BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In re the Matter of	)	
	)	Docket No. UE-010395
AVISTA CORPORATION, d/b/a AVISTA	)	
UTILITIES	)	**POST-HEARING BRIEF OF AVISTA**
	)	**CORPORATION**
Request Regarding the Recovery of Power	)	
Costs Through the Deferral Mechanism	)	
	)	
	)	
	)	

Avista Corporation (hereinafter "Avista" or "the Company") respectfully submits its Post-Hearing Brief in the above-captioned matter. Avista has incurred substantial deferred power costs in the discharge of its public service obligations, bringing financial pressures to bear that require immediate rate relief. The rate relief is necessary to allow the Company to cover its ongoing operating costs, fund the construction of additional generation, satisfy its bank covenants, and maintain an investment grade credit ratings. This brief will elaborate on why such conditions are important to the Company.

The Company respectfully requests that the Commission issue an order that provides, at a minimum, the following:

1. Approval of a continuation of deferred accounting for power costs to allow the Company the opportunity to address recovery of the costs in a future proceeding. The Company has proposed that deferred accounting continue through December 2003.

2. Approval of a surcharge at a sufficient level and duration to begin to recover the deferral balance over a reasonable period of time (recovery plan), to provide the needed reassurance to the investment community. The Company has proposed a 36.9% surcharge to be effective through December 2003. At the conclusion of the upcoming rate case, the Company would modify both the amount and duration of the surcharge, if needed, in order to reflect the outcome of the general case. (Exh. 250-T, p. 5, ll. 15-18)[1]

3. Approve accounting treatment that allows Avista to credit the surcharge revenues against the deferral account balance (on a subject to refund basis), which would allow the Company to begin to immediately reduce the size of the deferral balance.

I. INTRODUCTION

On July 17, 2001, Avista filed its Petition, together with proposed tariff ("Original Sheet 93") requesting rate relief by way of a 36.9% increase applied to all classes of retail customers, with the proposed tariff to become effective on September 15, 2001, and remain in effect for a period of 27 months.[2] As explained in its Petition, the combination of record-low hydroelectric conditions and unprecedented high wholesale market prices occurring at the same time has caused the need for prompt rate relief. Indeed, hydroelectric conditions for 2001 have deteriorated to the lowest level since records have been kept. (See Petition at pg. 1). As explained in its Petition and testimony submitted in this proceeding, current estimates show that if prompt rate relief is not granted, the Company would be unable to complete anticipated financings and would be unable to meet certain debt covenants by the end of this year, with the result that the Company's ability to borrow under its line of credit would be impacted.

[1] The Company has not requested more than is necessary in its filing. In fact, Mr. Eliassen testified that "we have not asked for more than we need, and in fact may not be asking for enough, in my opinion." (Exh. 152-T, p. 9, ll. 6-14). The Company has attempted to ask for only what it needs through this surcharge relief in order to balance the needs of the Company to build its financial strength against the need to hold customer rates to the lowest practical level. (Id.) In the public hearing on September 10, 2001 in Spokane, many members of the public expressed the importance of Avista remaining a healthy, vibrant, locally controlled utility.

[2] On September 5, 2001, the Commission issued its Fourth Supplemental Order Suspending Tariff Revision, extending the proposed effective date of Sheet 93 beyond September 15, 2001.

Previously, this Commission had approved the Company's request for a deferred accounting mechanism that allowed Avista to defer certain increased power-supply-related costs beginning July 1, 2000, and ending on June 30, 2001. (See "Order Approving Establishment of a Deferral Mechanism to Track Power Cost Expenses" issuing on August 9, 2000, in Docket No. UE-000972). Subsequently, on January 24, 2001, the Commission approved the Company's request to modify the deferral mechanism to include certain other power supply related components and actual system load requirements. (See "Order Granting Request to Modify Power Cost Deferral Mechanism Order" in Docket No. UE-000972).

On May 23, 2001, the Commission approved a Settlement Stipulation between Avista and other parties in Docket No. UE-010395 which, among other things, extended the deferred accounting mechanism through the earlier of February 28, 2003, or the date the deferral balance was estimated to become zero. In this manner, the Company had hoped to fully recover its deferred costs without a price increase to its retail customers. It was explicitly recognized, however, that the Company's ability to fully offset the deferred costs under the Settlement Stipulation was premised on a number of assumptions, including, but not limited to, streamflow conditions, thermal plant performance, level of retail loads, and wholesale market prices during the deferral period. The Settlement Stipulation (Exh. 1, p. 4) states:

> The Company shall petition the Commission to alter, amend, or terminate the Settlement Stipulation (or propose other appropriate action) should the deferral balance increase or be reasonably anticipated to increase substantially due to unanticipated or uncontrollable events, such as unplanned outage of a large company-owned thermal unit, or worsening drought conditions. Nothing in this Settlement is intended to predetermine any issue in that proceeding or to preclude the company from proposing any particular remedy in its Petition, including the need for rate relief.

During hearings conducted in Docket No. UE-010395 in connection with the Stipulation, upon questioning by the Chair of the Commission, Marilyn Showalter, Mr. Kelly Norwood, on behalf of the Company, testified:

> If we find that the costs are increasing higher than what we anticipated, then we have the opportunity to make a filing, come back before you, and propose any number of solutions, and it may be extending the mechanism to allow further offsets. It could involve a price change also, but that would be left for that filing and would not be decided here.

(Tr. Vol. II, p. 20, ll. 3-10). Upon further questioning, Mr. Norwood also spoke to the impact of smaller surpluses than otherwise assumed in the Stipulation:

> Q. CHAIRWOMAN SHOWALTER: You said high market prices could cut both ways. So could low market prices, I would think. If you have a surplus in the market that suddenly isn't as high as you thought it might be, you might not be compensated for that deferred account as fast as you thought.
>
> A. MR. NORWOOD: That's absolutely correct.

(Tr. Vol. II, p. 23, ll. 1-7). Finally, Chairwoman Showalter appropriately observed:

> I'll just say that I think it's a laudable goal to try to get through this very volatile and uncertain period without a rate increase, and it seems to be a doable goal, and I just applaud the parties for trying to work through this and coming up with what seems to be a doable plan, but I note that it is stated in terms of a goal, not a flat commitment, which I think is appropriate under the circumstances. I hope it all works out. (Emphasis added).

(Tr. Vol. II, p. 36, ll. 10-19).

In fact, conditions have worsened: subsequent to the Settlement Stipulation power supply conditions have deteriorated substantially, resulting in increased costs due primarily to changes in hydroelectric generation and wholesale market prices. The Company has had to make additional purchases of energy at high prices from the short-term wholesale market in order to cover deficits caused by the further decline in hydroelectric generation. These purchases have caused deferred power costs to increase to levels much higher than previously expected. Furthermore, the recent substantial decrease in forward wholesale market prices has reduced the value of future surplus energy on Avista's

system for 2002 and 2003 that could be used to offset the deferral balance. Therefore, it no longer appears possible to offset the deferred power costs through the value of future surplus energy sales.

No party has disputed that the Company's filing is consistent with the terms of the Settlement. Indeed, Staff Witness Elgin acknowledges that the Company's Petition to Amend "is consistent" with the Settlement Stipulation. (Exh. 451-T, p. 3, ll. 18-20). He goes on to observe that the Settlement Stipulation permits a petition to amend on the basis of worsening hydro conditions, which has occurred. (Id.)[3] Staff Witness Schooley concludes that drought conditions have "worsened" since the Settlement Stipulation was signed. (Exh.401-T, p. 4, ll. 12-14). In fact, Mr. Schooley goes on to testify:

> Staff understands that the current hydro conditions being experienced in the region are unusual and may result in new critical year figures. Staff also understands that hydro-generation projections have deteriorated somewhat in the period subsequent to the Settlement Stipulation being approved, and that these lower water conditions were not expressly anticipated by the plan. The 37% surcharge is also based on projections that are not only worse than earlier projections, but also significantly worse than critical water year levels. (Emphasis supplied).

(Id. at p. 6, ll. 1-7).

In its Second Supplemental Order Granting Intervention, Establishing Process and Procedural Schedule, dated August 15, 2001, the Commission appropriately recognized that this phase of the proceedings is "limited in scope"; the Commission will "consider only the question whether Avista requires immediate rate relief in the form of a surcharge that will permit it to recover certain power costs reflected in its deferral account, subject to refund." (See ¶12, p. 3 of Order). Given the expedited nature of these proceedings, the Commission, in this phase of the proceedings, "will not determine the prudence of Avista's power costs or make determinations regarding substantive issues that may be raised in subsequent proceedings concerning the appropriate treatment of such costs for rate and accounting purposes." (Id. at ¶14). Among the issues set aside for a subsequent phase of this

[3] Staff agrees that Section 4 of the Settlement Stipulation allows the Company to Petition the Commission to amend the Stipulation should unanticipated or uncontrollable events occur that cause the deferral balances to increase substantially. (Exh. 451-T, p. 14, ll. 17-19).

proceeding by the Commission were the prudence of the power costs incurred, and the optimization of the Company's resources to the benefit of customers. (Id.)

II. CIRCUMSTANCES GIVING RISE TO THE NEED FOR IMMEDIATE RATE RELIEF

As testified to by Mr. Ely, Avista's Chairman of the Board, President and CEO, the combination of the worst hydroelectric conditions since records have been kept, together with unprecedented high electric wholesale market prices, has created the need for immediate rate relief by means of this surcharge filing. (Exh. 50-T, at p. 1, l. 23 - p. 2, l. 12). This relief, in the amount requested, is necessary for the Company to obtain financing to support its ongoing operations. In fact, as testified to by Mr. Ely and other Company witnesses, Avista has yet to obtain necessary construction financing for the Coyote Springs II project, because lenders remain concerned about the size of the deferral balance and the absence of some form of rate relief in order to deal with recovery of those costs. (Id.) Moreover, if needed cash is not forthcoming by means of surcharge relief, the Company will not be able to borrow under its main line of credit. (Id.) Commission approval of the requested surcharge, therefore, is essential to the Company's plans to continue to access the capital market in order to meet its obligations and to construct necessary power resources to meet future customer needs, as testified to by Mr. Ely. (Id.)

A. THE COMPANY IS EXPERIENCING THE WORST HYDRO CONDITIONS EVER RECORDED

Mr. Norwood, Vice President of Energy Resources, presented testimony regarding the unprecedented nature of current streamflow conditions. (See Exh. 100-T, at p. 3, l. 10 - p. 5, l. 2). It is undisputed that the Pacific Northwest has been experiencing extremely low streamflow for 2001. Specifically, for Avista's owned and contracted-for hydroelectric generation, current estimates show that 2001 will produce the lowest hydroelectric generation output in the 73 years for which records have been kept. (Id. at p. 4, ll. 1-3). As shown at page 1 of Mr. Norwood's Exh. 102, in a critical

water year, Avista would expect hydroelectric generation of approximately 150 aMW below normal; however, actual conditions through June 2001 together with projections for the balance of 2001 are for only 360 aMW for generation output, which is 194 aMW below the normal hydroelectric generation level of 554 aMW. (Id. at p. 4, ll. 8-11).

At the time the Settlement Stipulation was developed, hydroelectric generation for the year 2001 was expected to be 135 aMW below normal, as compared with the much lower July estimate in this filing of 194 aMW below normal, resulting in an additional substantial reduction of 59 aMW in available hydroelectric generation. (Id. at p. 4, ll. 18-21). (See also Exh. 102 comparing expected 2001 monthly hydroelectric generation at the time of the Settlement Stipulation with current estimates.)

B. UNPRECEDENTED WHOLESALE MARKET CONDITIONS HAVE ALSO HAD A DIRECT IMPACT ON THE NEED FOR SURCHARGE RELIEF

In addition to the record drought conditions experienced by Avista, Avista has been directly and substantially affected by wholesale market conditions. In his testimony, Mr. Norwood describes the unprecedented and sustained high wholesale electric short term market prices and price volatility. (See Exh. 100-T, p. 5, ll. 5-7). As testified to by Mr. Norwood, volatility in the market place increased dramatically in 2000. Exh. 103, p. 5, demonstrates the dramatic rise in monthly forward prices, as well as the volatility of those prices.

Recently, however, wholesale prices have declined considerably, due in part to FERC's June 19, 2001 Order, which, among other things, implemented new price mitigation caps in the entire Western market. This decline in prices, however, has had a direct impact on the Company's ability under the Settlement Stipulation to reduce the level of deferral balances. (Exh. 100-T, p. 6, l. 20 - p. 7, l. 6)

It is, of course, recognized that power costs in a general rate proceeding are based on "normal conditions" which include weather-normalized retail loads, normal streamflow conditions, normal thermal operating conditions and normal wholesale market price conditions. In fact, as explained by Mr. Norwood, the Company's existing retail rates include power costs that are based on the

assumption that short-term purchases can be made at an average price of $23.45/MWh. (Id. at p. 7, ll. 11-21). The Company's purchases of short-term energy at prices in excess of $200/MWh to meet energy deficiencies, however, have caused a significant increase in power costs to the Company. (Id. at p. 7, ll. 10-17) This has been combined with the worst hydroelectric generation conditions on record for Avista's hydroplants. In the final analysis, low streamflow conditions have required the Company to purchase additional energy from the short-term market to replace the lost hydroelectric generation, at a time when prices were at historically high levels.

Mr. Norwood testified that the actual power cost deferral balance of June 30, 2001, was $109 million for the Washington jurisdiction. (Exh. 100-T, p. 7, l. 22 - p. 8, l. 5). Current estimates, however, of the deferral balance are $198 million as of December 31, 2001, $211 million at the end of 2002, and $251 million at the end of 2003. (Id.) (See also Exh.103, p. 6, which includes a chart showing the electric deferral balances of the Washington jurisdiction from January 2001 through December 2003). Mr. Norwood explained the reasons for this increase in the deferral balance:

> The dramatic increase in the deferred balance of $109 million (Washington jurisdiction) at June 30, 2001, to $198 million (Washington jurisdiction) at December 31, 2001 is driven primarily by purchases at high prices in the short-term market to cover the deficiencies for July-December caused by the record low streamflow conditions for Avista. The Company chose to cover those deficiencies in advance through short-term fixed price contracts, among other measures, rather than risk the potential for even higher prices as the summer drew nearer.

