

1 BEFORE THE WASHINGTON UTILITIES AND
2 TRANSPORTATION COMMISSION

3	WASHINGTON UTILITIES AND)	
	TRANSPORTATION COMMISSION,)	Docket No. UE-030751
4)	
	Petitioner,)	Volume II
5)	Pages 28 to 88
	vs.)	
6)	
	AVISTA CORPORATION, d/b/a)	
7	AVISTA UTILITIES,)	
)	
8	Respondent.)	
9	_____)	

10

11 A hearing in the above matter was held on
12 December 15, 2003, from 1:25 p.m to 2:50 p.m., at 1300
13 South Evergreen Park Drive Southwest, Room 206, Olympia,
14 Washington, before Administrative Law Judge KAREN CAILLE
15 and Chairwoman MARILYN SHOWALTER and Commissioner
16 RICHARD HEMSTAD and Commissioner PATRICK J. OSHIE.

17 The parties were present as follows:

18 THE COMMISSION, by DONALD T. TROTTER, Senior
19 Assistant Attorney General, 1400 South Evergreen Park
20 Drive Southwest, Olympia, Washington 98504-0128,
Telephone (360) 664-1189, Fax (360) 586-5522, E-mail
dtrotter@wutc.wa.gov.

21 AVISTA CORPORATION, by DAVID J. MEYER,
22 General Counsel, East 1411 Mission Avenue, Spokane,
Washington, 99220, Telephone (509) 495-4316, Fax (509)
495-4361, E-mail dmeyer@avistacorp.com.

23

24

Joan E. Kinn, CCR, RPR
25 Court Reporter

0029

1 INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES,
2 by MATTHEW PERKINS, Attorney at Law, Davison Van Cleve,
3 1000 Southwest Broadway, Suite 2460, Portland, Oregon,
 97205, Telephone (503) 241-7242, Fax (503) 241-8160,
 E-Mail mail@dvclaw.com.

4 THE PUBLIC, by ROBERT W. CROMWELL, JR.,
5 Assistant Attorney General, 900 Fourth Avenue, Suite
6 2000, Seattle, Washington, 98164-1012, Telephone (206)
 464-6595, Fax (206) 389-2058, E-Mail
 robertcl@atg.wa.gov.

7 CITIZENS UTILITY ALLIANCE AND SPOKANE
8 NEIGHBORHOOD ACTION PROGRAM, by JOHN O'ROURKE, 212 West
9 Second Avenue, Spokane, Washington 99201, Telephone
 (509) 744-3370, Fax (509) 744-3374, E-Mail
 o'rourke@snapwa.org.

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

0030

1 -----

2 INDEX OF EXAMINATION

3 -----

4 WITNESS: PAGE:

5 ALAN P. BUCKLEY 32

6 KELLY O. NORWOOD 32

7 DONALD W. SCHOENBECK 32

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

0031

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

2 JUDGE CAILLE: Good afternoon, we are here
3 for a hearing on the settlement stipulation in Docket
4 Number UE-030751. This is a hearing to determine
5 whether the settlement and stipulation is in the public
6 interest regarding the prudence of the ERM recovery
7 items in the filing that encompasses from July 1st,
8 2002, to December 31st, 2002.

9 We are in a hearing room in the Commission's
10 headquarters in Olympia, Washington. My name is Karen
11 Caille, I am the presiding Administrative Law Judge, and
12 I will be joined by the Commissioners in a few minutes.

13 I would like for the parties to please enter
14 your appearance. Short appearances are fine.

15 Mr. Perkins, I don't know if I have a long
16 appearance from you, which includes like E-mail and
17 address, so if you will give me all that.

18 And same for you, Mr. O'Rourke, I don't
19 believe I have that from you. So let's begin with the
20 company.

21 MR. MEYER: Thank you, Your Honor, for
22 Avista, David Meyer.

23 JUDGE CAILLE: Go ahead, Mr. Perkins.

24 MR. PERKINS: My name is Matt Perkins. I'm
25 here for the Industrial Customers of Northwest

0032

1 Utilities. I work for Davison Van Cleve. It's 1000
2 Southwest Broadway, Suite 2460, Portland, Oregon 97239.
3 Our phone number is (503) 241-7242, fax is (503)
4 241-8160. Our E-mail address is mail@dvclaw.com.

5 JUDGE CAILLE: Thank you very much.

6 Mr. Cromwell.

7 MR. CROMWELL: Robert Cromwell on behalf of
8 the Public Counsel section.

9 JUDGE CAILLE: Mr. O'Rourke.

10 MR. O'ROURKE: John O'Rourke for Citizens
11 Utility Alliance of Washington, 212 West Second Avenue,
12 Spokane, Washington 99201, E-mail o'rourke@snapwa.org.

13 JUDGE CAILLE: Thank you.

14 And Mr. Trotter.

15 MR. TROTTER: Thank you, Donald T. Trotter,
16 Assistant Attorney General for the Commission.

17 JUDGE CAILLE: All right, if I could have the
18 witnesses all stand at the same time, I will swear you
19 in.

20

21 Whereupon,

22 ALAN P. BUCKLEY, KELLY O. NORWOOD, and DONALD
23 W. SCHOENBECK, having been first duly sworn, were called
24 as witnesses herein and were examined and testified as
25 follows:

0033

1

2 JUDGE CAILLE: All right, I will go collect
3 the Commissioners, and we will proceed.

4 (Discussion off the record.)

5 JUDGE CAILLE: I would like to welcome the
6 Commissioners to the Bench, we have taken appearances
7 and the witnesses are sworn, would you like us to go
8 around the room and have the various gentlemen introduce
9 themselves?

10 CHAIRWOMAN SHOWALTER: Sure.

11 JUDGE CAILLE: All right.

12 Go ahead, Mr. Meyer.

13 MR. MEYER: David Meyer.

14 MR. NORWOOD: Kelly Norwood with Avista
15 Utilities.

16 MR. BUCKLEY: Alan Buckley, Commission Staff.

17 MR. SCHOENBECK: Don Schoenbeck on behalf of
18 the Industrial Customers of Northwest Utilities.

19 MR. PERKINS: Matt Perkins on behalf of the
20 Industrial Customers of Northwest Utilities.

21 MR. CROMWELL: Robert Cromwell with the
22 Public Counsel section of the Attorney General's Office.

23 MR. O'ROURKE: John O'Rourke with the
24 Citizens Utility Alliance of Washington.

25 MR. TROTTER: Donald T. Trotter, Assistant

0034

1 Attorney General for the Commission.

2 JUDGE CAILLE: Thank you.

3 The procedure that we agreed upon for this
4 afternoon was for Public Counsel to go ahead and make a
5 statement since Public Counsel and SNAP and CUA are the
6 parties that are not signing parties on the settlement,
7 and so we thought the most efficient process would be
8 for them to present their objections, and then we will
9 go to looking at the settlement and the stipulation
10 itself.

11 So, Mr. Cromwell, if you would like to begin.

12 MR. CROMWELL: Thank you, Your Honor.

13 Good afternoon, for the record my name is
14 Robert Cromwell. I am an Assistant Attorney General
15 with the Public Counsel section of the Attorney
16 General's Office on whose behalf I appear today. I will
17 give you a brief recitation of the reasons for our
18 objections to the settlement now pending before you and
19 why the Public Counsel section recommends that it be
20 rejected.

21 There are three factual issues regarding the
22 allocation of costs which we believe to be improperly
23 resolved by the settlement. First, the Enron contract
24 buyout; second, the Coyote Springs 2 failures; and
25 third, the disposition of high priced natural gas

0035

1 contracts. We also recommend rejection of the
2 settlement based upon policy concerns regarding the
3 apparent lack of a coherent strategy for the sale of
4 high priced gas contracts and the failure of the
5 settlement to provide forward looking guidance on what
6 are extraordinary costs and what are ordinary costs.
7 For these reasons individually and collectively, we
8 recommend rejection of this proposed settlement and
9 reestablishment of the litigated procedural schedule.

10 The amount of the proposed disallowance, \$3.2
11 Million, is insufficient given the range of issues
12 identified by the parties to this proceeding and the
13 recommended disallowances. It is inappropriate for rate
14 payers to bear the burden of \$15.2 Million in additional
15 power supply costs for this period since it places too
16 many costs associated with extraordinary events on rate
17 payers as compared to shareholders.

