

BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET NO. UE-991255

DIRECT TESTIMONY OF THOMAS D. DUKICH
REPRESENTING AVISTA CORPORATION

1 I. INTRODUCTION

2 Q. Please state your name, business address and present position with the
3 Company?

4 A. My name is Thomas D. Dukich. My business address is East 1411 Mission
5 Avenue, Spokane, Washington. I am the Manager of Rates and Tariff Administration. I joined
6 the Company in 1978 after having been previously employed as an Associate Professor at
7 Gonzaga University.

8 Q. Would you briefly describe your duties?

9 A. My responsibilities as Rates Manager include the formulation and management
10 of the Company's plans and activities related to the regulation of gas and electric services in
11 the states of Washington, Idaho, Oregon, and California.

12 Q. Would you describe your educational background?

13 A. I graduated from the University of Minnesota in 1967 with a B.A. in Psychology
14 and Business, and from the University of Montana in 1972 with M.A. and Ph.D. degrees in
15 Experimental Psychology, Statistics and Research Design. During my 20 years of employment
16 at Avista I have completed courses and seminars on strategic planning, forecasting, finance,
17 accounting, rate design and pricing.

18 Q. What is the scope of your testimony?

19 A. I discuss the basis for Avista's proposal relating to the disposition of the book
20 gain resulting from the sale of Centralia ("the sale"). In my testimony I attempt to provide a
21 general framework of issues for the Commission to consider rather than focusing on a specific
22 methodology regarding the disposition of the gain. I also briefly discuss the Company's

1 position regarding the depreciation-based proposal put forth by PacifiCorp.

2 Q. Are you sponsoring any exhibits in this proceeding?

3 A. Yes, I am sponsoring Exhibit Nos. 307 through 310, as marked for
4 identification. I will introduce and describe these exhibits, as appropriate, later in my
5 testimony.

6 II. GAIN ON THE SALE

7 Q: Has the Company concluded that it is in the public interest to sell Avista's
8 share of Centralia?

9 A: Yes, for the various reasons summarized in Mr. Ely's testimony.

10 Q: Is there a gain on the sale of the Company's share of Centralia?

11 A: Yes. The after-tax gain related to the sale of the Company's 15% ownership
12 share is approximately \$29.6 million. Mr. McKenzie testifies to the calculation of this book
13 gain.

14 Q. Is it necessary to include the book gain in the economic analysis in order to
15 satisfy the no-harm standard as a result of the sale?

16 A. No. Mr. Johnson's analysis shows a present value of cost savings to customers
17 of \$7.7 million over the 20 year study period. His analysis excludes the book gain on the sale.
18 Therefore, the book gain represents additional value over and above the no-harm standard and
19 a determination needs to be made regarding the disposition of the gain.

20 Q: What should the Commission take into consideration in its decision related to
21 the disposition of the gain?

22 A: The Commission should consider various alternatives and, most importantly,

1 should consider the soundness of the rationale underlying these alternatives. In addition, the
2 Commission may want to consider how these alternatives relate to the unique circumstances
3 of each of the companies involved in the sale, i.e., the disposition of the gain for Avista may
4 appropriately be different than that for PacifiCorp or Puget Sound Energy.

5 III. PROPOSAL

6 Q. Turning now to the Company's proposal for the disposition of the gain on the
7 sale of Centralia, what are you recommending?

8 A. I am asking the Commission to consider allowing Avista to retain all of the book
9 gain relating to the sale. Admittedly, this may be viewed by some as an "aggressive" position
10 for the Company to take. But I believe there are circumstances that warrant giving this
11 proposal serious consideration. Should the Commission decide that 100% is not appropriate,
12 the Company believes there is still a rational and reasonable basis that would support a
13 shareholder retention level above the depreciation based approach proposed by PacifiCorp. I
14 also recommend that the Commission consider the gain in its historical context. I believe that
15 a discussion that puts the gain in an historical context unique to Avista will provide useful
16 information for the Commission to consider, regardless of the methodology the Commission
17 ultimately adopts.

18 In part, the rationale behind the Company's proposal begins with a principle that this
19 Commission recently articulated in its order in Docket No. UE-990267 relating to the sale of
20 the Colstrip Generating Plant ("Colstrip Order").