Witness Norwood further testified that year-end deferral balances for 2001 are based on "firm contractual commitments":

> The decision to cover those deficiencies in advance was based on the recent volatility in market prices, the warnings of impending rolling blackouts in California, the persistent refusal of federal policy-makers to mitigate market prices, and the continuing deterioration of hydroelectric generation conditions. Therefore, the costs included in the deferral estimates for July through December 2001 are costs for which the Company has already made firm contractual commitments.

(Exh. 100-T, p. 8, ll. 10-17).

C. AVISTA HAS TAKEN STEPS TO MITIGATE THE INCREASED POWER COSTS

The Company has taken a number of steps to mitigate the increased power costs, including the increased operation of its thermal resources, locking in fixed-price purchases in the prior year, and aggressively pursuing conservation and load curtailment programs. (Exh. 100-T, p. 9, ll. 18-23). As testified to by Mr. Norwood, the benefits from these measures has caused the net increase in the deferral balance during 2001, of approximately $230 million on a system basis, to be well below what would have otherwise been a gross increase in cost of approximately $400 million. (Id. at p. 9, ll. 8-23)[4]

The Company took a variety of measures to mitigate the Company's price exposure in the face of very high and volatile power prices in the forward market. Included among the measures are the following:

1. Communication of Market Conditions and Conservation Messages to Customers.

The Company undertook a very aggressive, and ultimately effective, media campaign aimed at communicating the challenges facing the Northwest and the need for conservation. Indeed, in a mid-June survey 87% of Avista's customers recalled seeing Company advertising regarding conservation, and 73% of those customers said that they had taken some action to reduce energy use as a result of the advertising messages. (Exh. 100-T, p. 14, ll. 15-21). As a result, loads through June of 2001 were 25 aMW below pro forma loads (i.e., in the Company's last general rate case) and were 53 aMW below loads forecasted by the Company for the same period. This correlates directly into a reduction in the amount of energy that Avista would have otherwise had to purchase from the short-term market,

---

[4] The combination of hydroelectric impacts and short-term purchases at higher market prices by the Company for the year 2001 represents a gross increase in energy-related costs of approximately $400 million on a system basis; by way of comparison, this exceeds Avista's annual gross retail electric revenues on a system basis of approximately $360 million. (Exh. 100-T, p. 9, ll. 14-17).

with an estimated reduction in the deferral balance of approximately $26 million on a system basis. (Id., p. 15, ll. 1-4).

2. Implementation of Retail Buy-Back Tariffs.

With Commission approval, the Company implemented three separate "buy-back" programs: the industrial buy-back program (see Schedule 70-R) allowed the Company to pay its Schedule 25 large-load customers to curtail all or a portion of their load; the irrigation buy-back program (Schedule 70-S) is applicable to pumping service customers under Tariff Schedules 31 and 32; and finally the "all-customer buy-back" program (Schedule 92) allowed Avista to pay participating customers up to 5 cents/KWh for the curtailment of energy. (Exh. 100-T, p. 15, l. 10 - p. 16, l. 16).

3. Short-Term Fixed Price Electricity Purchases.

The Company purchased forward electricity contracts in the latter part of 2000 to serve load obligations in 2001, in order to reduce exposure to further increases in short-term market prices. (Id., p. 16, l. 20 - p. 17, l. 7).

4. Permit Modifications for Rathdrum and 2001 Forward Natural Gas Purchases.

The Company filed with pollution control authorities to extend the hours of operation for the Rathdrum turbine; had it not done so, Avista would have had to shut the units down once the operating hour limit was reached. Moreover, the Company made forward natural gas purchases at fixed prices to cover quantities necessary to operate the Rathdrum turbines during 2001. Therefore, increased operation of Rathdrum to cover hydroelectric generation deficiencies and the purchases of gas in advance served to limit the exposure to higher prices. (Id., p. 18, ll. 1-6)

5. Delayed Delivery of Exchange Power Under the WNP #3 Settlement Agreement.

Under a provision of the WNP-3 Agreement, the Bonneville Power Administration (BPA) called on over 200,000 MWh of energy for the months of January - April and June 2001, to be provided by Avista at a price based on the operating costs of the Northeast Combustion Turbines. Through negotiations initiated by Avista, BPA agreed to delayed the delivery of energy until the fourth quarter of 2001, and relieve Avista of further obligations under the Settlement Agreement for the

2000/2001 operating year. At the time of the transaction, the estimated benefits inuring to customers by delaying the deliveries was $6.1 million. (Id., p. 18, ll. 11-19)

6. Exercise of Energy Storage Opportunities.

Avista took advantage of its rights under the Pacific Northwest Coordination Agreement to store energy in the federal hydro system through BPA. This enabled Avista to recall energy during periods when market prices were very high, thereby optimizing its own resources more effectively by taking advantage of the hourly scheduling flexibility of the energy returns. (Id., p. 19, ll. 6-16).

7. Granted Permission to Increase Operation of Northeast Combustion Turbines.

Under the existing air emissions permit for the Northeast Turbines, the units are allowed to run approximately 500 hours per year. On the initiative of the Company, Avista was able to successfully negotiate agreements that gave Avista permission to run the units for additional hours. The Company received permission to run the units for additional hours in August and September 2000, and beginning again February 21, 2001 and continuing through the Governor's Energy Supply Alert. (Id., p. 19, l. 20 - p. 20, l. 23) Avista is also in the process of installing new pollution control equipment to reduce emissions from the plant and increase operating hours from 500 hours annually to 3,000 hours of full operation. (Id, p. 21, ll. 11-16)

8. Acquisition of Small Generation Resources.

The Company initially selected a variety of projects and sites for up to 85 MW of generation that could be installed quickly and could run on natural gas, diesel fuel, or a combination thereof. These units are dispatchable and do not have to run if purchasing energy in the short-term market is less costly. As forward market prices declined, the Company elected to cancel some of the projects, including the Othello diesel-fired turbine project. (Id., p. 22, ll. 4-22).

9. Resource Acquisition Under the RFP Process.

In the summer of 2000, Avista issued an RFP for approximately 300 MW of supply and received proposals by 23 parties representing a variety of measures, including market-supplied power, natural gas turbines, wind power and small hydroelectric power. Coyote Springs II was selected as the

best option. As testified to by Mr. Norwood, the addition of Coyote Springs II in mid-2002 will put Avista in a surplus condition for 2002 and 2003, further reducing the Company's exposure to the volatility of the market during this period. (Id., p. 23, ll. 4-12).

III. FINANCIAL EXIGENCIES REQUIRE THE NEED FOR IMMEDIATE RATE RELIEF

Through the testimonies of Company witnesses Ely, Eliassen, and Peterson, the Company explained why immediate rate relief is imperative, not only for credit rating purposes, but also in order to position the Company to issue common equity in the future and to otherwise complete financing of the Coyote Springs II generating project.

A. IMPACT ON CREDIT RATINGS.

As testified to by Mr. Peterson, if a surcharge is not approved, as requested by the Company, it is "highly likely that there will be a significant downgrade of the Company's credit ratings." (Exh. 200-T, p. 7, ll. 15-16). Exhibit 201, at p. 3, is Moody's news release issuing on July 26, 2001 in which Moody's stated:

> Fixed income investors should remain wary that, absent significant levels of support from regulators to implement the rate surcharges, Avista's cash flow would be subject to further extreme pressure and jeopardize its ability to finance its operations at a reasonable cost because of the heightened credit risk that would exist. Among the credit concerns would be Avista's potential inability to meet certain financial covenants in bank credit agreements, which would preclude access to bank funds. Under this scenario, the prospects for a precipitous downgrade of Avista's ratings would be highly likely. . . . Moody's believes that regulatory support for the surcharges requested would go a long way toward helping stabilize credit quality, subject to satisfactory prudence determinations expected to be dealt with as part of a base rate proceeding, later this year. Moody's also notes that regulatory support would improve Avista's ability to access both debt and equity capital at a reasonable cost. (Emphasis added)

(See also Exh. 200-T, p. 7, l. 19 - p. 8, l. 6).

Even more recently, Standard and Poor's lowered Avista ratings on August 2, 2001, and placed the Company on CreditWatch with negative implications. In its Release (Exh. 2), S&P stated:

> The ratings downgrade reflects the increasing business risk at subsidiary Avista Utilities, stemming from the continuation of significantly deteriorated hydro generation conditions, increasing financial risk resulting from mounting power-cost deferrals, and uncertainty regarding the outcome of the Company's recent filing for a rate surcharge with the Washington Utilities and Transportation Commission (WUTC) and the Idaho Public Utilities Commission (IPUC). The CreditWatch listing addresses the <u>potential for the assignment of speculative-grade ratings, unless the Company receives adequate relief in the form of a rate surcharge within the next few months, completes a proposed equity offering, and closes financing for the Coyote Springs 2 plant. Without these events, Avista's liquidity may be compromised and ratings will be further lowered</u>. . . . Avista's financial profile has weakened over the past 18 months, as internally generated funds have been inadequate to fund capital spending and purchased-power costs, leading to credit protection measures that remain very weak for the rating category. (Emphasis added).

Mr. Peterson, on behalf of the Company, also sponsored Exh. 201, which shows Avista's credit rating history for secured and unsecured debt; this Exhibit shows that ratios have been deteriorating and, without additional equity financing and improved cash flows from operations, projected 2001 financial indicators as shown in this Exhibit are not adequate to maintain investment grade (BBB) credit ratings. (Exh. 200-T, p. 8, ll. 15-18).

Mr. Peterson described in his testimony the consequences of falling below an "investment grade" rating:

> Institutional investors such as pension fund managers are much less likely to purchase securities (in fact, some are legally precluded) with ratings below investment grade. As a result, a drop to below investment grade would have a significant impact on the Company and its customers by causing a substantial increase in borrowing costs (or in a worst case scenario, the Company may not be able to issue securities at all) to finance the business. . . . It is imperative that the Company be able to obtain financing for new base load resources such as Coyote Springs II, which will be an integral part of the resources needed to serve the Company's load obligations. The Company also needs to issue common stock to move financial ratios toward a level that provides a credit rating that will allow the Company to complete financing when needed and at a reasonable cost.

(Exh. 200-T, p. 8, ll. 20 - p. 9, l. 9).

B. SURCHARGE RELIEF IS NECESSARY IN ORDER TO ISSUE COMMON EQUITY.

As indicated above in the S&P Release (Exh. 2, supra), the Company must receive adequate surcharge relief within the next few months, complete a proposed equity offering, and must close the financing for the Coyote Springs II plant. Absent these events, Avista's liquidity "may be compromised and ratings will be further lowered." (Id.). However, as testified to by Mr. Peterson, financial advisors have told the Company that projections showing that Avista may be unable to borrow under its bank credit lines will "make it very difficult, if not impossible, to sell common stock at a reasonable price and in the time period the Company had planned." (Exh. 200-T, p. 7, ll. 4-12). As further explained by Mr. Peterson, and as underscored by S&P, access to additional common equity is an "integral part" of the financing plans that will enable Avista to operate effectively and to have access to debt markets (which requires the Company to issue common stock so that its debt-to-equity ratio remains balanced). (Id.)

C. SURCHARGE RELIEF IS ALSO NECESSARY IN ORDER TO COMPLETE THE FINANCING OF THE COYOTE SPRINGS II PLANT

Since deferral balances have continued to grow, banks have told Avista that they will not complete the construction financing of Coyote Springs II based on the Company's current credit risk. (Exh. 200-T, p. 6, ll. 1-4). Mr. Peterson, who on behalf of the Company has been very active in trying to secure necessary financing for Coyote Springs, captured the financial predicament of the Company in its testimony:

> Absent the construction financing for Coyote Springs II, the Company would need to borrow significant amounts under the corporate credit facility to finance Coyote Springs II. However, based on current projections for the bank line covenants, without the construction financing for Coyote Springs II, the company would be precluded from borrowing under the credit facilities since it would not meet the coverage tests. Given the latest projections, the Company will not be able to obtain conventional construction

> financing for this project from commercial banks without the assurance of near-term cash recovery of deferred energy costs.

(Exh. 200-T, p. 6, ll. 8-15).

However, as testified to by Company witness Eliassen, with the requested surcharge, which would allow the Company to begin recovery of the deferral balances over a reasonable period of time, the Company would be able to continue to access capital to meet its obligations and discharge its service obligations to its customers. (See Exh. 150-T, p. 2, l. 20 - p. 3, l. 1).

D. SURCHARGE RELIEF IS NECESSARY FOR THE COMPANY TO MEET ITS BANK COVENANTS.

The Company, through Mr. Peterson, sponsored testimony and exhibits showing projected ratios under the current bank line covenants, demonstrating that without the proceeds from the anticipated sale of common stock and the Coyote Springs II construction loan, the Company would be in violation of covenants under this line of credit, (i.e., the fixed charge ratio) by September 30 of this year, and would continue to be in violation throughout 2002. (See Exh. 200-T, p. 2, ll. 1-3) This would constitute an event of default under the current credit agreement and would eliminate an important source of liquidity the Company needs to fund expenditures on a current basis. (Id.)

These corporate credit facility covenants were based on projections developed in early May of 2001 which, at the time, showed that the deferral balances would be virtually recovered by February of 2003, which corresponded with the original Settlement Stipulation in Washington. That plan, however, assumed completion of the Coyote Springs II financing and the issuance of common stock in 2001, in order for the Company to meet its covenants. (Id. at p. 2, ll. 17-22). As explained by Mr. Peterson, there is a direct impact on customers, if the Company fails to meet its covenants:

> In the absence of a surcharge or other increased revenue mechanism, the Company is unable to generate enough cash to continue to operate the Company, including funding committed power purchases, constructing planned power resources and other facilities, and meeting our various cash requirements for debt service. In this case, the

> Company's ability to operate and acquire power in the future would be hampered, which would ultimately impact the cost to provide service to our customers.

(Id. at p. 4, ll. 2-7).