18 First, with regard to the Enron contract
19 buyout. Avista proposed originally to account for the
20 Enron contract buyout as a lump sum power purchase.
21 This despite the ERM being structured to reflect
22 contract term accounting to prevent Avista from gaming
23 the ERM. For reference I would cite you to Exhibit 49
24 at page 5. We concur on this one procedural point in
25 the settlement stipulation, that the Enron contract

0036

1 termination should be amortized over the original
2 delivery period of the energy contract as is detailed on
3 page 5 of the settlement. That said, we believe this
4 kind of contract buyout should clearly be viewed as an
5 extraordinary cost that requires specific justification
6 by Avista in an annual ERM filing to evaluate first
7 whether action was prudent, and second, whether recovery
8 through the ERM is appropriate. This points to the need
9 for clarification regarding ordinary versus
10 extraordinary costs and what documentation Avista should
11 be expected to provide in their annual filing to justify
12 these costs. I will briefly address this issue in a
13 moment, and Mr. O'Rourke will elaborate on it from
14 SNAP/CUA's perspective.

15 Second, rate payers should not be financially
16 responsible for the Coyote Springs 2 delays. Coyote
17 Springs 2 was originally scheduled to become operational
18 June 1st of 2002, but it did not become operational
19 until 13 months later on July 1st of 2003. As Staff
20 witness Buckley said in his testimony:

21 The imminent commercial operation of
22 Coyote Springs 2 was pivotal for Staff
23 support of the ERM.

24 Mr. Buckley was referring, of course, to the
25 original rate case settlement. Please see Exhibit 56 at

0037

1 page 47. Delays associated with Coyote Springs 2 are
2 truly extraordinary as the record in this docket
3 indicates, and dubious decisions were made resulting in
4 significant delay, uncertainty, and risk. I would cite
5 your attention to pages 7 through 9 of Exhibit 49
6 regarding design decisions and the risks the company
7 assumed in using a single three phase transformer design
8 which appear from the evidence now before you to be
9 custom made equipment without readily available
10 replacements. The company made a business decision to
11 utilize the single three phase design instead of three
12 single phase transformers, which would have
13 substantially decreased down time associated with
14 failure due to the more readily available replacements.

15 Further, a careful review of Mr. Carlberg's
16 testimony, Exhibit 26, reveals a timeline of decision
17 making, or rather a lack thereof, due to the liability
18 dispute with Alston that significantly contributed to
19 the delays experienced at Coyote Springs 2. The
20 company's poor business decision was compounded when the
21 second transformer also arrived defective. The current
22 status of the original transformer is unclear on this
23 record, whether it is now available as a spare or
24 whether it continues to gather dust, broken, the subject
25 of continued dispute. It is our position that these

0038

1 business decisions are ones for which shareholders and
2 not rate payers should be at risk.

3 With respect to the costs associated with the
4 delays at Coyote Springs 2, there are several different
5 analyses in the record and a range of costs associated
6 with Coyote Springs 2 from the settling parties
7 themselves as well as Ms. Elder. We object to the
8 settlement's proposed resolution of costs associated
9 with Coyote Springs 2 not only for the review period now
10 before you but also for costs properly to be considered
11 in the 2003 ERM review which is scheduled to occur next
12 spring. The settling parties purport to resolve costs
13 associated with a review period not yet before you which
14 would bind the Commission's subsequent review of this
15 issue at that time. Given this Commission's concerns
16 regarding the policy question inherent in settlements
17 that bind the Commission's future review of matters not
18 yet properly before it, we believe this is an additional
19 reason for rejection of this settlement.

20 Considering these two issues alone, the Enron
21 contract buyout and the costs associated with the delays
22 of Coyote Springs 2, the \$3.2 Million disallowance to
23 the ERM in the settlement is insufficient and unfairly
24 places the burden of these extraordinary costs and
25 questionable decisions onto rate payers.

0039

1 COMMISSIONER HEMSTAD: Mr. Cromwell, do I
2 understand your position to be that the -- you describe
3 the Coyote 2 issues as involving the I believe your term
4 was dubious decisions by the company, is it Public
5 Counsel's position that individually and collectively
6 those decisions constitute imprudence, or is it your
7 position you're simply raising those issues and want a
8 determination of that issue by the Commission?

9 MR. CROMWELL: The latter, Your Honor. I
10 believe that while we question the prudence of the
11 decision, a number of the decisions that were made
12 individually as well as the collective consequence of
13 those decisions, we have not directly addressed that
14 topic in the testimony that we -- that our expert filed
15 in this proceeding. The argument that I make to you
16 today reflects our concerns about the collective impact
17 of those decisions and the costs that are a consequence
18 of those decisions on the part of the company.

19 COMMISSIONER HEMSTAD: Well, if the matter is
20 one of differing views or uncertainty, but would that
21 not be at least a subject that would lend itself for
22 possible settlement, in other words resolving those
23 differences?

24 MR. CROMWELL: It may well be. I think the
25 question would be first whether such a settlement

0040

1 reasonably allocates those costs, and two, whether such
2 a settlement includes costs that are properly before the
3 Commission at this time, in other words within the July
4 1 through December 1, 2002, review period. It's our
5 position that both those questions should be answered in
6 the negative.

7 COMMISSIONER HEMSTAD: I guess I didn't grasp
8 the last point you were making. I understand your point
9 that it's a matter not yet before us, but would you
10 restate that again so that I understand it.

11 MR. CROMWELL: Sure. As I understand it, the
12 settlement before you today purports to resolve 12
13 months of costs associated with the Coyote Springs 2
14 outage.

15 CHAIRWOMAN SHOWALTER: Which 12 months, and
16 can you point us to the part of the settlement that
17 you're talking about?

18 MR. CROMWELL: Yes, it may take me a moment,
19 I apologize. If you go to page 3, letter B, impact of
20 delay, availability of Coyote Springs 2, it identifies
21 that the project was scheduled for commercial operation
22 mid 2002 but began actual operation July 1, 2003. The
23 settlement provisions on Coyote Springs 2 I believe are
24 farther back at E, it would be Roman III.E on page 7,
25 and it looks like it's one very long sentence that

0041

1 purports to resolve cost impacts associated with delay
2 through July 1, 2003.

3 CHAIRWOMAN SHOWALTER: So that's in the past,
4 so I'm trying to get how this is binding us in the
5 future.

6 MR. CROMWELL: Oh. Because what is currently
7 before you, Chairwoman Showalter, is the ERM review
8 period of July 1, 2002, through December 31, 2002. The
9 2003 ERM review will come before you sometime prior to
10 April 1 of 2004 when the company makes that filing.

11 CHAIRWOMAN SHOWALTER: Okay. But so this is,
12 when you say this is an earlier resolution of a past
13 period, then otherwise would have occurred but it's
14 still in the past; is that correct?

15 MR. CROMWELL: Perhaps my temporal references
16 were inartful. What I'm attempting to articulate is
17 that there are past actions which will not be properly
18 before you until the future point when the company makes
19 its 2003 review filing, and the settlement that is
20 before you today purports to resolve costs both within
21 the 2002 review period that is properly now before you
22 and 2003 costs that will then be before you at the time
23 the company makes the 2003 filing.

24 COMMISSIONER HEMSTAD: Are those costs able
25 to be bifurcated, or is it ultimately a single issue in

0042

1 the context of this issue of not deciding, of your point
2 of not deciding a future matter?

3 MR. CROMWELL: It's my position that the
4 costs that are before you today are those associated
5 with the review period that is before you today.

6 COMMISSIONER HEMSTAD: But my point is, are
7 the costs going forward to June 30, 2003, that otherwise
8 would not have been included in the six month period
9 here, are they able to be bifurcated, or is it a single
10 issue?

11 MR. CROMWELL: I think they can be bifurcated
12 with regard to the costs that are proposed for inclusion
13 at the time that they are proposed for inclusion. I
14 think you are correct in that it is a single, I hate to
15 -- I hesitate to call it a single incident because I
16 believe that the record reflects that there were a
17 series of incidents as well as decisions attendant to
18 them that occurred during the 2002/2003 time frame that
19 resulted in the costs that are sought to be resolved
20 through this proposed settlement.

