Agenda Date: April 11, 2007
Item Number: A1

Docket: U-070311
Company: Avista Corporation

Staff: Mike Parvinen, Deputy Assistant Director - Energy

Recommendation

Issue an order granting the accounting petition in Docket U-070311 as filed.

Discussion

On February 14, 2007, Avista Corporation (Avista or company) filed an accounting petition with the commission requesting retroactive approval to account for certain debt repurchase costs in a manner that deviated from the commission’s rules. This filing responds to issues staff raised in recent discussions related to the appropriate amortization of costs associated with repurchasing debt for the period 2002 to 2006.

This accounting petition requests authority to continue the use of the accounting treatment for the debt repurchases that have occurred to date including the prior accounting treatment for these repurchase costs. The company states that any repurchases going forward will be in conformance with Federal Energy Regulatory Commission (FERC) General Instruction 17 (FERC 17) or the company will seek prior commission approval.

FERC 17 concerns the accounting for costs associated with the repurchase of debt. The commission has adopted FERC 17 through WAC 480-90-203 and 480-100-203, which directs gas and electric utilities to use the uniform system of accounts published by FERC.

In simple terms, FERC 17 states that when debt is repurchased and new debt is not issued to accomplish the repurchase, the costs to repurchase the debt should be amortized over the remaining life of the original debt that was retired. On the other hand, if new debt is issued to accomplish the repurchase, then the company can elect to: 1) expense the costs in the current year if the cost is small; 2) amortize the costs over the remainder of the original life of the debt retired; or 3) amortize the costs over the life of the new debt. Any deviation from these options requires prior commission approval. *See* WAC 480-90-203(3) and 480-100-203(3).

Avista has deviated from FERC 17 without commission approval by amortizing debt requisition costs over the average life of all outstanding debt. The company states that it chose the amortization method based on what it believed was reasonable and appropriate at the time.

This issue has arisen from the energy crisis of 2000 and 2001. Avista issued $400 million of high cost debt to purchase power and natural gas. This resulted in high cost debt and an increased debt ratio (total debt to total capitalization). Avista’s financial position weakened and its credit rating dropped below investment grade, which also triggered the interest rate on other debt issuances to increase. Avista’s interest costs rose over $35 million a year, a 52% increase.

Avista, in order to improve its financial position, began a program of reacquiring the high cost debt in order to reduce interest expense. Based on data supplied by Avista, the company repurchased a total of $325,540,000 in debt in 58 separate open market transactions from 2002 to 2006. The total cost of these transactions to be amortized was $23,709,308. The effect of Avista deviating from the FERC 17 accounting requirements varies by year and is shown in Attachment A and B. Line 13 of Attachment B, which identifies the difference in the debt amortization by year between the FERC 17 and Avista method, is shown in graph form in Attachment A.

Attachments A and line 13 of Attachment B show that Avista was able to increase earnings in 2002 and 2003 by amortizing the debt reacquisition costs using the method it employed. The impact on rate payers is debatable given that the company's last two rate cases were settled. However, 2003 and 2004 were the test periods in those rate cases and the company used its booked costs in its debt rate presentations. One could reasonably assume that customers received the benefit using Avista booked debt costs in the 2003 test period and then a slight higher cost, when compared to the FERC 17 approach, in the 2004 test period. Customers will incur higher costs for the next several years using the company's proposed method.

On April 6, 2007, the Industrial Customers of Northwest Utilities (ICNU) submitted a letter to the Commission with comments and recommendations regarding this filing. ICNU's primary concerns are addressed elsewhere in this memo or they missed the mark. The stated PSE case supports staff and not ICNU in that the Commission reaffirmed that accounting petitions must be filed, but recovery of costs was allowed as though a petition was in place (except a return on the balance). Also, no attempts were made with staff to resolve any issues. Staff's only discussions with ICNU were prior to the March 14, 2007, open meeting in which this item was pulled from the agenda. Staff, at that time, provided its opinion that ICNU could argue the appropriate rate making treatment in the next general rate case even with approval of the petition. No conversation has taken place since then. Staff was not aware of ICNU's specific concerns and position until its April 6 letter.

Conclusion

Staff considered two options with regard to this petition: 1) Set the matter for hearing where the commission could consider other remedies including penalties and writing off the difference in total amortization in order to bring the company back into conformance with FERC 17; or 2) Approve the petition as filed. While staff does not support or condone the actions of Avista with respect to the accounting methods it has followed related to the cost of reacquired debt, the staff does support this petition to the extent that Avista acknowledges improper past accounting practices and agrees to follow the commission's rules in the future, or to seek prior permission to vary from those rules.

Attachment A
Attachment B