. Although the settling parties in the general rate case proposed changes to the ERM, the Commission found that an adequate record did not exist on which to make a determination regarding the proposed changes. Thus, the Commission did not approve the ERM proposal and required Avista to make a subsequent filing to initiate a comprehensive inquiry into the Energy Recovery Mechanism.
- 12 Avista, accordingly, filed its petition in this proceeding. Avista proposed to continue the Company's ERM with several structural modifications. The proposed modifications addressed both the methodology for calculating differences between actual and authorized net power costs, and the sharing relationship between the Company and its customers with respect to excess power costs or power cost savings. Avista proposed, among other things, to eliminate the so-called deadband from the ERM under which the Company was required to absorb 100 percent of the first \$9 million in excess power costs and allowed to retain 100 percent of the first \$9 million in power costs savings incurred in a given year. Excess power costs, or power costs savings beyond the \$9 million threshold were shared between the Company and the customers on a 90/10 (ratepayer/Company) basis under the original ERM. Avista proposed to apply the 90/10 sharing to all excess power costs or power cost savings. Avista also proposed to add transmission revenue and expense components to the ERM calculations.
- 13 The procedural schedule we established in this proceeding gave the other parties sufficient time to conduct discovery and to thoroughly analyze the ERM and Avista's proposed revisions. On April 21, 2006, ICNU, Public Counsel, and the Commission Staff filed their response testimonies.
- 14 Mr. Randall Falkenberg, for ICNU, stated that Avista's proposed changes to the ERM failed to meet the principles established by the Commission in the recent

PacifiCorp case, Docket No. UE-050684. Most significantly, Mr. Falkenberg testified, the Avista proposal contained no deadband, and would not equitably allocate power cost risks between ratepayers and shareholders.

15 ICNU recommended that the Commission modify the ERM deadband and sharing mechanism to include a \$5.0 million deadband, a 50/50 sharing band for power cost variations from \$5.0 to \$13.0 million, and a 90/10 sharing band for variations in excess of \$13.0 million. ICNU also proposed that the Commission integrate an earnings test into the modified deadband and sharing mechanisms that would result in no power cost deferrals when Avista's return on equity ("ROE") is within 100 basis points of its last allowed ROE.

16 Mr. Steven Johnson, for Public Counsel, made eight recommendations for modifying the ERM:

- The deadband should be reduced from \$9 million to \$6 million.
- Power costs from \$6 million to \$12 million over the baseline would be shared 50/50 between ratepayers and the Company.
- Above \$12 million the sharing band should remain 90/10 ratepayer/Company.
- All transmission costs for delivering power to Avista's system should be included in the ERM. The variable transmission costs, generally described as wheeling revenue and expense, should be included in the net power costs portion of the ERM and, correspondingly, Company-owned transmission plant costs should be included in the retail revenue credit after approval in a general rate case.
- Only the amount of new long-term power contracts that are at or below the authorized proforma net power cost should be included in the net power supply costs. Once reviewed and approved in a general rate case, the full cost of a new long-term power contract should be included in the proforma retail revenue credit of the ERM. Contracts with terms greater than 2-years should be considered long-term contracts.
- An adjustment for major thermal plant outages should be included in the ERM.
- Brokerage fees should be included in the net power cost portion of the ERM.

17 Staff, through Mr. Alan Buckley's testimony, proposed that the Commission continue to authorize Avista to use the ERM, though not necessarily on a permanent basis. Mr. Buckley testified that the Commission should accept Avista's proposed modifications to the ERM related to transmission revenues and expenses, and calculation of the retail revenue credit, albeit with an additional modification. Mr. Buckley also testified to Staff's view that the Commission should reject the Company's proposal to eliminate the deadband, but should modify the existing dead band so that the Company would bear 50 percent of power cost variations up to \$18 million instead of bearing 100 percent of power cost variations up to \$9 million. Finally, Mr. Buckley stated that the Commission should order Avista to address issues identified by Staff concerning return and normalized net power supply in the next general rate case.

18 The Settlement Agreement reflects careful consideration by the parties of each other's respective proposals for modifications to the ERM and a reconciliation of their various proposals to achieve balanced results that are in the public interest. We are satisfied on the basis of the full record before us that the sort of careful review we required in Order No. 05 in Dockets UE-050482 and UG-050483 occurred in the context of this proceeding. The parties have closely analyzed the ERM and have proposed modifications that significantly improve the mechanism relative to its original form and relative to the proposal we rejected as inadequately supported in the general rate case. We commend the parties for their efforts.

19 We find the proposed Settlement Agreement to be in the public interest and determine that we should approve and adopt it as a full resolution of the issues in this proceeding.

### **FINDINGS OF FACT**

20 Having discussed above all matters material to our decision, and having stated general findings, the Commission now makes the following summary findings of fact. Those portions of the preceding discussion that include findings pertaining to the Commission's ultimate decisions are incorporated by this reference.



- 21 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including electric companies.
- 22 (2) Avista is a “public service company,” and an “electrical company” as those terms are defined in RCW 80.04.010 and as those terms otherwise are used in Title 80 RCW. Avista is engaged in Washington State in the business of supplying utility services and commodities to the public for compensation.
- 23 (3) The proposed modification to the deadband previously established as part of Avista’s ERM and the proposed sharing bands are useful mechanisms that allocate appropriately between shareholders and ratepayers the risk of power cost variability the ERM is meant to address and should motivate Avista to effectively manage or even reduce its power costs.
- 24 (4) The proposed modifications to the ERM concerning the treatment of transmission revenues and expenses, transmission fixed-costs, long-term power supply contracts, major plant outages, and brokerage fees improve the ERM mechanism and are in the public interest.

### **CONCLUSIONS OF LAW**

- 25 Having discussed above in detail all matters material to our decision, and having stated general findings and conclusions, the Commission now makes the following summary conclusions of law. Those portions of the preceding detailed discussion that state conclusions pertaining to the Commission’s ultimate decisions are incorporated by this reference.
- 26 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

- 27 (2) The Settlement Agreement filed by Avista, ICNU, Public Counsel and Staff, attached to this Order as Appendix A and incorporated by reference into the body of this Order is in the public interest and should be approved and adopted.

**ORDER**

THE COMMISSION ORDERS THAT:

- 28 (1) The Settlement Agreement filed by the parties on June 7, 2006, is approved and adopted in full and as a final resolution of this proceeding.
- 29 (2) Avista is authorized and required to make any compliance or other filing necessary to effectuate the terms of this Order.
- 30 (3) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, any compliance or other filing that implements the requirements of this Order.
- 31 (4) The Commission retains jurisdiction to effectuate the terms of this Order.

DATED at Olympia, Washington, and effective June 16, 2006.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

Philip B. Jones, Commissioner

**NOTICE TO PARTIES: This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.**

[Service Date June 16, 2006]

## **APPENDIX A**