21 CHAIRWOMAN SHOWALTER: Are you saying you
22 haven't had an opportunity to look at those costs and
23 review them? Does your objection simply go to that past
24 time period was set up for our review at a later time
25 period or that somehow you as a party are prejudiced by

0043

1 our resolving those if we do in the settlement?

2 MR. CROMWELL: What I can tell you is that
3 the focus of our inquiry in this proceeding as a party
4 was on the 2002 period. While I can not tell you that
5 we have been constrained in the scope of the discovery
6 that we have conducted, we have not -- we did not focus
7 on costs associated with the 2003 review period.

8 CHAIRWOMAN SHOWALTER: I have a question when
9 you said that you think we should revert to litigation,
10 back to litigation, I'm trying to understand what you
11 mean by that. Are you saying that we should reject the
12 settlement and proceed with our hearing?

13 MR. CROMWELL: Correct.

14 CHAIRWOMAN SHOWALTER: All right. But if we
15 do that, what are the contested issues from your point
16 of view that you have raised in that proceeding as it
17 goes forth? What would that proceeding look like?

18 MR. CROMWELL: Well, I think it would depend
19 upon -- well, I think ultimately it depends upon what
20 the Commission's ruling is on this settlement proposal
21 that is before you, and then that would determine what
22 the scope of the issues that would be before you in that
23 hearing process. As we recently experienced with the
24 other matter that is now before you from this company,
25 when the settlement was not accepted in whole, the

0044

1 parties that chose to exercise revocation, then
2 proceeded on what I would, I suppose I would perhaps
3 inartfully, call the litigative process that brought the
4 hearing back before you, and all issues were argued, and
5 I expect all issues will be briefed to you based upon
6 that hearing.

7 CHAIRWOMAN SHOWALTER: Well, assuming that
8 happens, I'm trying to get a sense from you as to what
9 your issues in that litigation are. Are they as
10 reflected in the testimony that you and your witness
11 filed in the proceeding?

12 MR. CROMWELL: Certainly the focus of our
13 witness's testimony were the out of cost, excuse me, the
14 out-of-market gas contracts and the costs associated
15 with Avista's moving those contracts and selling them
16 off. That was the focus of the inquiry that we made
17 with and supported with the testimony of our witness.

18 As to the issues that we would address,
19 Ms. Alder also addresses the costs associated with
20 Coyote Springs 2 in regards to if this Commission made
21 the determination that the unavailability of Coyote
22 Springs 2 was not an event that should inure to the cost
23 of rate payers in this proceeding. She provided a
24 figure for you to consider as to what the forgone
25 benefit would have been to the ERM had the expectation

0045

1 that all the parties had at the time that the general
2 rate case was resolved by settlement, namely that Coyote
3 Springs 2 would be on line and available, and that the
4 significant implication is that underlying the majority
5 of the data that the company has provided in this case
6 is the assumption that Rathdrum is the marginal heat
7 rate that is available, and Coyote Springs 2 has a
8 significantly improved heat rate over Rathdrum, and it
9 moves the numbers that are before you significantly, and
10 that is part of what Ms. Elder addressed in her
11 testimony.

12 COMMISSIONER HEMSTAD: Well, I realize you
13 haven't completed your presentation, but are there any
14 issues in the settlement agreement that you would find
15 acceptable?

16 MR. CROMWELL: The one that I previously
17 identified for you, which was that the settlement
18 stipulation would have the Enron contract buyout be
19 amortized over the delivery period rather than as was
20 originally proposed by the company in its testimony in
21 an up front.

22 COMMISSIONER HEMSTAD: Okay, and I understand
23 that issue, but so all other issues you would not agree
24 with in the settlement agreement?

25 MR. CROMWELL: Correct.

0047

1 judgment going to what?

2 MR. CROMWELL: Well, there were a series of
3 decisions beginning with the initial design decision.

4 COMMISSIONER HEMSTAD: All right, back to the
5 issues that you earlier described?

6 MR. CROMWELL: Yes.

7 COMMISSIONER HEMSTAD: I guess I'm having
8 some difficulty understanding. Are you saying ipso
9 facto that the delay inherently means costs should be
10 absorbed by shareholders, or apparently you're saying
11 that the issue of those subissues within the topic of
12 delay should be litigated?

13 MR. CROMWELL: I don't think I would agree
14 that it's an ipso facto matter of imprudence, but I
15 think that this Commission should examine very carefully
16 and determine for itself whether it believes that as an
17 initial matter whether the design decision that resulted
18 in the failure that occurred originally, the subsequent
19 decisions to maintain the same design to go with the
20 same supplier that resulted in the same -- well, I
21 apologize, in a different type of failure but with the
22 same result, and then, of course, the continued dispute
23 with Alston over the, if you will, the liability for the
24 initial failure and the delays that were attending to
25 that in bringing the second transformer over.

0048

1 COMMISSIONER HEMSTAD: I'm trying to grapple
2 with the issue of take the matter of the initial design
3 decision, those are matters of I suppose engineering and
4 about which arguably reasonable people can differ,
5 therefore subject to ultimate compromise or back to a
6 position that it was as a matter of fact simply the
7 wrong decision about which people should not have a
8 dispute, and between those two choices apparently your
9 view is the former, not the latter. And if so, why
10 isn't that a matter for potentially settling?

11 MR. CROMWELL: Well, I think it, as a
12 predicate matter, I think your initial point in terms of
13 an engineering decision is correct, that reasonable
14 minds could differ as to the propriety of a given design
15 over another design. Any engineering design has
16 tradeoffs regarding reliability, costs, long-term O&M
17 costs, et cetera. Clearly the company made the decision
18 it felt was in its best interests at that time. And I
19 think the question for you to consider in that context
20 is whether given the actual course of events where the
21 failures continued to compound and the delays accrued as
22 a result and the costs that are proposed to be born by
23 rate payers as a result of those continued decision
24 makings are proper or not.

25 COMMISSIONER HEMSTAD: But isn't the issue of

0049

1 the appropriateness of the decision made in the context
2 of what the company knew at the time, not with the
3 benefit of hindsight?

4 MR. CROMWELL: Absolutely, and clearly this
5 company considered many different options. If you
6 review the white paper that Mr. Carlberg attached to his
7 testimony, you will see that the company considered a
8 number of different options at the time and decided
9 quite clearly to continue and stay the course, and
10 further problems occurred. I guess ultimately it's a
11 question of if a captain is going to steer the ship into
12 the storm, ultimately the captain at some level is
13 responsible for the outcome. And if you keep steering
14 your ship into storms, eventually your ship might sink.

15 COMMISSIONER HEMSTAD: But what should the
16 captain do, turn around and go back?

17 MR. CROMWELL: It may be prudent to go back,
18 it may be prudent to heave to and simply ride out the
19 storm where you are. I don't purport to be an engineer
20 or to have the answer to that.

21 But I think as to your first question, this
22 Commission does have to decide whether given the record
23 before it, the decision making that the company engaged
24 in at the time it engaged in that decision making was
25 reasonable and prudent.

0050

1 As to your second question regarding whether
2 this is a topic that would be amenable to settlement, I
3 would agree that it is a topic, as any discussion of
4 money ultimately can be, subject to resolution through
5 alternative dispute resolution and settlement. And
6 perhaps it's unfortunate that the process that occurred
7 in this case was not one that was more conducive to
8 that type of resolution, but --

9 COMMISSIONER HEMSTAD: In what regard, you
10 were not a participant or given entry to the discussion?

11 MR. CROMWELL: I can not address to you on
12 the record discussions I was not a part of. I also for
13 ER 408 reasons, it would not be proper for me to discuss
14 the content of discussions that may have occurred which
15 I heard about. But what I can tell you in response to
16 your second question is that yes, in the broader scope
17 of things, any matter of cost where you're talking about
18 dollars can be resolved through settlement. That didn't
19 occur here, and it's our position that the \$3.2 Million
20 that's proposed for resolution of these issues is
21 insufficient.

22 COMMISSIONER HEMSTAD: I don't want to
23 prolong this, but when you say that didn't occur here,
24 you mean the proper discussion of costs or some costs
25 weren't discussed?

0051

1 MR. CROMWELL: I hesitate only because I'm
2 trying to be careful about what I represent.

3 COMMISSIONER HEMSTAD: I understand the
4 rules.

5 MR. CROMWELL: All I can say is that it is my
6 view that the process that occurred here was not
7 conducive to resolving these in a manner that would be
8 acceptable to us. The figure that was reached in the
9 settlement that is now before you substantively was not
10 sufficient in our view.