E. SURCHARGE RELIEF IS CRITICAL IN MEETING THE COMPANY'S FINANCING NEEDS.

As explained above, Avista has needs for funding of not only Coyote Springs II, but also a number of small generation projects, as well as for normal capital construction and funding conservation programs, and in order to repay maturing securities. Mr. Eliassen testified that current estimates show that, without a surcharge, utility financing needs will total $434 million from now until the end of 2002, primarily to fund energy costs, required utility construction (including generation projects) and to cover debt and preferred stock maturities. (Exh. 150-T, p. 6, l. 18 - p. 7, l. 2). Moreover, in the 2003 to 2005 time frame, the Company will continue to need to gain access to capital markets to fund ongoing construction requirements and to refinance maturing obligations. (Id.)

Approval of a surcharge is not only critical to improve the Company's cash flow – a basic indicator of the Company's financial health – but will also provide an important "signal to the financial community," as testified to by Mr. Eliassen:

> Approval of a surcharge will not only provide needed cash flows, but, just as important, will be a signal to the financial community that the Commission will continue to take prompt actions to support the financial health of the Company. Commission support and action through a surcharge is critical to enable a Company to complete financing needed for continued utility operations and to help mitigate potential reductions in credit ratings.

(Id. at p. 7, ll. 9-14).[5]

---

[5] If the full impact of the deferral balance was reflected in income by amortizing the projected balance in the deferral account over 27 months (October 2001 through December 2003) with no revenue offset, Avista's normalized Washington electric rate of return would be a negative zero point five percent (-0.5%) over the amortization period. (Exh. 150-T, p. 8, ll. 1-9).

Staff's recommendations, in this proceeding, include the assumption that "Avista is able to finance the Coyote Springs II plant and that Avista successfully issues $67,600,000 of common stock in the remainder of 2001." (Schooley Testimony, Exh. 401-T, p. 20, ll. 1-7). Staff, however, has proposed "conditions" to be attached to the surcharge that, if adopted by the Commission, would likely prevent the Company from completing these financings. (See discussion, infra, in Section V).

As explained by Mr. Eliassen, the Company's ability to finance the Coyote Springs II plant and to issue common stock on any reasonable terms is contingent upon a plan to begin recovery of the deferral balance over a reasonable period of time, through the surcharge proposed by the Company. (Exh. 150-T, p. 10, l. 17 - pp. 11-12). The investment community has continued to stress its reluctance in providing additional funding without a regulatory decision that provides cash flow to cover power costs and to reduce, and ultimately eliminate, the deferred power cost. (Id.) Therefore, Mr. Schooley's "assumptions" concerning issuance of new equity and financing of Coyote Springs II are valid only if the Company is granted the proposed surcharge without the conditions recommended by Staff. (Id.)

F. DEFERRAL BALANCES MUST BE RECOVERED OVER A RELATIVELY SHORT PERIOD OF TIME.

The Company has proposed to apply the surcharge over a 27 month period ending at year-end 2003. Mr. Eliassen explained in his testimony why it would not be possible to amortize the deferral balance over a longer period of time. (Exh. 150-T, p. 11, ll. 3-19) According to Mr. Eliassen, the Company must quickly reduce the deferral balances to a reasonable level. Under what the Company proposes, the deferral balance would be approximately $62 million at year-end 2002 and would be zero by year-end 2003. Mr. Eliassen stated that:

> The Company is not in a position to extend the recovery beyond 2003 since we must continue to strengthen the Company financially to continue to have access to capital markets throughout this period. There will be the continuing need to improve our credit, generate adequate cash to fund utility construction, and plan for any additional resources that may be required.

(Id. at p. 11, ll. 8-13).[6]

The proposed 27-month recovery period (through December 2003) attempts to balance the overall rate impact to customers against the need for timely cash flow improvement related to the deferred costs. As was explained by Company witness Falkner, a surcharge period shorter than December 2003, but providing full recovery, would improve the financial health of the Company sooner, but would result in significantly higher surcharge rate increases. (Exh. 250-T, p. 4, ll. 20-22).

The Company is also proposing to reduce the level of the surcharge in other ways. As explained by Company Witness Falkner, the Company is proposing to accelerate the amortization of the PGE balance in order to reduce the deferred power cost balance by $53.8 million by December 31, 2002. (Exh. 250-T, p. 6, ll. 11-24).[7] Had the Company not proposed to accelerate the amortization of the PGE credit, the overall surcharge increase to customers would have been approximately 48% – rather than the Company's proposed 36.9% increase. (Id. at p. 7, ll. 21-24)

Finally, the impact of the rate increase to residential customers from the surcharge will be moderated somewhat by the Residential Exchange Credit recently approved by the Commission. Pursuant to the BPA Residential Exchange Program, the Company made a tariff filing in Docket No. UE-011143 to pass the estimate annual benefit through to its residential and small farm customers. This

---

[6] In addition to other measures to mitigate the impact of the deferrals, as discussed in Section II. C. above, the Company has also attempted to save cash in other ways. As testified to by Mr. Ely and Mr. Eliassen, the Company has implemented budget cuts and other cash-saving measures, has initiated a hiring freeze, and has looked for alternative financing means to minimize Company investment. (Exh. 50-T, p. 8, ll. 16-26) While important, these initiatives are not sufficient in and of themselves to satisfy the cash flow shortfalls that are caused by the deferred power costs. (Id.)

[7] In the Company's most recent general rate case, the Commission made an adjustment for what it characterized as "PGE Contract Test Year Buydown Funds," reflecting the monetization of a long term capacity contract with PGE. Accordingly, the Company is currently amortizing a portion of this PGE monetization balance over a multi-year period. The Company, however, is proposing in this proceeding to accelerate the amortization of the PGE credit balance and apply the increased amortization against the deferred power cost balance, in order to reduce the amount of deferred power cost to be collected by means of the surcharge. (Exh. 250-T, p. 6, ll. 11-19).

decrease amounts to approximately 7.7% for a residential customer using 1,000 KWh hours per month. (Exh. 300-T, p. 4, ll.16-22)

IV. EVIDENCE OF RECORD DEMONSTRATES THAT THE COMPANY HAS SATISFIED THE CRITERIA FOR EMERGENCY OR INTERIM RATE RELIEF

Whether this case is processed under the "interim" standards previously enunciated by this Commission, or whether this case is otherwise characterized as a surcharge proceeding, the end result is the same: the Company has provided compelling evidence, through testimony, exhibits, discovery and hearings, demonstrating financial need for rate relief pursuant to a plan that would provide reassurance to the investment community. Staff Witness Elgin, on cross-examination, acknowledged that the case "should be processed under the Commission's standard to broadly regulate in the public interest and provide sufficient revenues for a company to solve its problems related to the power supply issues that are on its balance sheet and get to a general rate case. . ." (Tr. Vol. VI, p. 587, ll. 10-19)

The Commission articulated standards for interim relate relief in WUTC v. Pacific Northwest Bell Telephone Co., Cause No. U-72-30, Second Supplemental Order Denying Petition for Emergency Rate Relief (October 1972) (hereinafter "Pacific Northwest Bell"). The evidence of record clearly demonstrates that the Company has satisfied these criteria. For its part, Staff also concludes that emergency rate relief is required based on the interim relief standards; according to Staff Witness Schooley, based on his analysis of these standards, "Avista shows an immediate need for rate relief," prompting Staff to recommend a rate increase of 32.6%. (Exh. 401-T, p. 23, ll. 4-6).

(1) The Commission has authority under proper circumstances to grant interim rate relief to a utility, but this should be done only after an opportunity for adequate hearing.

In this case there has been an opportunity for all parties to submit testimony, to conduct cross examination, and to present their positions. In addition, public hearings have been conducted to receive further comment.

(2) An interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity.

The Company has satisfied this requirement, demonstrating that without a surcharge, "gross hardship or gross inequity" would occur, depriving Avista of the capital necessary to meet its public service obligations. The financial impacts chronicled in Section III and elsewhere of this Post-Hearing Brief demonstrate that, absent a surcharge, credit ratings would be negatively impacted, the Company may not be able to issue necessary common stock or complete financing for the construction of the Coyote Springs II generating plant. Accordingly, without surcharge relief, the Company and, more importantly, its customers would experience gross hardship and gross inequity. For its part, Staff also acknowledges that the Company has difficulty complying with liquidity conditions under applicable financial ratio covenants. (Exh. 401-T, p. 12, ll. 17-21).

(3) The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient, standing alone, to justify the granting of interim relief.

The Company is not predicating its application for surcharge relief solely on the basis of an inadequate rate of return; instead, rate relief is necessary for the Company to address its financial needs, preserve its credit and its access to capital markets under reasonable terms, cover day-to-day operating costs, and finally, to complete financing of generating projects, including the Coyote Springs plant.

Witness Schooley also agrees that this criterion has been satisfied. He noted that Avista's latest Commission-Basis Report (Docket No. UE-010690 for the period ending December 31, 2000) shows an actual return on rate base of -0.7% and a normalized return on rate base of 4.8%; these amounts are significantly below the return on rate base allowed in the latest rate case, Docket No. UE-991606. (Exh. 401-T, p. 13, ll. 2-10). He further observed that if the deferred power costs were reflected in results of operations by recording them as an expense, the "returns on rate base would be even lower." (Id.)

(4) The Commission should review all financial indices as they concern the applicant, including rate of return, interest coverage, earnings coverage and the growth, stability or deterioration of each, together with the immediate and short term demands for new financing and whether the grant or

failure to grant interim relief will have such an effect on the financing demands as to substantially affect the public interest.

Again, the testimony of record, as summarized in Section III of this brief, addresses the "financial indices" discussed in this standard. The testimony of Mr. Peterson discusses interest coverages and earnings coverages, both with and without surcharge rate relief, and the ability of the Company to meet its existing loan covenants, without which it cannot finance ongoing operations. Mr. Peterson's testimony, together with that of Mr. Eliassen, discusses the immediate demands for new financing, in order to address deferral balances, fund ongoing operations, and construct new generating plant, and how the absence of surcharge relief will impair the Company's ability to discharge its public service obligations. Simply put, failure to grant the necessary surcharge relief will substantially affect – in an adverse way — the public interest.[8]

Based on Staff's analysis, "Avista has immediate and short term demands for new financing upwards of $200 million . . . during the remainder of 2001." (Exh. 401-T, p. 14, ll. 6-8). Moreover, Staff discussed the requirement for Avista to meet certain fixed charge coverages under its covenants in the April 2001 bond issuance. Indeed, Staff acknowledges that the covenants in the recent financings require forward looking coverage estimates. According to Staff Witness Schooley:

> Avista's evidence shows a serious decline by the third quarter of this year with negative cash flow and an inability to cover its fixed interest charges. The trend improves over the next several quarters, but not to the point of meeting the fixed charge coverages required.

---

[8] See also WUTC v. Washington Natural Gas, Cause No. U-80-111 (March 1981), where the Commission concluded that the Company would continue to "experience a downward trend in its financial situation, and without immediate rate relief will not be able to raise sufficient capital from external sources to finance its 1981 construction projects." Moreover, the Commission has noted, in other contexts, that "the public interest would not be served by the Company's inability to obtain reasonable debt and equity financing . . . and such reasonable financing does not appear possible absent an immediate rate adjustment." WUTC v. Cascade Natural Gas Co., Cause No. U-74-20 (July 1974).

(Exh. 401-T, p. 18, ll. 3-6). In fact, Staff's analysis of changing hydro-generation assumptions and their impact on financial ratios demonstrated that all the scenarios examined produced "a shortfall in this covenant requirement [i.e., the required fixed charge coverage ratio of 1.25]." (Id. at p. 19, ll. 11-13). According to Staff, an increase of 32.6% over current revenues is required in order to bring the fixed charge coverage ratio to the required level of 1.25, from the projected December level of a negative 2.42. (Id. at. p. 20, ll. 1-7). All of this prompted Staff to conclude that "Avista needs cash from its utility operations in the very near future." (Id. at p. 20, ll. 13-15).

Even Witness Thornton, on behalf of ICNU and Public Counsel, agrees that the Commission could grant, as an option, some level of interim rate relief "targeting the same fixed charge ratio the Company used to demonstrate its financial distress." (See Exh. 601-T, p. 14, ll. 9-12). Mr. Thornton indicated that the Commission "might consider a lesser surcharge that is expected to result in meeting the minimum required fixed charge coverage ratios," although he professed that he had not "calculated what amount of increased revenue requirement would result in meeting the minimum fixed coverage ratios . . ." (Id. at p. 14, ll. 18-21). In fact, Staff Witness Schooley did just that — i.e., as shown above, he examined the level of cash needed to bring the fixed charge ratio coverage up to the required level of 1.25, from its existing projected December level of a negative 2.42, and Mr. Schooley concluded that this — standing alone — would require a 32.6% increase over current revenues. (Exh. 401-T, p. 20, ll. 1-7). Moreover, even Mr. Schooley's analysis assumed: (a) that Avista is otherwise able to finance the Coyote Springs II plant; and (b) that Avista is able to issue $67,600,000 of common stock in the remainder of 2001. (Id.)

(5) In the current economic climate, the financial health of a utility may decline very swiftly and interim relief stands as a useful tool in an appropriate case to stay off impending disaster. However, this tool must be used with caution and applied only in a case where not to grant would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders. That is not to say that interim relief should it be granted only after disaster has struck or is imminent, but neither should it be granted in any case where full hearings can be had and the general case resolved without clear detriment to the utility.

Accordingly, the Commission has recognized that interim rate relief should not be reserved only for those situations "after disaster has struck or is imminent"; rather, it is an appropriate remedy where one can reasonably anticipate serious consequences.[9] The credit warnings of Moody's and Standard & Poor's sound a clear warning concerning Avista's financial situation and the consequences of failure to obtain needed surcharge relief. Neither the Company nor its customers will benefit from the potential of speculative-grade ratings, either in terms of the Company's access to necessary capital or the cost thereof. The "clear jeopardy" to the utility and its customers, absent surcharge relief, should be apparent. Reasonable access to capital on reasonable terms to fund necessary activities to meet customer needs is at stake. Here again, Staff concluded that without significant additional revenue, Avista would not meet certain financial covenants. (Exh. 401-T, p. 21, ll. 12-16).

> (6) Finally, as in all matters, we must reach our conclusions with the statutory charge to the Commission in mind, that is to "regulate in the public interest" (RCW 80.01.040). This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all salient factors.

