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1 BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION

2 COMMISSION

3 In the Matter of the)
 Petition of)
 4)
 AVISTA CORPORATION, d/b/a) DOCKET NO. UE-060181
 5 AVISTA UTILITIES,) Volume II
) Pages 13 - 32
 6 for Continuation of the)
 Company's Energy Recovery)
 7 Mechanism, with Certain)
 Modifications.)
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10 A settlement conference in the above matter
 11 was held on June 15, 2006, at 9:33 a.m., at 1300
 12 South Evergreen Park Drive Southwest, Olympia,
 13 Washington, before Administrative Law Judge DENNIS
 14 MOSS, Chairman MARK SIDRAN, Commissioner PATRICK OSHIE,
 15 and Commissioner PHILIP JONES.

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17 The parties were present as follows:

18 AVISTA CORPORATION, by DAVID J. MEYER,
 General Counsel and Vice President, East 1411 Mission,
 19 Spokane, Washington 99220; telephone, (509) 495-4316.

20 WASHINGTON UTILITIES AND TRANSPORTATION
 COMMISSION, by GREGORY J. TRAUTMAN, Assistant Attorney
 21 General, 1400 South Evergreen Park Drive Southwest,
 Post Office Box 40128, Olympia, Washington 98504;
 22 telephone, (360) 664-1187.

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24 Kathryn T. Wilson, CCR

25 Court Reporter

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1 PUBLIC COUNSEL, by SIMON J. FFITCH, Assistant
2 Attorney General, 900 Fourth Avenue, Suite 2000,
3 Seattle, Washington 98164-1012; telephone, (206)
4 389-2055.

5 INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES,
6 by S. BRADLEY VAN CLEVE, Attorney at Law, Davison Van
7 Cleve, 333 Southwest Taylor, Suite 400, Portland,
8 Oregon 97204; telephone, (503) 241-7242.

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

2 JUDGE MOSS: Good morning, everyone. My name
3 is Dennis Moss, and I'm an administrative law judge
4 with the Washington Utilities and Transportation
5 Commission. With me on the Bench today are Chairman
6 Mark Sidran, Commissioner Pat Oshie, and Commissioner
7 Phil Jones.

8 We are convened this morning for purposes of
9 hearing about the settlement that has been filed and
10 proposed as a full resolution of the issues pending in
11 the matter of the petition of Avista Corporation doing
12 business as Avista Utilities for continuation of the
13 Company's energy recovery mechanism with certain
14 modifications, Docket UE-060181.

15 Our first order of business will be to take
16 appearances, and we will start with the Company,
17 Mr. Meyer?

18 MR. MEYER: Good morning, Your Honor. For
19 the Company, David Meyer.

20 JUDGE MOSS: Mr. Van Cleve?

21 MR. VAN CLEVE: Thank you. Brad Van Cleve on
22 behalf of the Industrial Customers of Northwest
23 Utilities.

24 MR. FFITCH: For public counsel, Simon
25 ffitich, assistant attorney general. Good morning, Your

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1 Honor.

2 MR. TRAUTMAN: Greg Trautman, assistant
3 attorney general, for staff.

4 JUDGE MOSS: Those are all the parties in
5 this proceeding. For our next order of business, I
6 would like to swear our witness panel, and then I'll
7 ascertain from counsel what their plans for the morning
8 are and then we will move forward from there. If the
9 witnesses would please rise and raise your right hands.

10

11 Whereupon,

12 MR. NORWOOD, MR. JOHNSON, MR. BUCKLEY,
13 having been first duly sworn, were called as witnesses
14 herein and were examined and testified as follows:

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16 JUDGE MOSS: I'll just ask you, Mr. Meyer.
17 Does the plan contemplate any preliminary comments from
18 counsel or any of the panelists?

19 MR. MEYER: There will be some comment from
20 ICNU's counsel. Their witness by agreement of the
21 parties did not appear because of the travel time and
22 expense involved, but Mr. Van Cleve will offer some
23 preliminary statement in support, but prior to
24 entertaining questions, Mr. Norwood will have some
25 preliminary rather short prepared remarks to make to

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1 sort of lay the groundwork for later questions.

2 JUDGE MOSS: Very well. Let me ask if any of
3 the commissioners have any preliminary remarks.
4 Apparently not. Was the idea for you to go first,
5 Mr. Van Cleve?