11 Is that an adequate explanation?

12 COMMISSIONER HEMSTAD: I will not pursue it.

13 MR. CROMWELL: Thank you.

14 CHAIRWOMAN SHOWALTER: Well, I would like on
15 the last, I believe you were talking about the natural
16 gas component of the --

17 MR. CROMWELL: If I could, that was my next
18 topic.

19 CHAIRWOMAN SHOWALTER: Oh, I thought you were
20 already on it, but go ahead.

21 MR. CROMWELL: Well, I was --

22 COMMISSIONER HEMSTAD: Part way through it, I
23 think.

24 MR. CROMWELL: -- starting in. I totally
25 lost the point where I was at, and I apologize if I

0052

1 repeat, but the other area of concern that we have with
2 this settlement is that it fails to resolve important
3 policy issues that we believe were presented by the
4 case. It's our concern that Avista appears to lack a
5 coherent strategy to minimize costs associated with the
6 disposition of the high priced gas contracts that it
7 possesses. Through numerous data requests we sought to
8 understand how and why Avista chose to execute the
9 natural gas sales on the days that it did. Avista
10 maintains that it sold gas and purchased power to meet
11 load based on a "daily look" at the market. While
12 attempting to discover what this is comprised of, the
13 company has consistently failed to provide a reasonable
14 explanation. Instead, the company continually refers
15 back to the individual transactions with the results as
16 the justification for their actions. For examples I
17 would cite you to Exhibits 14 and 21.

18 Avista has refused to directly answer our
19 question posed repeatedly. We asked why they chose to
20 transact on particular days and months. Instead they
21 reply that the particular days they chose were
22 appropriate and continue to point to Exhibit 21 without
23 explaining how and why they chose to transact on the
24 days they chose. Avista witness Storro indicates on
25 page 4 of Exhibit 5 that the company's:

0053

1 Strategy was to sell the gas through a
2 portfolio approach over a period of
3 time. By selling gas in several
4 transactions over time, it helps to
5 ensure that the company did not sell all
6 the gas at the least advantageous time.

7 However, if you have Exhibit 38 available to
8 you, you could see that a close inspection of Avista's
9 transactions to sell the August 2002 gas which was
10 originally intended for Coyote Springs 2 reveals that
11 these transactions do not seem to be consistent with
12 their strategy to sell gas in several transactions over
13 time.

14 CHAIRWOMAN SHOWALTER: I guess I want to
15 interrupt here, because it seems to me that we're
16 getting into in essence contested evidence. Should we
17 go forward? Isn't the nature of a settlement is that
18 the parties settle an issue without litigating those
19 contested issues, and in that respect I want to draw the
20 distinction between a settlement that does establish a
21 policy for the future, which of course the Commission
22 has to approve, versus a settlement that does not
23 establish or resolve a policy issue. And the settlement
24 in front of us seems to me to be in the latter group.
25 You have criticized it for its failure to establish a

0054

1 policy for a strategy for Avista, and it does appear
2 that it does not do that, but address why that is a
3 defect.

4 MR. CROMWELL: Okay, I will, thank you. The
5 two policy issues essentially are the lack of a
6 strategy, a coherent strategy, and two, discrimination
7 between ordinary and extraordinary costs. I think
8 you're absolutely correct that the settlement is black
9 box if you will in that regard. The reason we feel that
10 having both those issues is critically important is
11 because this is just the first of a number of annual ERM
12 reviews that are going to come before you. We are
13 concerned about the consequences and the apparent
14 consequence to a lack of a coherent strategy for these
15 gas sales. We're similarly concerned that what we saw
16 brought before the Commission in this filing were costs
17 that we would deem extraordinary that would need to be
18 specifically justified treated as ordinary for inclusion
19 through the ERM whereas the uncontroverted testimony at
20 the rate case was that the ERM was for inclusion of
21 ordinary costs specifically associated with hydro
22 variability.

23 CHAIRWOMAN SHOWALTER: Okay, but now then I
24 understand why you don't like the settlement because you
25 say it resolves those issues with payments that you

0055

1 don't agree with, but in terms of the policy
2 considerations, is it right that it simply reserves to
3 another day in a contested setting a ruling by this
4 Commission if it's posed to it appropriately an order
5 about strategy or extraordinary versus ordinary?

6 MR. CROMWELL: That's exactly correct, and
7 our concern is just that.

8 CHAIRWOMAN SHOWALTER: So you want it
9 litigated now is what you're saying?

10 MR. CROMWELL: Well, this is the first of
11 many of these instances that you're going to face, and
12 the issues won't go away, the costs won't go away. It's
13 my understanding that these out-of-market gas contracts
14 are going to be with this company and before this
15 Commission essentially through 2004 period, and they
16 taper off thereafter. So it's our position that it was,
17 and one of the reasons why we got significantly involved
18 in this proceeding initially as an initial matter was
19 because we felt that it was essentially a case of first
20 impression for this company's ERM. We thought it
21 important to flush these issues out before the
22 Commission and to have a resolution from the Commission
23 on these policy issues and the question of what's
24 appropriate.

25 COMMISSIONER HEMSTAD: If I can pursue that

0056

1 point, I suppose a strategy is to make daily decisions
2 about the nature of the market and whether it's the best
3 way to proceed that day by a marketer is whether to sell
4 or not. Another strategy is to have a relatively much
5 more mechanistic approach that says we'll always sell in
6 certain circumstances. I suppose one can argue one is
7 inherently better than the other. You could be a winner
8 in the first instance or you could be a winner in the
9 second or vice versa depending upon after-the-fact
10 analysis. Is this do you believe sort of this first
11 time through that the Commission listening to what will
12 be disputed evidence will be in a position to direct how
13 that kind of choice should be made?

14 MR. CROMWELL: It's our position that this
15 Commission is in a position to provide guidance to
16 Avista regarding its treatment of these out-of-market
17 gas contracts. In terms of having a daily look if you
18 will versus a more comprehensive strategy, I think the
19 question that the Commission has to ask is if the
20 company chooses to have a daily trading perspective, we
21 wake up, we look, we decide whether to trade or not to
22 trade, then presumably the experience of that would
23 guide one's future behavior. And, for example, the
24 trading that occurred last May would inform the trading
25 that would occur in June and July and August.

0057

1 COMMISSIONER HEMSTAD: Why?

2 MR. CROMWELL: Why? Because one hopes that
3 one learns from one's experiences.

4 COMMISSIONER HEMSTAD: But experience in the
5 market is as Morgan says prices vary.

6 CHAIRWOMAN SHOWALTER: I mean you could have
7 ten years of experience doing daily judgments or ten
8 years of experience doing quarterly judgments, is one
9 better than the other?

10 MR. CROMWELL: I don't think we are
11 purporting to advocate that one is necessarily better
12 than the other, but what I have identified for you
13 through Ms. Elder's testimony is that the strategy that
14 Avista purports to follow does not appear to be
15 reflective in the behavior that they engaged in in these
16 transactions. And if you review Exhibit I believe it's
17 38, I think there is ample evidence to indicate that
18 there isn't the type of distribution of trading activity
19 that you would assume from a daily strategy or that you
20 would see. There seems to be some other either behavior
21 or criteria that's guiding the activity.

22 COMMISSIONER HEMSTAD: I assume you're not
23 suggesting, are you, that the company would have been
24 incited by other factors other than to get the best
25 price it could in the sense that in this environment the

0058

1 interests of the shareholders and the rate payers would
2 be identical?

3 MR. CROMWELL: I think your supposition if
4 based on the assumption that the interests of rate
5 payers and shareholders is identical would be true. I
6 don't know that the interests of rate payers and
7 shareholders in the circumstances now before you are
8 identical.

9 COMMISSIONER HEMSTAD: Is that issue raised
10 in testimony?

11 MR. CROMWELL: I believe it is in Ms. Elder's
12 testimony. She addressed the different costs that are
13 proposed for inclusion in the ERM. I think the one
14 thing to keep in mind is that there are incentives for
15 costs based upon the structure of the ERM. For example,
16 if we were starting at zero on January 1 of '03, or
17 let's take '04 since it's soon enough to arrive, the \$9
18 Million dead band exists as an initial matter. The
19 company has a very strong incentive to minimize costs
20 that get booked to the ERM because it is responsible for
21 those initial \$9 Million of costs. Thereafter, the
22 incentive does change.