In this proceeding, all that Avista asks is that "reasoned judgment" take into consideration the "salient factors": Avista has incurred substantial deferred power costs in the discharge of its public service obligations, bringing financial pressures to bear that require immediate rate relief. The Company's need to cover its ongoing operating costs, construct additional generation, satisfy its bank covenants, and maintain its credit ratings all argue strongly for surcharge relief.

When Staff examined whether failure to grant immediate rate relief would cause "gross hardship or gross inequity," it acknowledged that "if investors are unwilling to provide funds, Avista may not be able to adequately invest in the infrastructure needed to serve those same customers," or may "only be able to issue debt at a higher interest level." (See Testimony of Schooley, Exh. 401-T, p. 22, ll. 11-16). These circumstances will surely inure to the detriment of customers.

Public Counsel seems to suggest that the Company's position is no worse off now than it was in the early 1980s when it requested interim rate relief. (Tr. Vol. V, p. 256, ll.12-15) That view is simply

---

[9] See WUTC v. Washington Water Power, Cause No. U-77-53 (September 1977).

wrong. According to Mr. Eliassen, the Company's financial condition is "significantly worse today" than it was at the time of the interim rate relief request in 1983.[10] (Tr. Vol. V, p. 256, ll. 12-15). Mr. Eliassen went on to explain that in the early to mid-1980s, the Company's total equity prior to the write-off of WNP 3 was in the range of $480 million; this should be compared with the Company's total equity today associated with the utility business (electric and gas) of less than $400 million. (Tr. Vol. VI, p. 736, ll. 6-20). If the Company had to write off $185 million of deferred power costs (reflecting end of September, 2001 balances), the Company would "have less than $200 million of equity left in the regulated business supporting our entire utility business for Washington and Idaho." (Id.) Therefore, the Company is not nearly as strong today in terms of the equity position it maintains within the utility, recognizing, as well, that the net utility assets today are only $400 to $500 million greater than in the early 1980s. (Id.).[11]

V. STAFF'S RECOMMENDED "CONDITIONS" FOR SURCHARGE APPROVAL WILL NOT ALLOW THE SURCHARGE TO ACCOMPLISH ITS INTENDED OBJECTIVE

A. "CONDITIONS" PROPOSED BY STAFF

---

[10] In fact, the Company's debt ratio in 1982 was 49.1% (Exhibit 155) as compared to the estimated debt ratio in 2001, without a surcharge, of 59.8% (Exhibit 201, p. 2). Furthermore, the pre-tax interest coverage was 2.89 in 1982 versus 1.59 estimated for 2001 (including AFUDC), and 2.39 versus 1.49, respectively, excluding AFUDC. (Id.)

[11] Public Counsel apparently seeks to contrast Avista's present need for rate relief with the Company's need for relief in the early 1980s, when the Commission denied interim rate relief to the Washington Water Power Company in Cause No. U-83-26. (See Fourth Supplemental Order (Cause No. U-83-26) issuing on October 17, 1983.) In that proceeding, the Company had filed a request for interim rate relief to correspond with the in-service date of the Kettle Falls Project (a 42 MW wood-waste fired generation plant). The Petition for Relief was filed on September 2, 1983, in order to have such relief coincide with the commercial service date in October of 1983. The Commission, in rejecting the Company's request for interim rate relief in that proceeding, believed that prudence issues unique to the Kettle Falls plant should be taken up in the context of a general rate proceeding. The Commission did not otherwise make findings with respect to whether or not the financial indices of the Company warranted interim relief.

Staff has proposed to attach a number of conditions to the rate relief that should be granted. Staff contends that: (1) the deferred accounting treatment previously authorized for power supply expenses should terminate effective June 30, 2001; (2) that the surcharge relief should only continue for a period of ninety days, unless the Company petitions to extend it; (3) that any revenues collected under the emergency rate relief should not be credited against the deferral balance; and (4) that Avista should be directed to file by September 17, 2001, a new direct case on the so-called Phase II issues, if it does not otherwise wish to rely on its previous evidence submitted on March 23, 2001, and should otherwise be directed to file a general rate case by September 28, 2001. (See Exh. 451-T, p. 13, ll. 16-23).

Simply put, these conditions would defeat the very purpose of the Company's request for surcharge relief — namely, to improve the Company's financial situation in a manner that reassures the investment community, thereby providing the Company with a means to gain access to capital on reasonable terms to fund the ongoing operations of the Company. As expressed by Mr. Ely, "in our view — a view that I believe is shared by members of the financial community — Staff has proposed conditions which effectively negate what would otherwise have represented a necessary step in resolving the extraordinary, emergency situation faced by Avista." (Exh. 51-T, p. 1, ll. 12-14). Mr. Ely testified, "in the strongest terms," that the surcharge, without the conditions proposed by Staff, is necessary for the Company to issue new equity financing and to complete financing for Coyote Springs II. (Id. at p. 1, ll. 20-23). With Staff's conditions, however, the Company, according to Mr. Ely, would "not be able to access capital at reasonable terms to fund the ongoing operations of the Company." (Id. at ll. 24-26). Moreover, this inability to access capital at reasonable terms "would likely lead to a drop in Avista's credit rating to below investment grade, which would result in adverse impacts to the Company, our customers and our investors," all as testified to by Mr. Ely. (Id. at p. 2, ll. 1-6). Accordingly, attaching the conditions proposed by Staff to even a 36.9% rate increase, in the final analysis, would not allow the rate increase to achieve its intended purpose.

B. IT IS IMPERATIVE THAT THE DEFERRED ACCOUNTING MECHANISM CONTINUE BEYOND JUNE 30, 2001.

The Company simply seeks to "preserve" the issue of cost recovery for later determination, by means of a continuation of the deferred accounting mechanism beyond June 30, 2001. It is clear to all that any revenues collected are subject to refund in the event that a subsequent prudence determination results in a disallowance of any portion of the costs.

Staff's proposal to eliminate the deferred accounting mechanism, effective June 30, 2001, would, as explained by Mr. Ely, "preclude future consideration by the Commission of the possible recovery of $74 million of expenses, during the months of July-September alone, that the Company believes were prudently incurred to meet its load requirements under the extraordinary hydro and market conditions being faced by the Company." (Exh. 51-T, p. 3, ll. 7-11). Staff's position to terminate the deferred accounting mechanism on June 30, 2001, could, therefore, conceivably require the Company to write-off (i.e., "expense") all deferred energy costs subsequent to June 30, 2001; a write-off of this magnitude would preclude Avista from issuing equity and quite possibly additional debt. (Exh. 51-T, p. 4, ll. 3-10).

Mr. Eliassen addressed this issue from the perspective of the financial community. After noting that the Company's "lead commercial bank" has informed Avista that its "regulatory risk has increased exponentially," based on the Staff testimony, Mr. Eliassen went on to observe:

> This reaction on the part of our lead bank was based, in part, on the Staff recommendation to end the deferral of energy costs effective June 30, 2001. In the opinion of the bankers, this would require the Company to write-off all deferred energy costs incurred since June 30, 2001. From the months of July, August and September alone, these costs are expected to exceed $74 million. Our banks have informed us that, in their opinion, we will be unable to issue equity and probably will be unable to issue additional debt, given the risk that a write-off of this magnitude could occur. Our commercial banks believe that unless this issue is clearly resolved in the surcharge order, the Company will be unable to access any financing.

(Exh. 152-T, p. 3, ll. 1-8). Moreover, according to Mr. Eliassen, the reaction among other members of the investment community has "been quite uniform," leading to "heightened lender concerns that energy costs incurred by the Company to meet system load requirements would continue to mount and might

not be recovered." (Id. at p. 3, ll. 15-18). These same banks are unwilling to take the risk of financing ongoing operations or the capital construction budget, including the Coyote Springs project, unless the Company's financial condition improves. (Id. at p. 3, ll. 18-21). The $74 million of deferrals for July through September 2001 alone, represents 31% of the Company's gross annual retail revenue in the Washington jurisdiction. (Exh. 107-T, p. 2, ll. 2-3). As explained by Mr. Norwood, most of these costs are already known because of the commitments made to purchase power at fixed prices to replace the lost hydroelectric generation; the level of these costs are driven primarily by record low hydroelectric conditions and unprecedented high wholesale market prices. (Id. at p. 2, ll. 3-6).

It is imperative that the deferred accounting treatment remain in place beyond June 30, 2001, in order to provide the opportunity to recover deferred costs.[12] Interestingly enough, Staff has in the past criticized the Company for failing to obtain a deferred accounting order for the purpose of preserving for later consideration the recoverability of extraordinary expenses. In the Company's most recent general rate case, the Commission disallowed the 1991 Firestorm and 1996 Ice Storm adjustments, based on Staff recommendations, and noted that "Avista did not seek timely accounting orders for either event." (See Third Supplemental Order in Docket No. UE-991606 at p. 57, ¶ 207.)[13]

---

[12] The 27-month period ending December 31, 2003, was chosen to provide recovery of the deferred costs over a reasonable period of time, while also reducing the overall impact on customers, as compared to a shorter recovery period. It also provides the opportunity to capture the continuing extraordinary costs, while providing the opportunity for power cost offsets to the deferral balance during the same period. Finally, this 27-month recovery period provides a "plan" for the financial community as to how the deferred costs would be reduced to zero. (Exh. 107-T, p. 3, ll. 14-22).

[13] Staff Witness Schooley in his testimony opposing the Company's request for recovery of extraordinary storm damage costs in Docket No. UE-991606 criticized the Company for failing to establish an accounting basis for later recovery for these costs:

> Q. Did WWP or Avista attempt to establish an accounting basis for later recovery of this cost?
>
> A. No. No accounting petitions were filed to capitalize this expense for later recovery. It is only now, three years after the fact, that the Company presents a means to increase rates because of this expense.

Among Staff Witness Elgin's reasons for terminating the deferral mechanism was to send a signal to "firmly reiterate that Avista does not have an approved Power Cost Adjustment Mechanism (PCAM)." (See Exh. 451-T, pp. 21-22). The Company, and its investors and bankers, are already aware that a PCA mechanism is not now currently in place and that the Company may propose a PCA in its next general rate case filing this November. According to Mr. Norwood:

> A proposal to deprive the Company of the opportunity to show that over $74 million of power supply costs are extraordinary and were prudently incurred for the purpose of "reiterating" what is already clear to the Company and its investors, is completely without merit and unnecessarily exacerbates the very difficult financial situation facing Avista.

(Exh. 107-T, p. 3, ll. 4-8).

Upon further examination, Staff Witness Elgin acknowledged that not all elements of the Staff case were necessary to adopt as a package; rather, of the various elements, the Staff proposal to terminate the deferral accounting in June 2001 could be put to one side. (Tr. p. 648, ll. 10-25) In the words of Mr. Elgin, "I think that you could safely continue the deferral," but recognize that the deferral balance will continue to grow bigger. (Id.)

In summary, the Company urges the Commission to soundly reject Staff's recommendation to terminate the deferred accounting mechanism on June 30, 2001. The Company has proposed that, at the conclusion of the November 2001 general rate case, the Company would modify the surcharge amount and the duration of the surcharge rate, if needed, in order to reflect the outcome of the general rate case. Accordingly, all parties will have the opportunity in the general rate case to address both the duration and the amount of the surcharge. (See Exh. 51-T, p. 4, ll. 12-18).

(Exh. 107-T, p. 2, ll. 13-17)

C. STAFF'S PROPOSAL TO LIMIT THE DURATION OF THE SURCHARGE TO 90 DAYS PROVIDES LITTLE BENEFIT.

Staff's proposal to limit the duration of the surcharge to 90 days will, as stated by Mr. Ely, "simply not 'advance the ball' in the eyes of the financial community and does not provide necessary ongoing cash relief." (Exh. 51-T, p. 4, ll. 21-22). Nor does Staff's suggestion that the Company always has the option of seeking to continue emergency rate relief upon its expiration provide a meaningful alternative. As stated by Mr. Ely, the Company can "foresee no reasonable set of circumstances under which the Company would not be seeking to extend this surcharge relief were it scheduled to expire in 90 days." (Id. at p. 4, ll. 23-25). Surcharge relief is needed throughout the period contained within the Company's original proposal (through December 31, 2003). Because the Company will continue to need surcharge relief, the Company "would be right back before this Commission" literally within a month of its Order, with yet another petition to continue the rate relief. (Id. at p. 5, ll. 1-8). This timing would be required in order to provide the Commission and the parties with a sufficient opportunity to process the Company's renewed request for a surcharge relief before its scheduled termination in 90 days. Therefore, at the end of the day, the Commission and the parties in this proceeding will have, in the words of Mr. Ely, "accomplish very little," while creating "needless confusion and concern within the investment community, as well as with our customers." (Id. at p. 5, ll. 5-8). Therefore, surcharge relief should extend beyond any arbitrary 90 day period, remembering that any surcharge revenues collected will be subject to refund at the culmination of the Company's November general rate case. (Id. at p. 5, ll. 9-12).

As testified to by Company Witness Eliassen, a surcharge recovery period limited to 90 days, as proposed by Staff, would prevent the Company from accessing the equity markets, and quite possibly debt markets as well, inasmuch as it does not suggest a "plan" providing some reassurance of possible future recovery. (Tr. p. 321, ll. 2 - p. 322, ll. 10). For his part, Staff Witness Elgin

acknowledged that the Commission had, as an "option," to consider extending the surcharge beyond 90 days. (Tr. Vol. VI, p. 634, ll. 16-24).[14]

While it is true that the Company's proposed surcharge would only recover approximately $20 million prior to the end of this year, the Company's approach does represent a "plan" that will provide some reassurance to financial institutions. It is the existence of such a practical and viable "plan" — not simply a surcharge of limited duration, e.g., 90 days — that will provide the necessary signal, as testified to by Mr. Ely:

> . . . It gives them some assurance that there would be a plan. And its really the plan they're after, because the surcharge in and of itself only brings in about $20 million if it was approved in full on the 15th, only about $20 million between now and the end of year, which really doesn't go to solving the cash flow issues. But it allows the banks to step in and say then, you do have a plan, we do believe that you will be successful in carrying this through. (emphasis added)

(Tr. Vol. V, p. 189, l. 21 - p. 190, l. 5) The Company's proposed surcharge is the first step in order to allow the Company to implement other measures, such as the issuance of additional equity and the financing of Coyote Springs II. Whether viewed as the "first step" or as a "linchpin," the Company's proposal is critical.