21 Q. What principle did the Commission discuss in the Colstrip Order that relates to
22 your argument?

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A. The Commission discussed how a transaction should strike a balance between the interests of ratepayers and shareholders that is fair, and that preserves affordable service (Colstrip Order, pages 5 and 9). So, the first element I suggest the Commission consider is the historical balance that has evolved over the years between Avista customers and Avista shareholders, and take this balance into account in its determination of a fair and equitable disposition of the gain.

Q. What is the other element?

A. The second element is related to fairness. It is the notion that the benefit of a gain should follow the risk of possible loss. It would seem to be equitable that if shareholders take risk, that risk should result in occasional gains, not just exclusively losses. Stated another way, a policy that awards all or most of the gains to customers, and occasional losses to shareholders would seem to be inequitable.

Q. Please explain further the first element related to the balance that has evolved over the years between Avista customers and Avista shareholders.

A. Exhibit No. 307 shows Avista's overall electric rate of return since 1973, the first full year Centralia was placed in utility service. It is clear from Exhibit No. 307 that, more often than not, Avista's rate of return has been below that considered fair and reasonable and authorized by the Commission. Certainly, it is clear that Avista's rate of return has not been guaranteed during these years. And, I think it is fair to say, Avista shareholders have not been unduly enriched during this time.

Exhibit No. 308 shows how Avista's Residential rates have compared with over 200 other investor owned utilities for the last 20 years (1978 to 1999). Rates for residential

1 customers have consistently been among the very lowest in the United States, most often
2 ranking third lowest or better. A typical bill for an Avista electric customer has averaged less
3 than one half the U.S. average.

4 Q. What do you conclude from these two exhibits?

5 A. Customers seem to have been exceptionally well served over the past 20 years
6 in terms of rate levels, and it appears that shareholders have not been unduly enriched during
7 this time.

8 Furthermore, the Company has consistently receive high marks for its customer service.
9 For example, Theodore Barry & Associates, in an independent survey of electric utilities in
10 1998, ranked the Company number one in overall customer service performance. The
11 Company surpassed 33 other energy providers for the lowest annual customer service expense,
12 while receiving one of the highest customer satisfaction ratings in the survey group. In 1999,
13 Avista's customer service call center was selected as the Best Call Center of the Year by Call
14 Center Magazine.

15 Q. Did shareholders suffer any losses during the time periods covered by Exhibit
16 Nos. 307 and 308?

17 A. Yes, and this leads to the notion that the benefit of a gain should follow the risk
18 of possible loss.

19 Exhibit No. 309 shows the major write-offs booked by Avista since 1985. The after-tax
20 total for the electric utility system is \$58.7 million; pre-tax write-offs were in excess of \$96
21 million. These include write-offs associated with Skagit, WNP-3, Kettle Falls, Creston and the
22 sale of Meyers Falls.

1 Exhibit No. 310 helps put these write-offs in the context of the Company's net utility
2 plant investment since 1985. Between 1985 and 1998, electric net utility plant has increased
3 by \$52.2 million. Gross plant investment has increased by \$601.6 million. A comparison of
4 Exhibit Nos. 309 and 310 shows that after tax write-offs have exceeded the change in net plant
5 investment since 1985. In terms of incremental gross plant investment since 1985,
6 approximately 10% has been written off, after tax. On a before tax basis, 16% of incremental
7 gross plant investment has been written off.

8 Q. Are you claiming that the Company was treated unfairly by having to incur such
9 significant write-offs?

10 A. Fairness in past Commission decisions is not really the issue here. This is not
11 a matter of second guessing the Commission with regard to prudence and I am not contending
12 that the Commission should ignore the "used and useful" standard or any other rule or law.
13 What is relevant is that the shareholders took risk in making these investments in order to
14 discharge the utility's public service obligations. The net result is that shareholders did not
15 realize a return on their investment, or did not recover all of their investment, or both. In other
16 words, they took a risk and lost.

17 In the specific case of Kettle Falls and WNP-3, shareholders took a risk in building a
18 resource and in subsequent regulatory proceeding were not allowed to recover all of the costs.
19 Again, the exact reason for taking the write-offs is not the most important point. The important
20 point is that significant after tax write-offs have occurred—approximately 10% of gross plant
21 investment since 1985. Shareholders are exposed to unexpected losses. There is no guaranteed
22 return on the investments, or guaranteed return of the investments. Unexpected shareholder

1 losses are not recovered.