23 A good example of that is the Enron contract
24 buyout. One of our concerns about the company's
25 approach for including it in the 2002 review period

0059

1 that's now before you is because the dead band had
2 already been reached, whereas if the Enron contract is
3 amortized over the delivery period, as is proposed by
4 the settlement, there is a possibility that it would
5 fall completely within the dead band and rate payers
6 would not absorb those costs.

7 CHAIRWOMAN SHOWALTER: Back on the ERM, am I
8 right that under Ms. Elder's testimony you would have a
9 reduction of \$1.1 Million in the sharing account below
10 Avista's?

11 MR. CROMWELL: I believe it was 1.06, yes.

12 CHAIRWOMAN SHOWALTER: Okay. And then is it
13 correct that the settlement has a reduction of \$3.2
14 Million?

15 MR. CROMWELL: Yes.

16 CHAIRWOMAN SHOWALTER: So isn't the reduction
17 in the settlement three times as big as what you were
18 recommending?

19 MR. CROMWELL: Ms. Elder's recommendation
20 went only as to the high priced natural gas contracts
21 and did not go directly to the Coyote Springs 2 and
22 Enron contract buyouts with regard to the 1.06 was
23 focused only on the gas. Her recommendation regarding
24 the consequence of the Coyote Springs 2 failures was I
25 believe \$12.5 Million.

0060

1 CHAIRWOMAN SHOWALTER: Okay.

2 MR. CROMWELL: Well, as I said, one of our
3 concerns with regard to these policy issues is that they
4 will be major drivers of costs going forward both for
5 the ERM review that you will see next spring and the
6 subsequent years to follow. We believe that it's also
7 illuminating to contract the company's risk management
8 policy which can be found at Exhibit 19 which outlines
9 procedures and responsibilities to manage risk with the
10 utter lack of explanation we received from the company
11 as to how it effectively managed the risks associated
12 with the out-of-market gas. While the risk management
13 policy makes it appear that the company will do all
14 manner of things to manage risk, the only items the
15 company has identified in order to justify the \$14.7
16 Million associated with out-of-market gas sales is deal
17 tickets and related information for the specific 23
18 transactions they executed as well as their two sentence
19 description of their strategy. As I have explained, we
20 believe this is insufficient.

21 Given the amount of rate payer money at
22 issue, we assert that the company was obligated to more
23 carefully document its decisions including its decisions
24 to take no action and that it should have a strategy for
25 mitigating costs which can be documented. We believe

0061

1 the company's explanations are insufficient for the
2 Commission to make a finding that the company has
3 prudently managed the costs associated with these
4 out-of-market gas contracts and believe the Commission
5 should reject the proposed settlement on this basis.

6 CHAIRWOMAN SHOWALTER: Just procedurally, are
7 your comments here in the nature of a brief opposing the
8 settlement?

9 MR. CROMWELL: I have tried to succinctly
10 state the concerns we have regarding the settlement
11 that's now before you. I apologize if I'm reading it in
12 an overly mechanistic fashion.

13 CHAIRWOMAN SHOWALTER: Well, it's as if we
14 had called for comment on the settlement and you had
15 written something that was equivalent to what you just
16 stated on the record; is that right?

17 MR. CROMWELL: Fairly close, yes.

18 CHAIRWOMAN SHOWALTER: And I'm just asking,
19 proposing to the other parties, is there a need or do
20 you see a need to respond to Mr. Cromwell's comments, or
21 is your presentation in a moment going to be sufficient?

22 MR. MEYER: I think the latter was our intent
23 is that members of the panel could respond as needed and
24 offer their own comment on this, and that should suffice
25 to tee the matter up.

0062

1 MR. TROTTER: Right now I agree with company
2 counsel as to the current status of the statement that
3 Mr. Cromwell has made to date.

4 MR. CROMWELL: My final point is with regard
5 to ordinary versus extraordinary costs which we believe
6 should be examined individually by this Commission. The
7 Commission's fifth supplemental order in the general
8 rate case docket made it clear that the ERM was designed
9 to deal with normal variability and power supply costs,
10 again specifically the variability of hydro. I direct
11 your attention to Paragraph 39 of the fifth supplemental
12 order. The ERM was designed to deal with this normal
13 variability. With respect to extraordinary costs such
14 as the delay of Coyote Springs 2, there should not be a
15 presumption that such costs should be recovered through
16 the ERM. The company must make a showing that such
17 costs were prudently incurred. Even then the Commission
18 must determine what type of sharing is appropriate. The
19 ERM was not designed to place the burden of 90% of these
20 extraordinary costs on rate payers. In extraordinary
21 circumstances, sharing might be more appropriately 50/50
22 or 30/70.

23 In conclusion, since this is the first ERM
24 review, we believe it is important for the Commission to
25 provide guidance and direction regarding these important

0063

1 policy questions. We believe that taken collectively
2 the proposed settlement does not appropriately allocate
3 costs between rate payers and shareholders for the costs
4 proposed for inclusion in the ERM. Nor does it resolve
5 important policy questions this Commission will face
6 again all too soon. Finally, the settlement purports to
7 bind the Commission's future consideration of Coyote
8 Springs 2 costs by resolving all Coyote Springs 2 outage
9 associated costs in advance of the 2003 ERM review when
10 in our opinion half of those costs are yet to be
11 properly considered. Thank you.

12 JUDGE CAILLE: Mr. O'Rourke.

13 MR. O'ROURKE: John O'Rourke from the
14 Citizens Utility Alliance of Washington. Mr. Cromwell
15 did speak in detail and he answered your questions about
16 the ordinary versus extraordinary cost issue, but I have
17 come here today because we feel that this is a very
18 important issue that the Commission should address in
19 this the first ERM. Will the ERM continue to be a catch
20 all in which the company can dump all the costs it
21 wishes onto the rate payers, or does it become what it
22 was intended to be, a way to efficiently apportion
23 ordinary variations in power costs.

24 The language from Paragraph 38 of the
25 Commission's fifth supplemental order which authorized

0064

1 the ERM states that the ERM is for the recovery of
2 ordinary variations in power costs. It states:

3 We also clarified through colloquy with
4 the witnesses that the ERM is intended
5 to address only the ordinary variations
6 in power costs that may occur going
7 forward, not extraordinary costs.

8 In the following paragraph of that order,
9 Mr. Elgin from the Commission Staff says:

10 The ERM is expected to deal with "normal
11 variability of hydro" and that the ERM
12 is not meant to deal with "extraordinary
13 circumstances".

14 And in this case in his direct testimony,
15 Mr. Buckley identified the ordinary power costs he
16 thought belonged in the ERM. He said:

17 Anything other than normal weather
18 variation, normal variations in water
19 conditions, reasonable variations in
20 wholesale prices, and normal day-to-day
21 operations should be considered an
22 extraordinary variation.

23 And he said:

24 There should be no presumption that any
25 such item or variation is recoverable

0065

1 under the ERM.

2 And we agree, but unfortunately the critical
3 issue of what belongs in the ERM and what does not is
4 left unanswered by the proposed settlement. Unless the
5 Commission acts and clarifies this process, we can
6 expect to see the company continue to try to use this
7 process to recover more of the extraordinary costs that
8 this process was never meant to address. Without the
9 Commission's firm guidance on what belongs in the ERM,
10 we will be left with the current inefficient process in
11 which the company will present us with a haystack of
12 information, and we will be forced to search that
13 haystack for the needles that don't belong and then try
14 to convince the company or the Commission that they do
15 not belong.

16 And frankly speaking, public interest
17 organizations like mine, we don't have the resources to
18 pick through ERM's every year, and that's why we feel
19 that we need to go back to what the original words were
20 in the order and what we think the ERM was intended to
21 be. So we are asking the Commission to use this, the
22 first ERM, to establish that the ERM will only involve
23 ordinary costs and not extraordinary costs or events,
24 and so we ask the Commission to reject the proposed
25 settlement in its current form.