Mr. Eliassen, on behalf of the Company, also stressed the need for a "plan" that provides the level of annual revenues requested by the Company. A plan with the conditions proposed by Staff and intervenors would not be sufficient.

D. STAFF'S REQUIREMENT THAT ANY REVENUES COLLECTED NOT BE CREDITED AGAINST THE DEFERRAL BALANCE DEFEATS THE VERY PURPOSE OF THE SURCHARGE COLLECTION.

---

[14] Moreover, Mr. Elgin acknowledged that, as a precautionary measure, he had not given "any consideration" to the Company's need to promptly refile a request for interim relief to allow the processing of such a filing before the expiration of the proposed 90 day surcharge period; he stated that he didn't "know what would be the appropriate thing to do in that circumstance." (Tr. Vol. VI, p. 568, ll. 11-13).

Staff has proposed that any revenues collected under the emergency rate relief be booked in Account 254, Other Regulatory Liabilities. (See Exh. 551-T, p. 2, ll. 12-15). Accordingly, these revenues would not be credited against the balance of the deferred power costs.

Such a proposal undermines one of the primary purposes of the surcharge — i.e., a reduction in the size of the deferral balance. As explained by Mr. Ely, Staff's "recommendation, taken as a whole means that customers would experience a 32.6% rate increase (even assuming Staff's proposal), but without otherwise providing the Company with the ability to meet its financing covenants." (Exh. 51-T, p. 5, ll, 16-25). Mr. Ely went on to observe that "if we are to increase rates substantially to our customers, it should, at least, accomplish its intended purpose of improving the financial standing of the Company in the eyes of the investment community." (Id.) Therefore, revenues collected from the surcharge should be directly applied to offset the deferral balance, and in doing so, will help the Company meet its covenant requirements.

As further explained by Company Witness Falkner, Staff has incorrectly assumed that recording the surcharge revenue in a deferred liability account provides an offset to the deferred power costs already on the balance sheet. (Exh. 252-T, p. 10, ll. 1-6). Essentially, as explained by Mr. Falkner, the additional liability to be recorded on the balance sheet under Staff's proposal essentially creates a "short term loan of 90 days," which is subject to refund. (Id.) The power cost deferral balance, itself, would not be directly offset in the process and, therefore, would not provide a measure of comfort to the financial community. (Id.) Creating a liability instead of crediting the surcharge revenue against the deferral balance does not assist with meeting financial covenants; instead it only complicates the existing accounting and provides investors with "no positive regulatory message for the Company in Washington," according to Mr. Falkner. (Id. at p. 10, ll. 9-13).

Company Witness Eliassen observed that Staff's proposal to book surcharge revenues as a liability would deprive the Company of the full benefits of the surcharge revenues:

> Cash by itself will reduce borrowings, money we would otherwise borrow. But cash that comes into the company that is used then to offset the deferral and amortize the

deferral gives us in effect a real benefit. It's an added benefit. Reduction of the deferrals is critical. (Emphasis added).

(Tr. Vol. V, p. 231, ll. 1-6). Moreover, insofar as deferrals are reduced, such cash can be counted for purposes of meeting the Company's covenant requirements. (Tr. Vol. V, p. 232, ll. 10-12). Simply put, the coverage test with respect to the applicable loan covenants is very specific in that it provides that, to the extent you reduce the deferrals, you can include that cash in the calculation of the coverage ratio, as testified to by Company Witness Peterson. (Tr. Vol. V, p. 294, l. 19 - p. 299, l. 3).

Moreover, guidance can be had from the proper application of Financial Accounting Standard (FAS) No. 5. As explained by Company Witness Falkner, the Company could only book surcharge revenues as a liability, as proposed by Staff, if it was probable that a refund would be ordered. (Tr. Vol. VI, p. 449, ll. 3-25). Stated differently, FAS 5 accounting for contingencies comes into play if one were to take the Staff approach and book 100% of the surcharge revenues as a liability. This would be permissible only if the Company had already made a determination that it would not be able to retain any of the surcharge revenues – i.e., that it presumed that such costs would ultimately be found imprudent. (Id.).

Finally, while Mr. Parvinen may take issue with Company Witness Peterson's interpretation of the applicable covenant language, it is well to remember that Mr. Peterson (not Mr. Parvinen) was the one involved in negotiating the covenant language, and it was Mr. Peterson (not Mr. Parvinen) that has been engaged in discussions with banks concerning whether or not the Staff's proposed accounting treatment would assist the Company in meeting the covenant. (Tr. Vol. VI, p. 309, l. 6 - p. 310, l. 6).

E. STAFF'S RECOMMENDATIONS REGARDING THE TIMING OF ANY PHASE II OR GENERAL RATE CASE FILINGS ARE IMPRACTICAL.

Finally, Staff urges that Avista should be directed to file by September 17, 2001, a new direct case on any Phase II issues (assuming it does not otherwise rely on its March 23, 2001 filing), and should otherwise be directed to file a general rate case by September 28, 2001. Neither recommendation would prove conducive to creating a sound record for this Commission's reasoned

decision-making in either Phase II or the next general rate case. First of all, with regard to a September 17, 2001, deadline for a Phase II proceeding, this would clearly not allow Avista the opportunity to adequately address the issues that would need to be covered in the prudence filing. Essentially, this deadline has already passed. Nor will it do to suggest, as does Staff, that the Company always has the option of simply relying on its March 23, 2001 prudence filing. As explained by Mr. Norwood, major changes in wholesale market conditions and hydroelectric generation have occurred since that filing. Indeed, the months with the largest deferral entries have occurred subsequent to that filing, (i.e., April, June and July-September). (Exh. 107-T, p. 4, ll. 10-16). It is therefore important that Avista be given the opportunity to update its prudence filing so that this updated information can appropriately be provided to the Commission. (Id.)

Staff's recommendation to file a general rate case by September 28, 2001, is also misguided. The Company has already proposed to file a general rate case in November 2001. Such a case would cover a broad range of power issues, and therefore, it is important that the Company have a reasonable period of time following this proceeding to complete that filing. As testified to by Mr. Norwood, these specific power supply issues would address, among other things, the prudence of the deferred power costs, the regulatory treatment of the Coyote Springs II project, and a long-term periodic power cost adjustment mechanism. (Exh. 107-T, p. 5, ll. 9-12).

While the Company is not otherwise opposed to two separate filings (Phase II and a general rate case), the Company's proposal for a single filing has merit, given the overlap of issues concerning wholesale market conditions (past, present and projected), hydroelectric generation, and variation of power costs from normal. (Id. at p. 6, ll. 8-12).

Nor could the Company have previously filed a general rate case last fall in order to anticipate and address the situation now facing the Company. Mr. Eliassen, when asked by Chairwoman Showalter whether the Company could have filed a rate case last fall that would have anticipated the worst hydro conditions of record, responded:

> . . . If we had filed last fall or even sometime even in the first quarter of this year, I don't think that anyone anticipated what was going to happen, one with hydro conditions and two with the level of deferrals that we have incurred . . ..

(Tr. Vol. V, p. 274, ll. 19-24).

F. ADOPTION OF STAFF'S PROPOSED CONDITIONS WOULD HAVE A NEGATIVE IMPACT ON AVISTA'S CREDIT RATINGS

Mr. Ely states it directly and succinctly, when he observes that, were the Commission to adopt Staff's condition or those of other parties, "it would significantly increase the possibility that Avista's credit rating would be downgraded to BB, which is below investment grade." (Exh. 51-T, p. 6, ll. 5-6). The Company has barely managed to maintain a BBB- with Standard and Poor's; any downgrade to a BB would, in the Company's view, "likely cause the Company to be unable to access capital under reasonable terms." (Id. at p. 6, ll. 7-11). The result would be that the Company may not be able to issue common stock or fund the construction of Coyote Springs II. (Id.)

Previously discussed, in this Brief, was S&P's August 2, 2001, release which lowered Avista Corp.'s ratings to BBB- on its senior unsecured debt, in which S&P identified various steps that would need to be taken in order to avoid a further lowering of ratings:

> The CreditWatch listing addresses the potential for the assignment of speculative-grade ratings, unless the Company receives adequate relief in the form of a rate surcharge within the next few months, completes a proposed equity offering, closes financing for the Coyote Springs II plant. Without these events, Avista's liquidity may be compromised and ratings will be lowered. (Emphasis added.)

(Exh. 2). S&P has described the steps the Company must take. However, a rate surcharge with the conditions proposed by Staff, "likely would not allow the Company to complete the other necessary steps, which include the proposed equity offering and the financing of Coyote Springs II," according to Mr. Ely. (Exh. 51-T, p. 7, ll. 8-13).

Mr. Eliassen, on rebuttal, also expands on the negative impacts of a further reduction in the Company's credit rating. Should a downgrade occur, the Company may be unable to access capital at

all and the operating costs of the Company "could increase dramatically." (Exh. 152-T, p. 4, l. 23 - p. 5, l. 2). Indeed, even the impact of the August 2, 2001, S&P rating downgrade was direct and immediate. According to Mr. Eliassen, several counterparties that the Company relies upon to provide short-term and real-time energy suspended their authority to transact business with Avista, absent prepayments or other credit terms. (Id. at p. 9, ll. 15-21). (See also Rebuttal Testimony of Mr. Norwood, Exh. 107-T, p. 12, l. 10 - p. 13, l. 4).

Mr. Eliassen was also emphatic that the Company would not be able to issue new equity if the Commission adopts Staff proposals. (Exh. 152-T, p. 5, ll. 5-17). In fact, Staff's recommendations may preclude the sale of debt securities as well. (Id.) According to Mr. Eliassen:

> . . . The positions taken by Staff to limit the duration of the surcharge to 90 days, and to preclude the Company from using the proceeds from the surcharge to reduce the deferral balance exacerbates the problem. Adding to those issues, the risk resulting from Mr. Elgin's proposals may cause the Company to write-off all deferred power costs incurred since July, or the risks created by Mr. Lott that would require us to write-off all of the deferred costs of providing service, results in a situation that makes it very difficult — if not impossible — to obtain any financing at this time.

(Id. at p. 5, ll. 8-15).

VI. OTHER RECOMMENDED OPTIONS WILL NOT SUPPLANT NEED FOR SURCHARGE RELIEF

Intervenors, in particular, have suggested a number of other options that might be considered along with, or in lieu of, surcharge relief. These options include the sale or possible sale and leaseback of the Coyote Springs II plant, the suspension of dividends, the sale of subsidiaries, etc.

First, with reference to the suggested sale of Coyote Springs II, it is well to note that this proceeding is not the proceeding in which the prudence of that project or its disposition is to be determined. Before the Coyote Springs II plant is disposed of, one should be mindful of the fact, as testified to by Mr. Ely, that the Coyote Springs plant remains one of the lowest cost long-term options for satisfying load, especially given the fact that the TransAlta contract goes away in December 2003,

with the result that the Company would be in the market for additional resources even with Coyote Springs II. (Tr. Vol. 5, p. 202, ll. 1-6)). Simply put, as testified to by Mr. Ely, the "Coyote Springs II is still the best new generation plant that is out on the market at this point to fill the needs that we have going forward." (Tr. Vol. V, p. 203, ll. 9-11). Moreover, as testified to by Mr. Norwood, the Coyote Springs II plant is especially valuable as a long term resource given its flexibility and dispatchability, when compared with the purchase of a flat commodity product. (Tr. Vol. V, p. 376, l. 16 - p. 377, l. 2). Indeed, even Staff acknowledges that selling Coyote Springs II may not be the "wisest thing to do nor are we in a proceeding that should determine that," as stated by Staff Witness Schooley. (Tr. Vol. VI, p. 657, ll.7-9).

Nor is the sale/leaseback of Coyote Springs II a viable option, given the financial position of the Company. Mr. Ely explained why the Company cannot currently do a sale/leaseback for Coyote Springs:

> Q. Have you investigated the potential for a sale/leaseback type transaction for Coyote Springs II?
>
> A. Yes, we have. The issue there is the same of trying to get financing for it. You become the creditor for that, and no one is willing to take our credit right now as far as being able to do a sale or leaseback.
>
> Q. But in that case, the plant asset itself would serve as a security, would it not?
>
> A. No, it wouldn't, because you have to have the offtake contract, and that offtake contract would be to the company, and the company therefore does not have the credit rating that they're willing to take.

(Tr. Vol. V, p. 157, ll. 1-12). For his part, Mr. Eliassen, of the Company, also testified that banks are unwilling to look at a sale/leaseback transaction involving projects such as Coyote Springs, where there is uncertainty surrounding the ability to raise rates or have the cash to provide credit support for ongoing payments. (Tr. Vol. V, p. 280, l. 16 - p. 281, l. 2). Mr. Eliassen contrasted Coyote Springs with the earlier sale/leaseback of the Rathdrum project which was supported by an offtake contract with

Portland General Electric for 20 years that would generate more than $200 million of cash during that period of time. (Id. at p. 281, ll. 7-22).

Nor is the suspension of construction at Coyote Springs II a viable option. As explained by Mr. Ely, given the engineering and procurement contract, the penalties on suspending the construction of Coyote Springs II are "almost as large as continuing in the project"; besides, Mr. Ely explained that the plant is in fact needed for power supply as early as the fall of 2002. (Tr. Vol. V, p. 178, ll. 13-25).

Nor will it do to suggest, as does ICNU/Public Counsel Witness Thornton, that the Company cut its dividends on common shares as a prerequisite to surcharge relief. At the very time that the Company needs to demonstrate to investors that it can continue to pay interest and dividends, in order to continue to finance the Company, it would be counterproductive to cut the dividend. As explained by Mr. Eliassen, even the Company's banks, who have otherwise encouraged the Company to eliminate cash expenditures, sell assets and cut costs, have not requested the Company to cut the dividend; in fact, these banks would prefer to have the Company issue more stock to provide more debt protection, and thereby improve interest coverages, cash flow and a strengthening of the balance sheet. (Exh. 152-T, p. 6, ll. 16-19). Credit rating agencies would also prefer that the Company issue more equity to strengthen and improve its financial profile, as Mr. Eliassen explains. (Id. at p. 6, ll. 20-21). However, a dividend cut may preclude the issuance of additional common stock.