2 The question then becomes: If there is an unexpected gain, who should get it,
3 shareholders or customers?

4 Q. Are you familiar with any situation where shareholders took a risk and won?
5 For example, are you familiar with any situation where shareholders took a risk in building a
6 resource, or making a purchase, and in a subsequent regulatory proceeding were allowed by this
7 Commission to retain all or even a part of the “gain” or savings?

8 A. No. I can’t recall a single instance. Usually the opposite is true. For example,
9 the Company purchases over 100 average megawatts of power under long-term contracts from
10 the Mid-Columbia public utility districts at an average cost below a penny per kWh. The prices
11 for these contracts are well below market and have been for many years, which has provided
12 the Company's retail customers with significant benefits. But because there is no rate base
13 treatment or other provision for shareholders to benefit from these very favorable contracts,
14 100% of the benefits are being flowed through to customers.

15 Q. What do you conclude from this discussion?

16 A. Customers have enjoyed rates among the very lowest in the United States and
17 high levels of customer service. Shareholders, on the other hand, have frequently achieved
18 returns below those authorized by the Commission and have incurred substantial write-offs.
19 Shareholders have not shared in efficiency gains achieved by Avista management nor have they
20 shared in savings achieved by the purchase or construction of below market resources.¹ As

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22 ¹. However, for natural gas service, the Commission has recently allowed Company shareholders the opportunity to retain certain purchasing and gas management efficiencies through the Gas Benchmark Mechanism.

1 stated earlier, its seems inequitable for shareholders to receive none of the benefits from "good
2 decisions," or opportunity sales that do no harm to the customer, and yet absorb losses
3 associated with investments that were deemed to be above-market or imprudent.

4 Q. How does this relate to your recommendation on the gain associated with the
5 sale of Centralia?

6 A. The Company requests that the Commission carefully consider the balance of
7 equities between shareholders and customers in deciding on the disposition of the gain from
8 the sale of Centralia. Given the write-offs Avista has taken, and given the historically low rates
9 and high quality service enjoyed by customers, it would be reasonable and equitable in this
10 particular instance to allow the Company to retain 100% of the gain associated with the sale.
11 This result would be consistent with the second standard articulated in the Colstrip Order, i.e.,
12 it would be fair and it would preserve affordable, efficient service.

13 IV. PACIFICORP PROPOSAL

14 Q: Does the Company have a view with regard to PacifiCorp's proposal, should the
15 Commission not find the above arguments persuasive?

16 A: Yes. At a minimum, Avista shareholders should be no worse off than under the
17 depreciation-based proposal put forth by PacifiCorp. As the Company understands this
18 proposal, shareholders are allowed to retain a portion of the gain that is proportional to the un-
19 depreciated amount of the Centralia investment. The remaining portion of the gain would go
20 to ratepayers in the form of an offset that will provide a direct benefit to customers. Mr.
21 McKenzie discusses how the depreciation-based methodology would apply to Avista. He also
22 discusses the Company's proposal for the disposition of the customer's share of the gain under

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such an approach. Although this approach is considerably less desirable to the Company, the disposition of the gain discussed by Mr. McKenzie does address, albeit to a lesser degree, the equity issues previously addressed in my testimony.

Q. Does this conclude your direct testimony?
A. Yes.

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

DOCKET NO. UE-991255
APPLICATION TO SELL THE CENTRALIA POWER PLANT

EXHIBIT NO. 307

WITNESS: THOMAS D. DUKICH, AVISTA CORPORATION

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

DOCKET NO. UE-991255
APPLICATION TO SELL THE CENTRALIA POWER PLANT

EXHIBIT NO. 308

WITNESS: THOMAS D. DUKICH, AVISTA CORPORATION

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

DOCKET NO. UE-991255
APPLICATION TO SELL THE CENTRALIA POWER PLANT

EXHIBIT NO. 309

WITNESS: THOMAS D. DUKICH, AVISTA CORPORATION

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

DOCKET NO. UE-991255
APPLICATION TO SELL THE CENTRALIA POWER PLANT

EXHIBIT NO. 310

WITNESS: THOMAS D. DUKICH, AVISTA CORPORATION