0066

1 JUDGE CAILLE: Mr. Trotter, were you planning
2 to go next?

3 MR. TROTTER: No, Your Honor, I think it
4 would be appropriate for the panelists to go ahead.

5 I would like just to make one brief comment,
6 and that is that the order that we're talking about
7 setting up the ERM did not preclude the company from
8 asking for extraordinary costs. It simply asked them to
9 identify them and prove they're entitled to recovery.
10 We can debate about whether they have done that, but
11 it's certainly permitted under the Commission order for
12 them to ask for it, and certainly in this docket we
13 eventually got there. As you know, they were required
14 to produce specific testimony on the specific issues,
15 and they did so. So I guess just as a legal matter I
16 will need to take objection to Mr. O'Rourke's statement
17 that extraordinary costs are not recoverable through the
18 ERM, they plainly are. The order said that they have to
19 specifically request recovery, so they did, and that's
20 where we are. So I just wanted to point out to you that
21 is more of a legal matter than a matter to be addressed
22 by the experts.

23 But with that, I would just think that our
24 panelists can answer your questions or respond to what
25 they have just heard at your pleasure.

0067

1 COMMISSIONER HEMSTAD: Well, it would seem to
2 me we have two issues. One, there's a general defense
3 or the argument is about the settlement document that's
4 in front of us, and then there's the question of the
5 criticisms that are critiqued from Public Counsel. I'm
6 sure they overlap, but they're somewhat different. So
7 how does the panel or the attorneys, do the attorneys
8 propose that those issues be separated or merged?

9 MR. NORWOOD: I guess I would be glad to
10 respond to the issues raised by Public Counsel, but at
11 the same sense I don't want to go through some material
12 that you already know or are familiar with, but I think
13 it would be appropriate to respond to a number of the
14 issues that have been raised to clarify a number of
15 things that have already been raised by Public Counsel.

16 CHAIRWOMAN SHOWALTER: I mean it strikes me
17 that a kind of a presentation of the settlement and an
18 explanation of its elements during which you address the
19 objections raised by Public Counsel would be helpful.

20 MR. NORWOOD: Okay, I would be glad to do
21 that.

22 Okay, Mr. Buckley says that I can go, and
23 then he will go. I'm sure they will chime in as we move
24 through this.

25 So going then to the stipulation, and perhaps

0068

1 I will just walk through page by page so that we can
2 cover each issue in order, I will start with page 2
3 under contested issues. And the first issue identified
4 at the bottom of page 2 of the stipulation is Enron
5 contract buyout. And as you have heard, this is an
6 agreement where Avista had entered into an agreement
7 with Enron to purchase power from them for the period
8 2004 through 2006, so it was a three year purchase that
9 we had made from them. 25 megawatts was the amount.
10 The price is confidential. Through Enron's bankruptcy
11 and working with the bankruptcy judge, we had the
12 opportunity to enter into an agreement to buy out that
13 contract, and so through negotiations we were able to
14 negotiate a price to buy that contract out. And along
15 with that buyout, Enron actually owed Avista for prior
16 sales to them an amount of money. It was basically
17 accounts receivable for us where we had already provided
18 the services, but they had not paid us because of the
19 bankruptcy situation.

20 And so through that process, then we bought
21 out the contract, made a payment to Enron in October of
22 '02, which was during the review period, and we booked
23 that payment, approximately \$1.8 Million for the
24 Washington jurisdiction, we booked that to the account
25 555, purchase power account, and that entry was made

0069

1 consistent with what we're required to do under
2 generally accepted accounting principles. Under our
3 accounting practices and principles, we have to record
4 that, and we did consistent with those principles.

5 In the monthly report that we sent to the
6 Staff, the Commission, as well as the other parties, we
7 identified that contract as an item that occurred during
8 the period, and I think it was a week after that one of
9 the Staff members called us and asked for a copy of the
10 agreement. So in that sense, when we talk about
11 ordinary or extraordinary, what are the factors driving
12 the deferral balance, this was a case where we
13 identified that as an item, a unique item, and Staff
14 followed up and asked for more information. And then,
15 of course, in this filing then we have provided
16 testimony and supporting documentation of the economics
17 of the deal as well as the accounting for the deal.

18 Now it's my understanding that at least with
19 the signing parties to the stipulation there's no
20 disagreement that it was the right thing to do to buy
21 out the contract. The economics were right, it was the
22 right thing to do. The issue that we have before us
23 here in this case is that was it appropriate to book all
24 of it in '02, or should you have spread it to the '04 to
25 '06 period. Through this stipulation what we have

0070

1 agreed to is to remove \$921,000 from the deferral
2 balance currently and then amortize that balance over
3 the 2004 to 2006 period. And as part of the stipulated
4 settlement, we have agreed that that's a reasonable
5 resolution of that Enron issue.

6 I will make another comment about the or
7 respond to the comment about ordinary and extraordinary.
8 There are a number of things that have been raised here.
9 One example was the Colstrip outage, and there was a
10 question about is that ordinary, is it extraordinary.
11 It's a given that those types of projects are going to
12 be out from time to time, and in our view we don't think
13 that -- it's going to be very difficult to try to
14 determine now what's ordinary and what's not ordinary.
15 And what we have proposed through this stipulation is as
16 we continue to provide these monthly reports to the
17 Commission, to ICNU, to Public Counsel, we will continue
18 to identify those items that are driving the deferrals.

19 And also in here we have indicated that as we
20 get to the end of the year and get ready to file the
21 annual review filing that the -- we will -- the parties
22 can request a technical conference where we will get
23 together and provide opportunity for them to identify
24 any issues in those reports, and we'll talk about the
25 major factors driving the deferrals. And then we would

0071

1 plan to include testimony, exhibits, supporting
2 documentation around those issues as well as other
3 documentation regarding the deferrals for the period.

4 CHAIRWOMAN SHOWALTER: Well, just on this
5 issue of extraordinary and ordinary, this ties in with
6 Mr. Trotter's comments earlier, is this a correct
7 characterization? In order to litigate and resolve
8 these issues, we would have to first decide as a
9 conceptual matter what constitutes ordinary and what is
10 extraordinary, and then we would have to make a factual
11 determination of individual expenses as to which side of
12 that line they fell on, but that in any event, whether
13 they are ordinary or extraordinary, recovery is
14 available if justified, and that here the settling
15 parties agreed that amounts in the settlement are
16 justified without perhaps agreeing among themselves
17 whether those amounts fell on the ordinary or
18 extraordinary side of the line, that is from each of
19 your points of view, however you view extraordinary and
20 ordinary in these facts, you agree that the amounts in
21 the settlement are appropriate.

22 MR. NORWOOD: I don't think that from what --
23 I believe what Mr. Trotter said does not require us to
24 try to put it into a category of ordinary or
25 extraordinary. As Mr. Trotter said, the ERM mechanism

0072

1 allows us to recover the costs irrespective of whether
2 they're one or the other as long as there's opportunity
3 to review those costs. And what we have committed to do
4 is to identify those items through the monthly reports
5 and provide information through the filings so that all
6 the parties can review them, whether they're ordinary or
7 extraordinary, and then make recommendations on whether
8 they're reasonable or not.

9 MR. BUCKLEY: Let me add something on that.
10 I think the settlement also -- the main feature for me
11 is to -- and I think the other parties on the settlement
12 is that it still allows us to identify items on a
13 ongoing basis that we think may be extraordinary, if you
14 will, and require an additional level of testimony and
15 support to be included in the ERM. It's not meant to
16 preclude any outcome of any further litigation on those
17 issues. It's simply meant to kind of give a heads up to
18 the company saying the parties think that X is an issue
19 that you really need to do your homework on and provide
20 a reason for rate payers to be picking up those costs
21 through the ERM and -- but we could still litigate
22 whether we think those are appropriate to be included.
23 We may still disagree, and we may disagree to the extent
24 that they should be recovered if at all. But the point
25 is it allows us a chance to at least during the period

0073

1 to identify those.

2 And in my original testimony I was asking the
3 Commission to perhaps identify specific issues that may
4 be considered extraordinary versus ordinary. The
5 settlement does not require that but -- and I think it's
6 acceptable for purposes of the settlement. Because as
7 soon as we start identifying one issue, then another one
8 will come up that wasn't identified, and so I think it's
9 better just to do it on a month-by-month basis of us
10 looking at the reports, seeing what's going in there,
11 and then giving a heads up to the company on whether
12 that needs that extra level of support that the original
13 ERM settlement anticipated.

14 CHAIRWOMAN SHOWALTER: Okay. But that
15 monthly process you're talking about is prospective, and
16 what my question really has to do with the amounts of
17 money that are settled in this proposed settlement.
18 They're backward looking, right?