Mr. Eliassen explains that the Company is very close to a 60% debt ratio and will need to issue additional equity to help offset and support this debt. (Id. at p. 7, ll. 1-14) Cutting the dividend may preclude the issuance of common equity and thereby prevent the improvement of the debt equity ratio. (Id.) Finally, to put this issue into perspective, any "savings" from totally eliminating the dividend would approximate $23 million annually, and while not insignificant, would not make an appreciable difference" in our financial situation, as explained by Mr. Eliassen. (Id. at p. 7, ll. 1-6). In fact, the Company would like to issue approximately $70 million of additional common equity next year, representing an amount several times higher than that paid out in dividends. (Id.)[15]

---

[15] Nor is it true that prior dividend cuts were used only for investment in unregulated subsidiaries, as Mr.

As explained by Mr. Ely, if one suspends the dividend, "you will never issue any equity, and we have an issue around the amount of debt that we have on the balance sheet right now." (Tr. Vol. V, p. 179, ll. 20-25). Accordingly, ICNU's recommendation to cut the dividend runs directly counter to ICNU's other recommendation of issuing additional common stock; the two recommendations are mutually inconsistent, given Avista's present situation. As further explained by Mr. Ely, investors are concerned about the growth or appreciation in a Company's stock price, and if the dividend is cut, the investor will take his or her money elsewhere. (Id. at p. 193, ll. 4-22). In the final analysis, as explained by Mr. Ely, ratepayers do not benefit if the Company is unable to attract investors:

> Q. Supposing you are not attractive to investors so they do not materialize, then what does that mean for the Company or ultimately its ratepayers?
>
> A. What that ultimately means for the company if we cannot raise capital, and we have raised almost all the capital we can from the debt side, and so if we can't raise capital, it means that we may not be able to do the construction projects and be able to provide the reliability and the other things that our customers need to go forward.

(Id. at p. 193, l. 24 - p. 194, l. 6). Indeed, on cross examination, ICNU Witness Thornton agreed that he would not "characterize the reduction in dividend as a preferred option"; rather, he touted it as only one of many options that could be considered. (Tr. Vol. V, p. 343, ll. 22-25). Finally, Staff Witness Elgin, for his part, observed:

> I don't think it's appropriate for the Commission to tell the Company to cut its dividend. That's a Board decision, and that's something up to the board and between the board and the shareholders.

Thornton otherwise suggests. (See Exh. 601-T, p. 4, ll. 9-24; p. 12, ll. 2-4). The prior dividend reduction, amounting to less than $35 million on an annual basis, provided the Company with additional cash for utility capital expenditures, the payment of ongoing operating costs, the purchase of energy for customers and the reduction in debt levels. As explained by Mr. Eliassen, throughout this time the Company was also investing equity in non-regulated subsidiaries as well. It is therefore "not possible or reasonable to claim that all of the reduction went to a single investment of a single purpose." (Id. at p. 7, ll. 21-23).

(Tr. Vol. VI, p. 596, ll. 14-18).

There was also discussion, of record, concerning the Company's proposed capital budget cuts in order to preserve cash. Mr. Ely described approximately $60 million in cuts, mostly in the form of capital budget reductions over the balance of this year and next. Of this amount most savings were in the form of deferring costs, not eliminating them. (Tr. Vol. V, p. 171, l. 24 - p. 172, l. 1).[16] Mr. Ely also testified that it is entirely inappropriate to use capital cost deferrals in order to fund ongoing power supply costs:

> But I think from a capital standpoint, it's inappropriate to use money that has been I guess set aside to take and do capital improvements to support reliability and to provide for customer needs to use it for expenses on an ongoing day-to-day basis.

(Tr. Vol. V, p. 224, ll. 12-22). In the same manner, Mr. Ely testified that you would not use equity investment to pay off current power supply expenses; rather, equity financing is meant to acquire the funding to invest in new assets that provide investors with a return on their money. (Id. at p. 225, ll. 1-5).[17] Furthermore, cutting capital expenditures to cover the immediate operating costs of Avista does not begin to reduce the deferral balance in any way, and would not alleviate the concerns of the financial community regarding a plan to recover the deferred power costs over a reasonable period of time.

The use of accelerated depreciation, in order to provide needed cash, is not an attractive option either. Even its proponent, Mr. Thornton, on behalf of ICNU, acknowledges that he has not seen any other example where a commission has used accelerated depreciation in order to deal with the financial difficulties of the sort now experienced by Avista:

---

[16] The Company indicated during hearings in this proceeding that these were preliminary estimates of possible cuts to reduce the amount of cash going out the door, due to the Company's immediate need for cash and the difficulty in borrowing funds needed to support the ongoing operating costs. There has been no final determination of the actual cuts that could be made. Moreover, cutting capital expenditures to meet immediate cash needs is not something that can be sustained long-term.

[17] Public Counsel apparently argues that the Company was remiss in failing to supplement or revise its previously-filed Commission budgets for 2001/2002. Most of the capital cuts are of such recent vintage that the Company has yet to have an opportunity to provide this information in supplemental form.

> Q. [Commissioner Hemstad] Well, I was going to pursue your discussion about accelerated depreciation. You have had substantial experience in electric utility accounting. Can you cite to me an example where a Commission has used accelerated depreciation in order to deal with the financial difficulty of a Company.
>
> A. I can't, though I have seen accelerated depreciation for a number of other reasons. For instance, for new technologies, or I have seen accelerated amortization of credits, and that would be, for instance in the case of trying to mitigate a rate shock. So it does happen, but I haven't seen it for that particular reason.

(Tr. Vol. V, p. 345, ll. 2-14). Moreover, Staff Witness Elgin appeared uncomfortable with using accelerated depreciation in this context. (Tr. Vol. VI, p. 596, ll. 17-19).

As to the subject of any FERC-ordered refunds, Avista has taken the position that from a philosophical standpoint that it does not make sense to go back retroactively and provide refunds, as testified to by Mr. Norwood. (Tr. Vol. V, p. 381, l. 22 - p. 382, l. 19) As Mr. Norwood explained, decisions were made in the past based on FERC-established rules; retroactive refunds would create uncertainty in the industry and in a marketplace where parties already have concerns about further participation. Nevertheless, if refunds are ordered, Avista "will be there to participate," as reaffirmed by Mr. Norwood. (Id.) Depending on how FERC ordered refunds, the effect could be very different on Avista given the assumptions utilized. As explained by Mr. Norwood:

> . . . it clearly could be different for a number of these factors. And as I mentioned before, we have run some numbers, and depending on how you slice it, we could actually be refunding to others, as opposed to receiving money. So there's a lot of unanswered questions.

(Tr. Vol. V, p. 393, l. 18 - p. 394, l. 8). Furthermore, the potential for FERC ordered refunds does not affect the facts underlying this filing and the need for immediate relief. The issues surrounding potential refunds are complex and far from resolved. The FERC proceedings that are currently ordered will take time to work through. Avista cannot count on a refund at this time, and even if it could, it

would not occur soon enough or be large enough to address the financial challenges facing the Company. (Exh. 100-T, p. 12, ll. 11-15)

In conclusion, while several options or alternatives have been proffered by intervenors, in the final analysis, all fall far short of providing the necessary relief needed by the Company to reassure the investment community. Indeed, Staff Witness Elgin observed that consideration of these alternatives, and their long term consequences, should perhaps await a different proceeding:

> . . . Many of the alternatives, my impression of them are, to use the phrase, they are thinking off the top of the hat. They're not well thought out. We don't know what the long-term consequences of those decisions will be, and I would think that we are not in a point where the Commission should make those kinds of judgments based on limited knowledge. (Emphasis added).

(Tr. Vol. VI, p. 599, ll. 3-10).

VII. THE COMPANY'S NON-REGULATED SUBSIDIARIES ARE NOT THE CAUSE OF AVISTA'S FINANCIAL PREDICAMENT

Nor is the Company's present financial condition due primarily to the Company's subsidiaries, as suggested by Mr. Thornton. While historically the subsidiaries have had some impact on its condition, Mr. Eliassen explained that the deterioration of the Company's financial condition since the second quarter of 2000 is "primarily due to the unexpected need to fund more than $300 million we have 'invested' in deferred electric and gas costs, while also investing approximately $190 million in the Coyote Springs II resource." (Exh. 152-T, p. 8, l. 18 - p. 9, l. 3). In fact, Avista Capital (parent of the unregulated subsidiaries) is anticipated to be a "net contributor" of cash to Avista in the 2001-2002 time frame — not a "net cash drain" on the Company. (Id.)

Moreover, the earnings contributions of Avista Energy, as part of the nonregulated family, has been "critical to support the total earnings and equity of the Company," as testified to by Mr. Eliassen. (Exh. 152-T, p. 9, ll. 1-3). Indeed, Avista Energy will provide as much as $150 million of cash to the

parent utility over the next several quarters. (Tr. Vol. V, p. 278, ll. 7-16). Accordingly, the Company's nonregulated operations are providing a significant amount of earning support and cash. (Id.)

The dividending of amounts back to the parent corporation, however, does not in any sense mitigate the Company's request for surcharge relief. As explained by Mr. Eliassen:

> It has nothing to do with the surcharge. It's only one way that we're moving capital within the company to rebuild the equity of the utility to make sure that the utility is a strong business going forward, but also to rebuild the company's cash flows in other ways. . . It has nothing to do with the recovery of the surcharge or paying the bills for those $300 million plus dollars that we have invested in deferrals for gas and electricity through Q3 of this year. So while we've got all this money coming in and planned to come in from these businesses, it's not nearly enough to tide this company over given the amount that we have invested in gas and electric deferrals.

(Tr. Vol. VI, p. 729, l. 16 - p. 730, l. 5).

Nor have the activities of subsidiaries explained the Company's recent credit downgrades. As testified by Mr. Eliassen:

> . . . And all the downgrades and all the negative comments that have come from the rating agencies very specifically reference issues with the utility, with the growing deferral balances, with cash flow. And they say, yes, we still have non-regulated subs that they are concerned about, but we have been addressing those issues with them. Those aren't what's driving changes in ratings or negative outlook in the last 18 months.

(Tr. Vol. VI, p. 739, l. 22 - p. 740, l. 6).

VIII. CONCERNS RAISED BY STAFF AND INTERVENORS REGARDING INCLUSION OF NEW RESOURCES IN DEFERRALS ARE MISPLACED

Mr. Schooley, on behalf of Staff, recommends that the O&M and capital costs associated with certain company-owned resources be excluded from the deferral calculations. (See Exh. 401-T, p. 24). The Company, for its part, has undertaken a number of measures to mitigate the impacts of the volatile market prices and low streamflow conditions — measures which included the installation of small gas-fired and oil-fired generation projects. (See discussion, infra, in Section II.C) It is important

to note, as explained by Company Witness Norwood, that the benefits associated with the small generation projects are also reflected in the net deferred costs; it is therefore, appropriate to include both benefits and costs associated with these projects. (Exh. 107-T, p. 8, ll. 5-10).[18] It would, therefore, be patently unfair to exclude the costs associated with these projects while otherwise crediting the benefits against the deferral account, as explained by Mr. Norwood. (Id.) Moreover, only the fixed and variable costs of new small generation projects are included in the deferral mechanisms; any changes in capital and O&M costs relating to existing resources are excluded.[19] (Id. at p. 8, ll. 11-20). Because the issue of prudence relating to the deferred costs, including any capital and O&M costs will be addressed in the November general rate case filing, this Commission need not, and should not, make a prudence determination in this case.[20]

Mr. Schoenbeck, on behalf of ICNU, also argues that the Company is seeking recovery of resources not yet in-service and the recovery of short term power costs in a manner other than through traditional normalized ratemaking. (Exh. 651-T, p. 2). This analysis, however, does not take into account the contribution of the new resources to the deferral balance, inasmuch as it ignores the value of the generation. In any event, here again, the Company is not asking for permanent recovery of the fixed costs in this proceeding; rather, the prudence of the deferred costs will be addressed in the upcoming filing and it is not necessary for the Commission to rule in this phase of the proceeding with respect to those costs. (Exh. 107-T, p. 10, ll. 3-6).[21] Again, some perspective is in order. The majority of the

---

[18] The Settlement Stipulation (¶2) in Docket No. UE-010395, relating to the deferred accounting treatment, provides:

> Monthly deferral entries in the existing mechanism include both the total costs and total benefits of the measures taken by the Company to mitigate the deferred costs. [See Exh. 1].

[19] With the exception of the costs associated with increasing the available operating hours of the Northeast and Rathdrum combustion turbines.

[20] The Coyote Springs II project, scheduled for operation in June 2002, and its prudence, will be addressed in the November general rate case, prior to its in-service date.

[21] Mr. Schoenbeck also argues that through a surcharge, the Company would receive "ratepayer capital based upon speculative forecast assumptions, highly questionable power purchase transactions and fuel

costs are <u>known</u> because contractual commitments have already been made to purchase power at fixed prices to cover resource deficiencies caused by record low hydroelectric conditions. As explained by Mr. Norwood:

> If the upcoming prudence review of the deferred costs were to occur over a nine month period, the dollars collected by the Company during the nine month period, under the 36.9% surcharge, would be approximately $63 million (nine months of an annual revenue increase of $84 million). The dollars collected during the prudence review period would be only 58% of the <u>actual deferral balance</u> at June 30, 2001 of $109 million, and only 34% of the expected balance at September 30, 2001 of $186 million. Thus, the dollars collected during the prudence review period would be a fraction of the <u>actual costs</u> already incurred by the Company.

(Exh. 107-T, p. 9, ll. 8-14). Furthermore, as Mr. Ely has testified, the Company would only recover actual, prudently incurred expenses:

> The financial community has advised us that it is important for the Company and the Commission to address the projected deferral balance and to create a plan for prudence determination and possible recovery. That being said, in no way does this indicate that the Company would collect from customers anything but actual, prudently incurred expenses. The Company has previously outlined how this will be assured through the "subject to refund" provision and through a balancing-type account for the deferral recovery. If costs do not materialize, they will not be collected. If costs turn out to be lower than anticipated, the surcharge will end sooner. We believe customers are fully protected by the mechanisms we have already proposed. Furthermore, the Company's proposal rightly preserves for future determination all significant issues for all parties in this case, and no one is precluded from taking any position they choose in the prudence filing with regard to the surcharge dollars that are being collected subject to refund.