6 MR. VAN CLEVE: I can do that. Thank you,
7 Your Honor. ICNU is a party to the Settlement
8 Agreement. As the counsel for Avista stated, we are
9 not offering a witness in support of the panel due to
10 the travel time. Nevertheless, we fully support the
11 agreement, and we urge the Commission to adopt it.

12 We believe that the agreement strikes a fair
13 balance and sets out a framework for the ERM for the
14 next five years. We also believe it's consistent with
15 recent Commission precedent on power cost adjustment
16 mechanisms.

17 JUDGE MOSS: Thank you.

18 MR. FFITCH: Your Honor, we also discussed
19 with counsel that other panelists after Mr. Norwood's
20 opening statement might have an additional comment if
21 they wish to make that before the Bench questions.

22 JUDGE MOSS: We'll certainly allow time for
23 that, Mr. ffitch. Mr. Norwood, go ahead.

24 MR. NORWOOD: Thank you. If I may, what I
25 would like to do is go to the Settlement Agreement

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1 itself, which is marked as Exhibit 2, and briefly walk
2 through an overview of the ERM itself and the changes
3 the parties are recommending be made through this
4 agreement itself.

5 JUDGE MOSS: I'm going to interrupt you
6 because I neglected one thing, and that is we should go
7 ahead and admit the exhibits. The parties have
8 previously agreed we would stipulate in the various
9 prefiled testimonies and exhibits that were filed by
10 the Company and the various other parties.

11 In addition, I have had identified on our
12 exhibit list the joint testimony of Kelly Norwood, Alan
13 Buckley, and Stephen Johnson, and the Settlement
14 itself, Exhibit No. 2. So there being no objection, I
15 will admit all of those exhibits as marked on your
16 exhibit list and the record will stand as established
17 there. Go ahead; I'm sorry.

18 MR. NORWOOD: I'll start on Page 2 at the
19 bottom where it says "energy recovery mechanism," and
20 again, I'm going to be brief, but in general terms, the
21 energy recovery mechanism is designed to focus on those
22 purchase power expenses and fuel expenses net of
23 wholesale sales revenue, and within those accounts,
24 what we are focused on are weather-related changes,
25 which is driven by hydro, and also changes related to

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1 wholesale electric prices and wholesale gas prices.

2 Through this settlement agreement, whereas in
3 the past we were tracking changes in the majority of
4 wholesale sales and purchases, we have limited the way
5 that contracts are tracked in the ERM mechanism, and I
6 will get into more detail on that later. We do not
7 track plant investment through the ERM mechanism
8 itself.

9 In general terms, the way the mechanism works
10 is each month, we take a look at the actual power
11 supply costs that are at issue in the ERM, compare that
12 to the most recently authorized costs for the month.
13 To the extent there is a difference, then the Company
14 would either keep or absorb the first nine million
15 dollars of those differences each month within a
16 calendar year.

17 Under this settlement agreement, what the
18 parties are proposing is that the nine-million-dollar
19 annual dead-band be changed from nine million to four
20 million, and then beyond that four million, we've added
21 a layer of sharing, a fifty-fifty sharing. From four
22 million to ten million is a fifty-fifty sharing.
23 Beyond the ten-million-dollar difference in a calendar
24 year is the ninety-ten sharing with ninety to the
25 customer and ten to the Company.

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1 Then on Page 3 of the Agreement in
2 Paragraph B, there is a reference there to transmission
3 revenues and expenses. This is an issue that was
4 raised in the last rate case, and in this filing, the
5 Company proposed to include transmission revenues and
6 expenses in the ERM calculations, and as the Company
7 incurs more power costs or less power costs -- as an
8 example, if we have more hydrogeneration or less
9 hydrogeneration -- that may cause us to incur more
10 transmission expense, and in some cases, more
11 transmission revenue. So through this agreement, we've
12 agreed to add in the transmission revenues and expenses
13 in the calculation of the ERM so that those differences
14 during the year will be tracked.

15 Item C is the transmission fixed cost
16 component, and I think the easiest way to explain this
17 one is that as an example in a month, if retail loads
18 go up, they are higher than what was approved in the
19 most recent case, that will cause the Company to incur
20 higher power supply costs, but because loads went up,
21 we are also collecting more retail revenue.

22 So what we have is the retail revenue credit
23 where we credit back against the power supply costs the
24 retail revenue we are collecting from customers related
25 to power supply. In this agreement what we've done is

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1 we've agreed to not only credit back the retail revenue
2 related to power supply, we'll also credit back the
3 retail revenue related to the transmission component.
4 So that's the change we've approved here under Item C.