19 MR. SCHOENBECK: I would answer your question
20 as just an affirmative yes.

21 CHAIRWOMAN SHOWALTER: Thank you.

22 MR. SCHOENBECK: Whether you call these
23 issues ordinary or extraordinary, we have agreed that
24 these are the amounts that should be booked and the
25 reductions in the UM balance attributable to them.

0074

1 COMMISSIONER HEMSTAD: I will make a comment
2 and a question. All right, so the point is that whether
3 something ultimately is classified as ordinary or
4 extraordinary, all of those costs are potentially able
5 to be included within the ERM?

6 MR. BUCKLEY: The company can ask for those.

7 COMMISSIONER HEMSTAD: Yes.

8 MR. BUCKLEY: Yes.

9 COMMISSIONER HEMSTAD: Well, I would like to
10 interject right there and come back to Mr. Cromwell and
11 Mr. O'Rourke, do you disagree with that?

12 MR. CROMWELL: I would agree with
13 Mr. Trotter's analysis that the fifth supplemental order
14 in the underlying rate case does not preclude the
15 company from asking for recovery of costs. What I would
16 say --

17 COMMISSIONER HEMSTAD: Recovery of the
18 extraordinary costs --

19 MR. CROMWELL: Of extraordinary costs.

20 COMMISSIONER HEMSTAD: -- within the ERM?

21 MR. CROMWELL: Within the ERM. I would have
22 to go back and look at it, but that is my recollection.
23 To be honest, I haven't looked at the fifth supplemental
24 order in quite some time, but I think the point was that
25 the testimony before you in that case was that the

0075

1 purpose of the ERM was for recovery of ordinary costs,
2 and it was our expectation that any recovery of
3 extraordinary costs would be considered on a fact
4 specific basis with regard to that proposed cost.

5 CHAIRWOMAN SHOWALTER: Okay, but isn't this
6 proceeding, hasn't this proceeding, not today but
7 leading up to today, done exactly that?

8 MR. CROMWELL: That would I suppose depend
9 upon the outcome of this proceeding today.

10 CHAIRWOMAN SHOWALTER: Well, no, I'm saying
11 have the expenses, whether you call them extraordinary
12 or ordinary, been raised among the parties for review as
13 to whether they should be recovered either as
14 extraordinary or as ordinary?

15 MR. CROMWELL: Yes.

16 CHAIRWOMAN SHOWALTER: Okay, thank you.

17 MR. NORWOOD: May I add something there. In
18 Exhibit 3 in this docket is an excerpt of the
19 Commission's order. At the bottom of that page, it
20 says:

21 There is nothing in the settlement
22 stipulation that precludes the company
23 from seeking relief from extraordinary
24 or other circumstances that call for
25 modification of the ERM.

0076

1 That's the text that follows what
2 Mr. O'Rourke stated earlier in terms of ordinary and
3 extraordinary. I think it's also important to note that
4 when Mr. O'Rourke read his statement from Mr. Elgin's
5 testimony, he didn't finish all of what Mr. Elgin said
6 in terms of the definition or what we're looking at,
7 ordinary and extraordinary. And in here it shows that:

8 From Staff's perspective, the settlement
9 agreement does not deal with
10 extraordinary circumstances that we have
11 dealt with in 2000/2001 period that gave
12 rise to the existing deferrals. The
13 settlement does not deal with those
14 conditions, it just can't, those impacts
15 and costs are just too big.

16 And it goes on. My point is that the
17 stipulation and the order did not define what is
18 ordinary and extraordinary. It did not preclude the
19 company from including the costs that fall into these
20 accounts that are being tracked through the ERM, and the
21 company is committed to identify those issues monthly,
22 which we have. And the Staff has followed up with
23 questions and need more information, and I think that
24 works very well and we will continue that through the
25 future.

0077

1 COMMISSIONER OSHIE: Mr. O'Rourke, did you
2 have a comment?

3 MR. O'ROURKE: Yes, two concerns. When do we
4 have a general rate case, if these costs all go into the
5 ERM, when does the public at large participate in this
6 process, when does the public at large get to comment on
7 this if we -- if they can -- my vision of this is that
8 extraordinary costs, sure, they can petition, but it
9 would be public policy that it be rejected and that it
10 be put into a general rate case where there's larger
11 public participation.

12 CHAIRWOMAN SHOWALTER: I'm not sure you
13 should be asking me the questions, but I guess I will --

14 MR. O'ROURKE: Well, I didn't mean to ask you
15 a question. I'm just making a statement that --

16 CHAIRWOMAN SHOWALTER: Well, maybe that was a
17 rhetorical question.

18 MR. O'ROURKE: I mean what I'm saying is this
19 is the first ERM and these -- we don't want to paper
20 over these questions.

21 CHAIRWOMAN SHOWALTER: All right.

22 MR. O'ROURKE: I think now is the appropriate
23 time.

24 CHAIRWOMAN SHOWALTER: But isn't there going
25 to be a 90 day proceeding periodically with public

0078

1 notice and potential review of the expenses that have
2 not yet been resolved to date?

3 MR. NORWOOD: That's correct. On or before
4 April 1 of every year the company will file, and we have
5 committed here to file testimony and exhibits
6 identifying the deferrals through the ERM and what the
7 reasons were, and there's opportunity then for
8 participation by all parties.

9 CHAIRWOMAN SHOWALTER: And that seems to me
10 to be your answer, Mr. O'Rourke. Like any rate case, a
11 general rate case also can be settled. And it just
12 means that if we accept the settlement, then the issues
13 raised or not or policy issues not resolved in that case
14 or expenses to date resolved by the settlement are
15 resolved, the next period becomes the next period both
16 for the subsequent expenses or rates as well as for
17 ongoing or unresolved or new policy issues.

18 MR. BUCKLEY: I think it's also important to
19 point out that the purpose of the language in the
20 settlement is also to make sure that the burden of proof
21 is on the company to justify the inclusion into the ERM
22 and the associated cost, and I think that addresses -- I
23 think one of Mr. O'Rourke's problems is that it should
24 not be for the parties to look through that haystack for
25 the needle that -- and then bring that up as an issue.

0079

1 The purpose of this is to allow the parties that are
2 reviewing the monthly reports and the subsequent annual
3 filing or information or whatever we have at the end of
4 the period, whether it be a technical conference or
5 something like that, to point out and make it clear to
6 the company that these issues need to be supported and
7 that it's not up to those parties to provide the backup
8 or the burden of proof for including that into the ERM,
9 that it's the company's. I think that's what that does.

10 MR. NORWOOD: If I may continue on to Coyote
11 Springs 2 and the delay of that project. As has been
12 mentioned earlier, the project was originally scheduled
13 to come on line in the middle of 2002. The project was
14 delayed because of the bankruptcy as well as -- the
15 bankruptcy of Enron as well as the problems with the
16 generator step-up transformer. The project was delayed
17 until July 1 of 2003. We agree as a company that the
18 delay of the project during the ERM period did result in
19 costs being higher than what they otherwise would have
20 been if Coyote Springs had been available. As we have
21 progressed through this proceeding, the company has
22 negotiated with the parties and have agreed to reduce
23 the ERM balance by an amount that's listed in here
24 regarding the -- to reflect that delay in Coyote Springs
25 2, and we have agreed that -- to resolve that issue

0080

1 through June 30th of 2003.

2 Of course, there was some discussion earlier
3 about the end of '02 versus the end of '03, July of '03.
4 This really is a single issue. If this is not resolved
5 through June 30th of '03, we would be rehashing the same
6 issue. It's a 12 month outage. It's a continuation of
7 the same original outage of the plant, and so the
8 agreement of the signing parties anyway is that it is
9 reasonable and appropriate to deal with this now in this
10 proceeding, resolve it through June of '03.

11 We have continued to provide the monthly
12 reports, and of course this is December of '03, so we
13 continue to provide the monthly reports to Staff and
14 other parties related to the deferrals during the
15 January through June period.