---

costs." (Exh. 651-T, p. 11, l. 7) Assuming Mr. Schoenbeck hasn't already prejudged the issue, it is quite clear that the issue of prudence is not before the Commission at this time in this proceeding.

(Exh. 51-T, p. 7, l. 23 - p. 8, l. 5).

IX. STAFF AND INTERVENORS' PROPOSALS DO NOT ADEQUATELY TAKE INTO ACCOUNT FINANCIAL RAMIFICATIONS TO THE COMPANY

Mr. Schoenbeck, on behalf of ICNU, recommends an 11.9% surcharge for a 15 month period, derived by cutting off deferrals at June 30, 2001, and making a "risk adjustment." (Exh. 651-T, p. 3).

It is interesting to note that ICNU and Public Counsel's recommendations are not premised on any analysis of their probable financial impact on the Company, including its ability to maintain its credit ratings, to issue common stock, to satisfy counterparties' credit requirements, or to otherwise maintain access to capital.[22] On cross examination, Mr. Schoenbeck conceded that he had not examined the impact of his proposals on the Company's ability to: (1) meet its fixed charge coverage ratios under its covenants; (2) to issue new equity financing; (3) to complete the financing of Coyote Springs II; or (4) to maintain the Company's credit ratings. (Tr. Vol. VI, p. 479, l. 11 - p. 480, l. 25) Nor had Mr. Schoenbeck attended the previous day's hearings wherein extensive financial testimony was presented. (Id. at p. 531, l. 19 - p. 532, l. 7). Furthermore, Mr. Thornton, on behalf of both ICNU and Public Counsel, frankly acknowledged that he had not "calculated what amount of increased revenue requirement would result in meeting the minimum fixed charge coverage ratios" shown in the Company's Exhibit. (Exh. 601-T, p. 14, ll. 18-21).

For his part, Mr. Elgin, on behalf of Staff, could not state with any degree of assurance that his recommendations, if adopted by this Commission, would not result in a downgrade of the Company's credit. (Tr. Vol. VI, p. 572, l. 24 - p. 574, l. 5). In fact, Mr. Elgin acknowledges the importance of the Company maintaining its existing credit rating for the foreseeable future:

> Q. Mr. Elgin, in order to get to the resolution of those issues, as you have described them, in the course of the next general rate case or in the course of a

---

[22] A surcharge is a necessary first step in order for the Company to not only maintain access to the capital markets, but to maintain a credit rating that will enable other counterparties to continue to trade with us without otherwise requiring burdensome collateral.

> Phase II proceeding, is it your belief that the company would need to maintain in the meantime its existing credit rating?
>
> A. In the interest of ratepayers for obtaining and maintaining at least an investment grade bond rating, that is in the ratepayers interest and the company's interest.

(Tr. Vol. VI, p. 579, ll. 15-24).

Mr. Ely testified that "right now we're told by both the bankers and Wall Street that we're not in a position to issue common stock." (Tr. Vol. V, p. 181, ll. 17-19). According to Mr. Ely, "its something they want us to do, but it is something that they understand we can't do." (Id. at p. 182, ll. 10-12). Indeed, Mr. Thornton recommends the issuance of additional equity, among his menu of options. Nor was he surprised that banks would, as a matter of course, prefer to have the Company issue more stock to provide more debt protection and thereby improve interest coverages, cash flow and a strengthening of the balance sheet. (Tr. Vol. V, p. 331, ll. 7-15). In fact, Mr. Thornton is rather emphatic that the issuance of equity is "fundamental to what this company needs." (Tr. Vol. V, p. 349, ll. 19-21).

Mr. Eliassen testified that the termination of the deferral mechanism effective June 30, 2001, would leave approximately $74 million of deferred power costs in the third quarter that would be unrecoverable. In Mr. Eliassen's view, this would all look "very negative to anyone looking at the Company and looking at our balance sheet, looking at our liquidity." (Tr. Vol. V, p. 241, ll. 16-20). In fact, Mr. Elgin acknowledges that termination of the deferral mechanism would require the Company to expense entries after June 30, 2001. (Tr. Vol. VI, p. 636, ll. 5-17). When asked, on cross examination, of the probable reaction of the investment community to the expensing of $74 million in the third quarter, Mr. Elgin acknowledged that "well there candidly there would be some concern on an ongoing basis. . . .." (Tr. Vol. VI, p. 646, ll. 2-10). [23]

---

[23] The creation of a so-called "side account" really would accomplish nothing. As described by Mr. Lott, the Company would still have to expense any amounts recorded in such a "side account"; if it were otherwise allowed to defer such expenses in such an account, it would have all the earmarks of a deferred accounting mechanism. (See Tr. Vol. VI, p. 705, l. 13 - p. 706, l. 7).

X. DEFERRAL BALANCES PROVIDE A SOUND BASIS FOR SURCHARGE RELIEF

As of June 30, 2001 the deferral balance is $109 million. Mr. Schoenbeck, on behalf of ICNU subtracts out a "risk adjustment" of approximately $25 million leaving a net figure of $83 million. He goes on to acknowledge that the Company would have a very high probability of recovering at least 95% of this $83 million in any subsequent prudence review.

> . . . I don't want to put a probability higher than 95%, but it's in that type of a probability for the $83 million I'm willing to give. Under reasonableness review, I think that there would be that high of a probability that they would get that amount of money.

(Tr. Vol. VI, p. 493, ll. 8-12). Keep in mind that if the surcharge were to continue for twelve (12) months, under its proposal, the Company would only collect $87 million — approximately the same amount as Mr. Schoenbeck deems highly probable for recovery based on the June 30, balances alone (and even if one were to accept his "risk adjustment").[24]

Moving forward from the end of June, the deferral balance increases to $186 million by the end of September.[25] These numbers are based on verifiable contractual commitments.[26] (Tr. Vol. VI, p. 730, ll11-18). Mr. Schoenbeck acknowledges that the actual hydro generation for the months of July, August and September, should be relatively close to the Company's projections due to the historic limited precipitation that occurs during this period of the year. (Exh. 651-T, p. 8, ll. 7-9). In fact, as

---

[24] Elsewhere, Mr. Schoenbeck reaffirmed that he was relatively comfortable with the prudence of costs incurred up to July. He went on to observe that he was "highly confident" of the dollars as of the June 30th date, and "did not have a problem with those contracts and agreements for the power that was delivered during that period. . ." (Tr. Vol. VI, p. 548, ll. 23-25).

[25] The end of September 2001, deferral balance is $186 million — a figure that does not reflect any capital or O&M costs relating to Coyote Springs II. (Tr. Vol. VI, p. 537, ll. 6-9). In fact, it is not until June of 2002 that the first entries for Coyote Springs II capital costs are reflected. (Tr. Vol. VI, p. 536, ll. 9-15).

[26] The Company already knows it will incur very substantial power costs beyond June 30, 2001, of approximately $74 million, representing costs during July, August and September. (Exh. 107-T, p. 10, ll. 16-23).

testified by Mr. Eliassen, actual hydro generation for those months has actually been below the Company's estimates included in the deferral calculations in this filing. The estimated hydro production in July was 338 average megawatts (the actual was 318 average megawatts); the estimated hydro generation for August was 246 average megawatts (the actual level of hydro generation was 236 average megawatts); the estimated September production was 228 average megawatts (September is now estimated to provide only approximate 216 average megawatts). (Tr. Vol. VI, p. 731, ll. 7-16). This prompted Mr. Eliassen to observe that the Company is buying more energy on the market than planned for these months; and in his words, this "lends a lot of credibility to the numbers" that put the level of deferral balances at $186 million in Washington as of the end of September. (Tr. Vol. VI, p. 731, ll. 23-25).[27]

And, as concerns the balance of the year, Mr. Schoenbeck seems to incorrectly suggest that the Company has assumed below normal precipitation. That is not correct. In fact, our deferral balances for October through December of 2001 assume normal precipitation. (See Bench Request, No. 5; Exh. 5).

Let's put Mr. Schoenbeck's proposals into better perspective: Mr. Schoenbeck concedes that, assuming it would take nine months to complete a prudence evaluation, under the Company's proposal, it would collect only approximately $63 million during this period, subject to refund. (Tr. Vol. VI, p. 544, l. 15 - p. 545, l. 2). The collection of $63 million would represent only 34% of the end of September of 2001 deferral balance of $186 million. (Id.). Stated differently, this Commission would have to disallow in excess of 66% or 2/3 of the end of September deferral balance ($186 million) as part of its subsequent prudence review, in order for there to be any refunds owing to customers.[28]

---

[27] During the public hearing on September 10, 2001, Dave VanHersett, an independent consultant on energy matters and a participant in Avista's Integrated Resource Planning process, stated that he could not have predicted the changes in market prices that have occurred.

[28] Remember that the same Mr. Schoenbeck opined that he was quite comfortable with the notion that the substantial majority of the end of June deferral balances would ultimately be deemed prudent.

Indeed, a 36% surcharge rate increase would be justified, even if one were to employ all of Mr. Schoenbeck's assumptions, save one — i.e., using the September 30, 2001 deferral balances instead of his use of the June 30, 2001 balances. If one starts with the end of September balance of $186 million of deferral balances and subtracts out his recommended $53 million as an appropriate amortization of the PGE credit, and further subtract his recommended "implicit risk adjustment" figure of $25 million, that leaves a resulting figure of $108 million. If we divide the $108 million by the approximately $300 million of revenue that would be received by the Company over the 15 month period proposed by Mr. Schoenbeck, this translates into approximately a 36% surcharge. Stated differently, the only change in Mr. Schoenbeck's calculation is to take the deferral balance at the end of September (not June) of 2001 and use Mr. Schoenbeck's same 15 month amortization period and his deductions for risk adjustment and amortization of the PGE credit. (Tr. Vol. VI, p. 537, l. 6 - p. 539, l. 18). One arrives at the same result – a need for a 36% rate increase – if one were to use end of September (not June) balance.

Finally, with regard to Witness Schoenbeck's proposed "risk adjustment" of $25.6 million, which he subtracts from June 30, 2001 deferral balance in arriving at his recommended level of surcharge relief, he contends that the Company necessarily assumes the risk that market prices and/or hydro generation could deviate from expected levels. (See Exh. 651-T, p. 13, ll. 6-14). He further employs a number of assumptions, including the use of 1988 water conditions, as a predicate for arriving at his so-called "placeholder" adjustment. (Id.).

Any examination by this Commission of the extent to which the Company should "assume the risk" that market prices or hydro generation will deviate from certain "base" levels or "proformed" levels must necessarily await the next general rate filing. That is the appropriate forum for addressing that issue, insofar as the Commission will also be addressing broader questions surrounding power costs adjustment mechanisms, risk sharing, the resetting of "base" or "proformed" power costs, as well as the appropriate use of hydroelectric and wholesale market pricing data. It is premature for the Commission, in this proceeding, to embark on such a piecemeal analysis as suggested by Mr. Schoenbeck. In any event, even Staff, for its part, recognizes that Mr. Schoenbeck has "laid some

cards on the table now" that Staff would otherwise "be addressing in Phase II" in this proceeding. (See Schooley Testimony, Tr. Vol. VI, p. 666, ll. 11-18).

Moreover, it should also be remembered that even before the deferral mechanism was in place to record power cost deferrals, the Company had already absorbed approximately $20 million in power costs that will not be recovered. As testified to by Mr. Ely:

> . . . before we filed for the deferral mechanism, there was in excess of $20 million that the company incurred as expenses prior to that filing. There was even some after the filing because the mechanism, the original deferral mechanism wasn't a perfect mechanism . . ..

(Tr. Vol. V, p. 225, l. 24 - p. 226, l. 3). Accordingly, approximately $20 million, representing Washington's share of power costs, have been expensed by the Company and will never be recovered through rates, even though those dollars were previously spent in order to procure necessary supplies for the Company's customers. (Tr. Vol. V, p. 226, ll. 13-20). It would be patently unfair for the Commission to also now accept Mr. Schoenbeck's proposal to further reduce cost recovery by $25 million and impose yet a further write-off.

XI. ACCOUNTING FOR DEFERRALS AS A REGULATORY ASSET UNDER FAS 71 IS NOT AN ISSUE TO BE DECIDED BY THIS COMMISSION

Staff Witness Lott contends that the Commission, through its prior accounting orders, has not created a regulatory asset and it should not be treated as such on the Company's financial statements. (Exh. 501-T, p. 3, l. 22 - p. 4, l. 3). In effect, however, Staff raises an issue that does not require Commission determination in this proceeding. As explained by Company Witness Falkner, it is up to the Company to initially make determinations regarding how its financial statements reflect Generally Accepted Accounting Principles (GAAP), but the ultimate decision requires the concurrence of the Company's independent auditors. (Exh. 250-T, p. 2, ll. 7-10).

The deferral mechanism and its associated accounting, as reflected in its disclosure statements, was reviewed by the Company's independent auditors, the international accounting firm of Deloitte & Touche, LLP (D&T). As will be discussed below, Mr. Thomas Hoover, the lead partner from D&T on Avista's audit engagement, explained the basis for his firm's decision. Mr. Hoover described, in his testimony, the process by which D&T reaches it's decision on such matters: following its audit of the financial statements included in Form 10-K, his firm concluded that the "consolidated financial statements presented fairly, in all material respects, the financial position of Avista Corp. and subsidiaries at December 31, 2000 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America." (Exh. 350-T, p. 2, ll. 3-9). Mr. Hoover described the nature of the firm's independence, as is required by professional standards and the manner in which the auditors preserve their independence. (Id. at p. 2, ll. 11-16). Moreover, prior to rendering an opinion, all financial statements and disclosures are reviewed by a "second partner who has significant experience with a firm along with the expertise in the industry (i.e., "concurring partner")." (Id.)