5 Item D is long-term power supply contracts,
6 and under this provision, we propose that for any new
7 contracts that are longer than two years or more than
8 50 megawatts that the cost that would be included in
9 the ERM would be limited to the level of power supply
10 costs that were included in the last rate case or the
11 market price of power for a one-year period, whichever
12 is lower. So in that sense, any new long-term
13 contracts beyond two years of 50 megawatts would need
14 to be addressed in the general rate case prior to any
15 increase in costs being tracked through the ERM.

16 Avista has currently a renewable RFP
17 currently outstanding, and we are in the process of
18 selecting some resources there. This agreement would
19 allow the Company to acquire up to 50 average megawatts
20 of renewable resources and have those tracked through
21 to the ERM.

22 Item E relates to major plant outages. Under
23 this provision, the Company has agreed that in a year
24 where we have a major plant outage which causes the
25 availability factor of Coal Strip or Kettle Falls or

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1 Kelly Springs to be less than seven percent, then
2 Avista could need to demonstrate that number one, fixed
3 costs continue to occur at those plants, and number
4 two, that the outage was not the result of imprudent
5 actions on the part of the Company. So in order for us
6 to continue to recover those costs, we would need to
7 demonstrate that in the ERM proceeding.

8 And then Item F on Page 4 addresses brokerage
9 fees. This is also an item that was raised in the last
10 case. As the Company incurs power purchases or sales,
11 primarily on a short-term basis, many times the Company
12 will use a broker to link up the buyer and the seller,
13 and there are fees associated with that. Those are
14 included in our rate case. The parties have agreed
15 here that to the extent those change each year, these
16 changes would also be tracked.

17 Item G refers to the effective date of
18 revisions to the ERM. The parties are proposing that
19 the changes be effective January 1 of 2006. Item H,
20 the provision there is that Avista will initiate a
21 filing but no sooner than five years from the date that
22 the Settlement is approved, if it's approved, to allow
23 all parties the opportunity again to review the ERM and
24 make recommendations.

25 Item I relates to -- it says "ERM

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1 stipulation," and the purpose here is that to the
2 extent that the ERM is not modified here, the prior
3 operation of the ERM would continue. So to that
4 extent, we are not changing something. It remains the
5 same as it was before.

6 And then Item 7, there are some items that
7 we've agreed to address in the next generate case.
8 Item 1 there says that the Company agrees to file
9 testimony in this next general rate case on the costs
10 of capital impact of the ERM. Item 2, the Company will
11 file a prudence case on its hedging strategy for power
12 purchases and purchases of gas used for power
13 generation on a perspective basis in its next general
14 rate case.

15 Item 3 addresses the allocation of common
16 costs related to the retail revenue credit. That was
17 an issue that was raised in the last case, and we've
18 all agreed to address that in the next case. Item 4
19 relates to the production property adjustment, and
20 we've agreed to address that one also in the next case.

21 The remainder of the Agreement falls into
22 what I would characterize as boilerplate language, so I
23 think I'll stop there.

24 JUDGE MOSS: Thank you, Mr. Norwood.
25 Mr. Johnson, do you have anything to add to that?

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1 MR. JOHNSON: This is Steve Johnson on behalf
2 of public counsel. Mr. Norwood did quite a good job
3 there. I just wanted to say that public counsel was
4 party to the original ERM and felt that it was not
5 completely well-developed, and within that agreement
6 had a review period in the meantime, and this is that
7 review time.

8 We identified a number of the issues, many of
9 which Mr. Norwood went through in the section regarding
10 transmission and power contracts and even small
11 sweep-in-the-corner items like brokerage fees, and we
12 are satisfied with the resolution of those issues in
13 this settlement agreement and recommend that you adopt
14 this, and I think he's reviewed it fairly well, so
15 unless Alan wants to say something...

16 MR. BUCKLEY: The other parties have stated
17 the issues fine.

18 JUDGE MOSS: That would bring us to the point
19 in time when we have questions from the Bench, if there
20 are questions from the Bench. Commissioner Jones?