16 MR. SCHOENBECK: Could I add something on
17 this one, Kelly, are you done?

18 I would also like to say we were very
19 supportive of having this particular issue go through
20 the full 12 month period because it's actually, as was
21 duly noted, we have all the historical information
22 already, all of these events have occurred, and right
23 now the debt is fresh, particularly with regard to not
24 only their replacement power purchases but also with the
25 alternative market purchases where both with respect to

0081

1 the market price of gas and the forward market price of
2 spot purchases. So since the information was so
3 current, we thought it would actually be an efficient
4 process to resolve this issue for the entire 12 month
5 period.

6 Having said that, I also want to say what
7 this particular part of the settlement does not address
8 which we could subsequently address in another ERM
9 application, and that has to do with the capital costs
10 associated with the plant, and it also has to do to the
11 extent with all the other spot market purchases. In
12 other words, to the extent the spot market purchases
13 incurred even for the period of January through June
14 2003 were extraordinarily high or far above what the
15 market prices were at that time, we could also challenge
16 those particular purchases. So in actuality it's a very
17 narrow issue that's being decided here, and what the
18 issue is is the variable of costs associated with the 12
19 month delay in Coyote Springs.

20 MR. TROTTER: Your Honor, may I just ask a
21 clarifying question?

22 JUDGE CAILLE: Yes.

23 MR. TROTTER: I think Mr. Schoenbeck said
24 there could be recovery of the capital costs associated
25 with Coyote Springs through the ERM, and I don't know if

0082

1 he meant that or a general rate case.

2 MR. SCHOENBECK: Oh, I meant a general rate
3 case.

4 MR. TROTTER: Perhaps Mr. Buckley can just
5 briefly indicate whether capital costs are recovered
6 through the ERM or whether those accounts do not include
7 that type of costs.

8 MR. BUCKLEY: I agree with that, that would
9 be an issue for the next general rate case. There is in
10 rate base or rates now embedded the original costs
11 associated with Coyote, but this would be an incremental
12 capital cost associated with those actions, associated
13 with the delay in the transformer in that.

14 MR. TROTTER: Thank you, Your Honor.

15 MR. NORWOOD: Moving on then unless there's
16 other questions on the delay of CS2.

17 Another issue that was raised earlier was the
18 natural gas contracts and the question of did the
19 company achieve the right value or adequate value from
20 the sale of those contracts. I think it is important to
21 note, and actually all three of the parties, Staff,
22 ICNU, and Public Counsel recognized that the original
23 decision to purchase that natural gas back in 2001 has
24 already been addressed in a prior proceeding, and so
25 what we're dealing with here and Public Counsel's case

0083

1 is witness Elder raised the issue of did we pick the
2 right days to sell the gas and in many cases buy the
3 power in order to gain the maximum benefit or the right
4 benefit for customers. And in our view, as I mentioned
5 before, there -- in most of the cases where we actually
6 sold the natural gas during the period, we actually
7 bought power, and the reason we did that was it was less
8 expensive to purchase electricity than to run the gas
9 through the turbines and produce electricity, and so we
10 sold the gas and bought the power.

11 Now in terms of did we pick the right days,
12 it's obviously difficult and I think everyone
13 understands and there was discussion earlier that can
14 you predict the market for electricity or natural gas,
15 and I believe the answer is no. If, for example, I knew
16 that the price of natural gas was going to be higher two
17 days from now, then I would obviously want to wait and
18 sell my gas two days from now. But the reality is I
19 would want to buy more gas today if I knew the price was
20 going to be higher, and then I would sell more gas two
21 days from now. The problem is you just don't know which
22 way the market is going to go whether it's tomorrow or
23 next week or next month or the quarters out.

24 What we have done, and we have outlined some
25 of it in the stipulation in an effort to try to respond

0084

1 to the concerns of Public Counsel, is to number one
2 provide more information around what the process is when
3 we make decisions. And maybe if I can just give you an
4 example. As we're looking out to the second quarter of
5 next year right now, Mr. Storro is the director of the
6 power resource group, he is looking at questions,
7 answering questions such as am I long or am I short.
8 And in some cases he may be long in April, or excuse me,
9 short in April but long in May-June if you have good
10 runoff. So he may be looking at decisions like selling
11 off April and then buying, or excuse me, buying April
12 and selling June. He's also looking at what the price
13 is for electricity in terms of making purchases as well
14 as the price of natural gas during that time frame, and
15 so he's going to be making decisions about if I'm short
16 am I going to buy electricity or am I going to buy gas.
17 So he's looking at the prices out there. He's also
18 looking at, to the extent he wants to make a deal,
19 looking at the counter parties that are available to do
20 a deal. And if, for example, out in June of next year,
21 you need to know whether June is trading yet. Is there
22 any liquidity in the market. It may be that Q2 is the
23 only thing that's trading right now, so if you want to
24 buy June, you have to buy April, May, and June.

25 So there's a number of factors that he's

0085

1 looking at in making his decisions around whether I buy
2 or sell. Unfortunately, there's not a magic formula or
3 a mechanism where you say, if all these things line up
4 automatically, then I automatically know that I'm going
5 to buy or sell. There just isn't that formula, so
6 there's all of those factors that go into the decision
7 to buy or sell.

8 What we have also indicated in here is that
9 we will continue to document and reinforce our
10 documentation to provide all those things that we look
11 at. I think it's been brought up earlier that there was
12 concern about, well, we provided documentation on the
13 days we did the deals, but there was concern about how
14 about the days you didn't do the deals. And in our
15 responses to discovery, we did provide information that
16 shows on a daily basis we do take a look at at least 18
17 months out what are our positions long or short, what
18 are market prices for that time period, both electric
19 and natural gas, what are the heat rates of our thermal
20 plants. And then given the market prices that are
21 there, is it going to be economic to run my thermals or
22 sell the gas and buy electricity. All of that analysis
23 is done on a daily basis, and we provided that in this
24 docket, and that will be available on a going forward
25 basis for everyone to take a look to see what the

0086

1 conditions were on a daily basis.

2 In our view in looking at the recommendation
3 of Public Counsel to the disallowance of the \$1,060,000
4 that they recommended, if you look at -- number one, my
5 concern is doing an after the fact Monday morning
6 quarterback approach of after the fact the numbers would
7 tell you yes, there are other days that we could have
8 chosen to get more value. The concern I have is that at
9 the time we did the deals, there really is no way to
10 know where the market is going to go. As is shown in
11 Mr. Storro's testimony, we actually did our own after
12 the fact where we took every day for six months prior to
13 the time that the gas was going to be delivered to see
14 on the days that we picked, did we do at least as well
15 as what the average would have been if you would have
16 done an equal amount every day, if you would have sold
17 an equal amount every day, and the result shows that we
18 actually did better than if you had chosen to sell an
19 equal amount every day or if you had done a random sale,
20 we actually did better than that. So even though I
21 don't believe that type of analysis is appropriate, I
22 think it demonstrates that we did make choices to
23 minimize the cost to customers, and in fact on every
24 occasion where we sold the gas, bought the power, it
25 resulted in a reduction in the cost to our customers

0087

1 which is credited back through the energy recovery
2 mechanism. And so for those reasons, I don't think that
3 the recommendation there is appropriate.

4 MR. BUCKLEY: Add a few comments. I think
5 this is a situation where we get there is some rebuttal
6 of previous comments by the parties versus the
7 settlement and just what the settlement, how it relates
8 to Staff's support of the settlement. I will simply
9 leave it at that. The settlement basically addresses, I
10 want to make it clear from a Staff perspective, only the
11 2002 gas resale transactions that were made, and it
12 addresses the adjustment that's proposed to the ERM
13 balance, it resolves any issues we have associated with
14 that time period only. The transactions that will be
15 made or have been made in 2003 will be reviewed in the
16 2003 review period and may be subject to, you know,
17 further testimony. So I just wanted to make it clear
18 what this settlement addresses as far as we're
19 concerned.

20 MR. NORWOOD: I think that covers the issues.
21 The issue of strategy for sales I think I have addressed
22 to some degree, and we have already covered the ordinary
23 and extraordinary.

24 JUDGE CAILLE: Are there any other questions
25 from the Commissioners?

0088

1 Mr. Cromwell, did you have anything further?

2 MR. CROMWELL: No thank you, Your Honor.

3 JUDGE CAILLE: Mr. O'Rourke?

4 MR. O'ROURKE: Nothing further.

5 (Discussion on the Bench.)

6 JUDGE CAILLE: All right, thank you everyone,

7 this will be taken under advisement.

8 (Hearing adjourned at 2:50 p.m.)

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25