Having read the testimony of Staff Witness Lott, Mr. Hoover flatly disagrees with his conclusion. First of all, Mr. Hoover noted that the FASB realized that, in a regulatory environment, "requiring a Company to obtain absolute assurances was unrealistic." (Id. at p. 3, ll. 20-23). Therefore, FAS No. 71 does not require absolute assurance prior to capitalizing a cost, only reasonable assurance. (Id.) According to Mr. Hoover, "based on all available evidence, we concurred with the Company's conclusion that it was appropriate and in accordance with General Accepted Accounting Principles to defer power costs as authorized by the Commission's accounting Order." (Id. at p. 4, ll. 11-13).[29]

[29] Mr. Hoover's review process included a variety of steps: After first discussing the issue with the Company, his firm reviewed a variety of documents including FAS No. 71, the FERC Chart of Accounts, the Staff Memo dealing with the proposed accounting mechanism, the Company's Petition and the Commission's Order relating to the Company's request to establish deferred energy accounting; D&T also looked at other utilities in the region to understand how they were addressing the issue and drew upon its experiences with comparable situations, in order to develop its conclusion that the

Furthermore, Staff, for its part, was aware that the implementation of the deferred mechanism was going to be recorded as an asset and would impact the current period earnings. Staff's memo dated January 24, 2001, under Docket No. UE-000972 (concerning the Company's proposal to modify the existing deferral calculations) states:

> Current period expenses are not recognized as current deductions to income, <u>thereby improving current earnings</u>. When disposition of the deferred amounts come, the escalated level of such deferred expenses exposes the Company to a greater potential of write-offs if full recovery of total amounts deferred is not granted. (Emphasis added).

(<u>See</u> Exh. 252-T, p. 4, ll. 1-5). Accordingly, Staff, for its part, recognized that the increased power costs would not affect earnings because the costs would be set aside through the deferral mechanism. As explained by Mr. Falkner "the only way that earnings would not be affected is if we accounted for the deferrals the way we ultimately did – <u>not</u> the way Mr. Lott suggested in his testimony." (<u>Id</u>. at p. 4, ll. 6-10).[30]

Staff Witness Lott agreed with Company Witness Hoover that the Company could include something as a regulatory asset under Generally Accepted Accounting Principals, while not otherwise reflecting the same on their reports to the Commission, and vice versa. (Tr. Vol. VI, p. 675, ll. 16-25). Moreover, Mr. Lott conceded that the Company had not violated any Commission order with respect to its accounting:

> Q. [Chairwoman Showalter]: Well I would like to followup on that. First of all is it your opinion, is the company today violating any Commission order with respect to this subject.
>
> A. The Commission order simply says that they're supposed to put a disclosure.

---

accounting was appropriate. (Exh. 350-T, p. 4, ll. 16 - p. 5, l. 3).

[30] Moreover, as explained by Mr. Falkner, there cannot be a write-off unless an asset has been first recorded; therefore Staff's recognition that there could be a write-off, by implication, supports the Company's ultimate accounting treatment of the deferred costs. (Exh. 252-T, p. 4, ll. 9-11).

> Q. I'm talking about a –
>
> A. So my answer is I would say the simple answer would be no. The order says that they are supposed to put this footnote if it's included in the financial statement.

(Tr. Vol. VI, p. 679, l. 23 - p. 680, l. 12). Furthermore, Staff Witness Lott concedes that this Commission has no authority or power to establish regulatory assets under Generally Accepted Accounting Principals:

> Q. Did Avista's June 23, 2000, petition in Docket No. UE-000972 also request its Commission permit the Company to create the power cost deferrals as regulatory assets under FAS 71.
>
> A. No. Such a request would not have been meaningful. <u>This Commission has no authority or power to unilaterally establish regulatory assets under Generally Accepted Accounting Principals (GAAP)</u>. Whether a regulatory asset is created depends on whether FAS 71 applies, considering the Commission's actions and all other relevant factors. (Emphasis added).

(Exh. 501-T, p. 6, ll. 9-15). Accordingly, the Company initially, and subject to the concurrence of its independent auditors, must make its <u>own</u> evaluation under FAS 71 concerning the appropriate accounting treatment under GAAP. Therefore, compliance with GAAP should not be an issue before this Commission in this proceeding, nor need the Commission rule thereon. Staff Witness Lott concedes that the Commission has no direct authority to order or direct the establishment or lack thereof of regulatory assets under GAAP. And, Mr. Lott concedes that the Commission does not have such "direct control." (Tr. Vol. VI, p. 697, l. 1).[31]

---

[31] Interestingly enough, even though Mr. Lott seems inclined to debate the probability of future recovery of deferred costs in light of remaining prudence issues, he does offer the view that:

> . . . It's quite probable, very probable that a large portion of this item [regulatory asset] will be recovered in some form going into the future . . ..

(Tr. Vol. VI, p. 693, ll. 5-7).

XII. STAFF'S PROPOSED COLLECTION OF SURCHARGE ON A UNIFORM CENTS BASIS WILL DISPROPORTIONATELY IMPACT LARGER-USE CUSTOMERS

Finally, the Company disagrees with Staff Witness Parvinen's proposal to apply the proposed surcharge on a uniform cents per KWh. While the Company acknowledges that there are valid arguments to support the use of a uniform cents per KWh application, the Company's overriding concern is the disparity in the resulting percentage increase to different customers, as explained by Mr. Falkner. (Exh. 252-T, p. 12, ll. 1-21). Even with Staff's proposed surcharge level of 32.6%, the resulting percentage increase to customers would range from 22.5% to 48% – with the largest industrial, commercial and institutional customers receiving the 48% increase. These latter customers do not otherwise receive any benefit from the recently filed tariff passing through to residential customers the BPA Residential Exchange Credit. (Id.)

During the public hearing conducted in Spokane on September 10, the Commission heard testimony from a variety of interests, including the Company's larger commercial and industrial customers. These customers provided testimony both in support of and in opposition to the Company's proposed increase. One way for this Commission to mitigate the impact of this increase on commercial and industrial customers would be to apply the surcharge on a uniform percentage basis as proposed by the Company, which would apply the increase across the board at a 36.7% level, instead of the uniform cents per KWh basis proposed by Staff. In this manner, the Commission would not burden the Company's larger commercial and industrial customers with a 48% increase.

In any event, the Company believes that the public hearing further demonstrated that there is support from the business community for a surcharge in the manner proposed by the Company, in order to preserve this Company's financial standing.

XIII. CONCLUSION

The Company is appreciative of the efforts of all parties in this proceeding and the Commission in expediting the review of this emergency rate relief application. Nevertheless, the Company has had to take strong exception to the various conditions and suggested adjustments proposed by the parties.

The difficult situation in which the Company finds itself, having incurred substantial power costs on behalf of its customers, requires immediate and direct action by this Commission in a way that enables the Company to continue to discharge its public service obligations and satisfy the ongoing concerns of the investment community. Perhaps Mr. Ely said it best:

> The situation facing the Company is unprecedented, given the volatility in the energy markets and the record low hydroelectric conditions. We ask this Commission to continue to be supportive of our efforts to work through these financial difficulties. Strong regulatory support for the Company's proposal, affirmatively expressed, will go a long way toward reassuring the investment community and allowing the Company to continue to access the capital markets under reasonable terms. That access is necessary to not only fund ongoing operations so that the Company can meet its public service obligations, but also to plan for the future through the construction of needed generating facilities.

(Exh. 51-T, p. 8, ll. 18-25).[32] Circumstances beyond the Company's control have impacted not only this area, but have prompted 30% to 50% rate increases in Seattle, Tacoma, Portland, Boise and in other areas of the Northwest. In the very least, this is a regional issue that has impacted all providers of electric service in ways that could neither have been anticipated nor controlled.

RESPECTFULLY SUBMITTED this _ day of September 2001.

AVISTA CORPORATION

By: ___________________________________
DAVID J. MEYER
Senior Vice-President and General Counsel
For Avista Corporation

[32] For its part, the Staff in Idaho has been very supportive of the Company's application and has recommended to the Idaho Commission that the Company's request be approved essentially as filed. (Exh. 51-T, p. 8, ll. 8-10).

CERTIFICATE OF SERVICE

I hereby certify that I have served Avista Corporation's Post-Hearing Brief in Docket No. UE-010395, by mailing a copy via overnight mail thereof, postage prepaid to the following:

Donald T. Trotter, Senior Counsel
Jon Thompson, Co-Counsel
Attorney General of Washington
PO Box 40128
1400 S. Evergreen Park Dr. SW
Olympia, WA 98504-0128

Simon ffitch
Office of the Attorney General
Public Counsel Section
900 Fourth Avenue, Suite 2000
Seattle, WA 98164-1012

S Bradley Van Cleve
Melinda Davison
Davison Van Cleve, PC
ICNU
1000 SW Broadway, Suite 2460
Portland, OR 97205

Don Brookhyser
Elizabeth Westby
Alcantar & Kahl, LLP
1300 SE Fifth Avenue, Suite 1750
Portland, OR 97201

Bill Benham
Ken McClanahan
BP Energy Company
501 WestLake Park Blvd.
Houston, TX 77079

Dated at Spokane, Washington this ___ day of September 2001.

____

TABLE OF CONTENTS

Page

I. INTRODUCTION....................2

II. CIRCUMSTANCES GIVING RISE TO THE NEED FOR IMMEDIATE RATE RELIEF....................6

- A. THE COMPANY IS EXPERIENCING THE WORST HYDRO CONDITIONS EVER RECORDED....................6
- B. UNPRECEDENTED WHOLESALE MARKET CONDITIONS HAVE ALSO HAD A DIRECT IMPACT ON THE NEED FOR SURCHARGE RELIEF....................7
- C. AVISTA HAS TAKEN STEPS TO MITIGATE THE INCREASED POWER COSTS. 9
  1. Communication of Market Conditions and Conservation Messages to Customers. 9
  2. Implementation of Retail Buy-Back Tariffs. 10
  3. Short-Term Fixed Price Electricity Purchases....................10
  4. Permit Modifications for Rathdrum and 2001 Forward Natural Gas Purchases. 10
  5. Delayed Delivery of Exchange Power Under the WNP #3 Settlement Agreement. 10
  6. Exercise of Energy Storage Opportunities. 11
  7. Granted Permission to Increase Operation of Northeast Combustion Turbines. 11
  8. Acquisition of Small Generation Resources. 11
  9. Resource Acquisition Under the RFP Process....................12

III. FINANCIAL EXIGENCIES REQUIRE THE NEED FOR IMMEDIATE RATE RELIEF....................12

- A. IMPACT ON CREDIT RATINGS. 12
- B. SURCHARGE RELIEF IS NECESSARY IN ORDER TO ISSUE COMMON EQUITY....................14
- C. SURCHARGE RELIEF IS ALSO NECESSARY IN ORDER TO COMPLETE THE FINANCING OF THE COYOTE SPRINGS II PLANT. 14
- D. SURCHARGE RELIEF IS NECESSARY FOR THE COMPANY TO MEET ITS BANK COVENANTS. 15
- E. SURCHARGE RELIEF IS CRITICAL IN MEETING THE COMPANY'S ITS FINANCING NEEDS. 16
- F. DEFERRAL BALANCES MUST BE RECOVERED OVER A RELATIVELY SHORT PERIOD OF TIME. 17

IV. EVIDENCE OF RECORD DEMONSTRATES THAT THE COMPANY HAS SATISFIED THE CRITERIA FOR EMERGENCY OR INTERIM RATE RELIEF 19

V. STAFF'S RECOMMENDED "CONDITIONS" FOR SURCHARGE APPROVAL WILL NOT ALLOW THE SURCHARGE TO ACCOMPLISH ITS INTENDED OBJECTIVE...25

A. "CONDITIONS" PROPOSED BY STAFF. 25

B. IT IS IMPERATIVE THAT THE DEFERRED ACCOUNTING MECHANISM CONTINUE BEYOND JUNE 30, 2001.......................................26

C. STAFF'S PROPOSAL TO LIMIT THE DURATION OF THE SURCHARGE TO 90 DAYS PROVIDES LITTLE BENEFIT...29

D. STAFF'S REQUIREMENT THAT ANY REVENUES COLLECTED NOT BE CREDITED AGAINST THE DEFERRAL BALANCE DEFEATS THE VERY PURPOSE OF THE SURCHARGE COLLECTION. 31

E. STAFF'S RECOMMENDATIONS REGARDING THE TIMING OF ANY PHASE II OR GENERAL RATE CASE FILINGS ARE IMPRACTICAL. 33

F. ADOPTION OF STAFF'S PROPOSED CONDITIONS WOULD HAVE A NEGATIVE IMPACT ON AVISTA'S CREDIT RATINGS. 34

VI. OTHER RECOMMENDED OPTIONS WILL NOT SUPPLANT NEED FOR SURCHARGE RELIEF...36

VII. THE COMPANY'S NON-REGULATED SUBSIDIARIES ARE NOT THE CAUSE OF AVISTA'S FINANCIAL PREDICAMENT 42

VIII. CONCERNS RAISED BY STAFF AND INTERVENORS REGARDING INCLUSION OF NEW RESOURCES IN DEFERRALS ARE MISPLACED 44

IX. STAFF AND INTERVENORS' PROPOSALS DO NOT ADEQUATELY TAKE INTO ACCOUNT FINANCIAL RAMIFICATIONS TO THE COMPANY 46

X. DEFERRAL BALANCES PROVIDE A SOUND BASIS FOR SURCHARGE RELIEF...48

XI. ACCOUNTING FOR DEFERRALS AS A REGULATORY ASSET UNDER FAS 71 IS NOT AN ISSUE TO BE DECIDED BY THIS COMMISSION 52

XII. STAFF'S PROPOSED COLLECTION OF SURCHARGE ON A UNIFORM CENTS BASIS WILL DISPROPORTIONATELY IMPACT LARGER-USE CUSTOMERS 55

XIII. CONCLUSION..56

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In re the Matter of	)	
	)	Docket No. UE-010395
AVISTA CORPORATION, d/b/a AVISTA UTILITIES	)	
	)	
Request Regarding the Recovery of Power Costs Through the Deferral Mechanism	)	
	)	

POST-HEARING BRIEF OF AVISTA CORPORATION

DAVID J. MEYER
AVISTA CORPORATION
Senior Vice President and General Counsel
P.O. Box 3727
Spokane, WA 99220
(509) 495-4316