21 COMMISSIONER JONES: Thank you, Judge.
22 Commissioner Jones. Mr. Buckley, do you think there is
23 sufficient incentive for the Company to manage
24 prudently its power supply costs, and what are those
25 mechanisms? The Company states the monthly ERM reports

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1 and the sharing-band mechanism, that those two together
2 provide a sufficient incentive for the Company to
3 manage prudently its power supply costs. Is that your
4 assessment of this settlement agreement?

5 MR. BUCKLEY: Yes, it is, and I think the
6 changes made here improve the incentives from the
7 standpoint of both the Company and the parties to
8 review the power supply costs, and I think the
9 continuation of the monthly reports that we get also
10 provide not only incentive for the Company to keep
11 track of their power supply costs but also
12 opportunities for the parties to comment on an
13 as-you-go basis during the year to do so.

14 COMMISSIONER JONES: Mr. Buckley, regarding
15 the Company's hedging strategy, I think we recently had
16 a hearing here on gas IRP of Avista, and they have
17 changed the risk-management policy, as I understand it,
18 in the Company. Have you had a chance to review that,
19 and specifically, the percentage of natural gas
20 contracts that they hedge for Avista.

21 MR. BUCKLEY: No.

22 COMMISSIONER JONES: This is for Mr. Norwood.
23 What is the overall ERM balance at the present? I
24 think we were considering the GRC, the general rate
25 case, the balance was a little bit north of 100

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1 million, and I think with a 10.8 surcharge applied, and
2 perhaps with better hydro conditions, snow pack, runoff
3 in '05, '06 this past winter that that has been
4 changed.

5 Can you give the Bench an update as to where
6 we stand today in your projection? I think in your
7 testimony you said something to the effect that if
8 present conditions, if hydro conditions are somewhat
9 benevolent, we could pay the ERM balance down to zero
10 by the end of '08 or '09.

11 MR. NORWOOD: Yes. At the end of 2005, my
12 recollection is that the balance in the ERM was 96
13 million, and the 10.8 percent surcharge that we have in
14 place today will collect roughly 31 million dollars on
15 an annual basis. If you look at the hydro conditions
16 this year, through the first quarter of this year,
17 hydro conditions and prices were such that power costs
18 were lower than base rates by 5.2 million; in other
19 words, a benefit of 5.2 million.

20 As we look through the balance of the year,
21 our expectation is that things will continue to look
22 favorable for the second quarter. Q-3 and Q-4
23 obviously are a question mark. As we run out of the
24 hydro and into the thermals in Q-3, Q-4, we expect
25 those numbers to maybe trend down a little bit, but the

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1 numbers today would tell us that we should end the year
2 in a benefit under the ERM mechanism, and under the new
3 sharing mechanism that we propose, there is an
4 opportunity to possibly reduce the ERM balance a little
5 bit given the hydro conditions that we have this year.

6 COMMISSIONER JONES: I have a question about
7 investors' perspective, and I had a chance to read
8 Julia Cannell, your witness -- didn't she focus on the
9 investors' perspective on the ERM?

10 MR. NORWOOD: Yes, that's correct.

11 COMMISSIONER JONES: Is it your understanding
12 that the analysts and the Wall Street investors, the
13 investors in Avista and other utilities, look at the
14 details of a PCA, power cost adjustment, mechanism
15 per se, or is it more a yes or no whether or not a
16 utility has a PCA?

17 MR. NORWOOD: They certainly do look at the
18 details, and I've had an opportunity to go back and
19 speak with both the credit rating agencies as well as
20 some of the analysts that follow our company. They are
21 certainly interested in the details. What they are
22 looking for is how effective the mechanism is.

23 And of course what they are looking for there
24 is, as we think about the dead-band for an example,
25 they do look to see what the possible variation in

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1 costs would be and how effective the mechanism would be
2 at dealing with that variability of costs.

3 COMMISSIONER JONES: So it's your perception
4 at Avista that they really get into the details of the
5 dead-band and either look at the monthly reports or the
6 drought conditions, the runoff, and get into that level
7 of detail. Because my understanding in reading briefly
8 some of the analysts' opinions, it appears to be more
9 at a high level. For example, there is one utility, as
10 we know, in this state that doesn't have a PCA.

11 MR. NORWOOD: I'm just speaking from my
12 experience in talking directly to all three credit
13 rating agencies as well as the analysts that follow us.
14 They do not look at the monthly reports, and we don't
15 provide that data to them.

16 We do provide quarterly information through
17 the earnings releases that we issue. We have
18 conference calls that are actually the earnings call
19 once a quarter where there is a number of parties that
20 follow our company, and they do ask questions about the
21 dead-band, but they tend to not get too far below that
22 in terms of the nitty-gritty details of the mechanism
23 itself.

24 COMMISSIONER JONES: Have you changed your
25 outlook medium-term to long-term on drought conditions

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1 in the Pacific Northwest? Are you looking at things
2 like global change and regional impact on drought,
3 water conditions in the Pacific Northwest?

4 MR. NORWOOD: Our power supply folks are
5 following that more now. We don't have any kind of
6 forecasting methodologies or procedures at this point
7 other than the current year that we are in, but all I
8 can say is we are starting to follow that more closely
9 as there is no information available on that.

10 COMMISSIONER JONES: I raise that point.
11 Perhaps my fellow commissioners have some questions on
12 the five-year period, but it just seems to me that a
13 4-A company like Avista that is so dependent on hydro,
14 and hydro depends on rain, on precipitation, as you
15 know, so a lot depends on factors beyond your control,
16 and the time frame in this settlement agreement picks a
17 number.

18 My only question is if events change, and
19 global climate change appears to be a fairly, quote,
20 "hot topic," if things change there, what is the
21 flexibility in this settlement agreement to deal
22 quickly in a hopefully nonlitigious manner that
23 resolves issues quickly? That's just a general concern
24 I have.

25 MR. NORWOOD: May I follow-up for a minute,

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1 if I may? Just another comment on the forecasting. In
2 the past, we have done analysis around, are there
3 trends, are there cycles, and of course, if indeed
4 there are effects from global warming or other issues,
5 that may change. The future may not be like the past,
6 but to date, we haven't identified any statistical
7 support for known trends or cycles. So as we look
8 towards five years, it's really an unknown whether you
9 are going to have good conditions or bad conditions.

10 In terms of next five years, this agreement
11 contemplates that this mechanism as proposed would
12 remain in place, and the Company wouldn't initiate a
13 filing to change it prior to the five-year period.

14 JUDGE MOSS: Mr. Buckley, did you have
15 something to add?

16 MR. BUCKLEY: Yes. It's important to
17 separate the difference between the ERM being set
18 methodology for five years versus base rates. The
19 Company can very well file immediately changes in base
20 rates for some period between now and the next five
21 years if they feel that the climate conditions have
22 changed to warrant that. The structure, plus or minus,
23 that set up an ERM would still be okay if there was
24 some basic changes that could be handled in the general
25 rate case.

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1 COMMISSIONER JONES: So Staff believes that
2 if there are basic structural changes to the regional
3 climate of the Pacific Northwest that affect hydro
4 conditions affecting this utility that that could best,
5 perhaps, be resolved through a general rate case.

6 MR. BUCKLEY: Yes, and any other major issues
7 like that.

8 COMMISSIONER JONES: Mr. Buckley, could we
9 keep it to one acronym? What is the proper acronym?

10 MR. NORWOOD: ERM.

11 JUDGE MOSS: Thank you. Commissioner Oshie,
12 did you have questions?

13 COMMISSIONER OSHIE: Actually, Judge, I don't
14 have any questions. I think that Commissioner Jones
15 has covered some areas I was interested in covering.

16 CHAIRMAN SIDRAN: I don't have any questions.
17 I actually have just a comment. This process has, I
18 think, achieved what we hoped it would achieve when we
19 separated this topic out from our approval of the
20 settlement in the general rate case. I think it meets
21 the criteria that were discussed in the PacifiCorp
22 case, and I commend the parties for having made this a
23 productive process and for having arrived at a
24 settlement agreement that in my view is a better ERM
25 both than the one that currently exists and then the

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1 one that was proposed in the settlement, so I think a
2 lot of hard work went into this, which is apparent, and
3 I'm pleased to see the product.

4 The only additional comment I would make is
5 obviously, whatever the future holds, while the parties
6 are bound by the Settlement Agreement, the Commission
7 is not. We will, of course, retain the flexibility if
8 things happen in the future that require adjustment, so
9 we will make the adjustments that need to be made, but
10 thank you for the good work you all put into this.

11 JUDGE MOSS: I believe that completes our
12 questions and comments from the Bench. Let me ask
13 counsel if there are any closing remarks or if we will
14 simply go off the record. Nothing further? Then we
15 will be off the record. Thank you all very much for
16 being here today.

17 (Settlement conference adjourned at 9:56 a.m.)

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