BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET NO. UE-991606

REBUTTAL TESTIMONY OF RONALD L. MCKENZIE

REPRESENTING AVISTA CORPORATION

Q Please state your name, business address and present position with Avista Corporation ("Avista" or "Company").

A My name is Ronald L. McKenzie and my business address is East 1411 Mission Avenue, Spokane, Washington. I am employed by Avista as a Senior Rate Accountant.

Q Have you previously provided direct testimony in this proceeding?

A Yes.

Q What is the scope of your rebuttal testimony?

A My rebuttal testimony addresses questions raised by Staff and Public Counsel concerning the impact of the Centralia sale, including the calculation of the gain, the impact of replacement power costs and the calculation and apportionment of state income taxes. In the process, I will address Mr. Roland Martin's proposals on updating the allocation percentage and how to handle the customer portion of the gain and explain why his proposals should be rejected.

Q Has the Commission issued orders pertaining to the sale of the Centralia Power Plant?

A Yes. The Commission has issued its Second Supplemental Order on March 6, 2000 and its Fourth Supplemental Order on April 21, 2000 in Docket No. UE-991255 pertaining to the sale of Avista's 15% interest in the Centralia Plant. The Commission has also issued an Original Order on March 22, 2000 and a Clarifying Order on April 21, 2000 in Docket No. UE-000080 pertaining to the sale of Avista's 2.5% interest in the Centralia Plant acquired from Portland General Electric.

Q Would you please summarize the requirements in the Centralia orders pertaining to the gain on the sale?

A Yes. The orders set forth and clarify how the gain is to be calculated and shared between shareholders and customers. Avista is required to recalculate the gain on the sale to match the date that the sale closes and provide the information to the Commission. Treatment of other states' taxes and treatment of the customer share of the gain are to be considered in these proceedings.

Q Has the Company previously provided information in its direct case with respect to its proposed treatment of the gain and replacement power costs?

A Yes. As I previously testified to in our direct case, at transcript pages 856-857, the Company proposed the following:

> "The Commission approved the sale of Centralia in Docket Number UE-991255. The Commission ordered that the rate treatment of the customers' share of the gain be addressed in this proceeding. With that in mind, the Company proposes that the customers' share of the gain be used to offset the Washington share of Ice Storm 1996 costs. We then propose that the remaining gain be amortized over an eight-year period, as was recently ordered in our Idaho case.
>
> The replacement power cost, as reflected in Exhibit C-194, should then be included in this case, together with the removal of the Ice Storm cost from Mr. Falkner's injuries and damages adjustment."

Q Do you have an exhibit showing the Company proposal, as outlined in your direct case, for the treatment of the customer portion of the gain?

A Yes. Page 1 of Exhibit No. ___ (RLM-1) shows the Company's proposal on how to treat the customer portion of the Centralia gain and shows the resultant impacts on the Company's electric revenue requirement. As indicated earlier in the Company's direct case, the Company proposes to first use the customer portion of the after-tax Centralia gain of approximately $19.9 million as shown on line 3 to offset Ice Storm 1996 costs of approximately $8.0 million as shown on line 4.

Q How is the Company proposing to treat the remaining portion of the Centralia gain after the Ice Storm offset?

The remaining after-tax gain of approximately $11.9 million shown on line 5 is proposed to be amortized to customers over an eight-year period and results in an increase in net operating income of $1,488,232 and a reduction in rate base of $11,161,741 as shown on lines 14 and 17, respectively, under the "Centralia Gain Adjustment" heading. Offsetting the cost of Ice Storm with a portion of the gain on the sale of Centralia will result in the removal of the amortization of Ice Storm costs from Mr. Falkner's Injuries and Damages Adjustment. The result is an increase in net operating income of $1,330,855 as shown on line 14 under the "Remove Ice Storm Adjustment" heading.

Q What is the net impact on the Company's revenue requirement of the Company's proposal regarding the sale of Centralia?

A Line 24 on page 1 of Exhibit No. ___ (RLM-1) shows the revenue requirement reduction of approximately $6.1 million associated with the Company's Centralia gain proposal. In addition, the rate base and costs associated with Centralia need to be removed from the test period and the replacement cost of power needs to be added. These changes are reflected in Exhibit C-194 and result in an increase in the revenue requirement of approximately $4.1 million. Mr. Norwood has addressed the cost of the replacement resource in his testimony given at the March 2000 hearing and in his rebuttal testimony. The net impact on the revenue requirement from the Centralia adjustments is a decrease of approximately $2.0 million.

Q Are the figures used to calculate the Centralia adjustments already reflected in the record in this case?

A Yes. Page 1 of Exhibit No. ___ (RLM-1) shows the source of all the information necessary to calculate the change in revenue requirement associated with the Centralia adjustments – matters which are already of record.

Q Does page 1 of Exhibit No. ___ (RLM-1) include slight revisions to the preliminary gain amounts associated with the sale of Centralia?

A Yes. Lines 1 and 2 on page 1 of Exhibit No. ___ (RLM-1) show gain amounts that reflect slight revisions to the preliminary estimated gain calculations that were reflected in the Centralia sale dockets. Exhibit No. ___ (RLM-2) shows the revised gain calculations. Page 1 shows the gain calculation for the Company's original 15% share of the Centralia Plant and page 2 shows the associated calculation and apportionment of state income taxes. Page 3 shows the gain calculation associated with the 2.5% share of the Centralia Plant purchased from Portland General Electric and page 4 shows the associated calculation and apportionment of state income taxes. However, at this point in time the calculations still include a number of estimates. It may be some time before final numbers are known. The Company will provide updated calculations, as actual amounts become available, with an update possibly being provided before the close of hearings in these proceedings.

Q How does the Company plan to handle the difference between the calculation of the gain shown on Exhibit No. ___ (RLM-2) or subsequent revisions to that exhibit and what the final gain may be after all figures are finalized?

A To the extent that the customer portion of the gain is increased or reduced, as final figures become available, entries would be made to adjust the deferred customer portion of the gain accordingly. In a future rate proceeding, the amortization amount reflected in rates or the amortization period would be adjusted to reflect any adjustments to the deferred gain that may have occurred.

Q Does Mr. Lazar object to the apportionment of state income taxes associated with the Centralia sale to Washington in his direct testimony?

A Yes. Mr. Lazar discusses his position on state income taxes at pages 30 and 31 of his direct testimony. His position is that Oregon and California state income taxes associated with the gain on the Centralia sale should not be apportioned to the Washington and Idaho jurisdictions. Mr. Lazar is silent on Montana state income tax. Mr. Lazar's position is without merit and should be rejected. To expect gas customers in Oregon and California to pay state income taxes associated with the Centralia sale is nonsense. State income taxes are a cost associated with the sale and should be shared by the jurisdictions receiving the benefit of the gain on the sale.

Q Would you please explain how state income taxes are handled in the calculation of the gain shown on Exhibit No. ___ (RLM-2)?

A Yes. Pages 2 and 4 of Exhibit No. ___ (RLM-2) show the calculation of state income taxes applicable to the gain on the sale of the 15% share and the 2.5% share of the Centralia Plant, respectively. Idaho, Montana, Oregon and California state income taxes will be impacted by the gain on the sale of the Centralia Plant. Those states use a three-part allocation factor based on property, sales and payroll that is applied to corporate taxable income to arrive at allocated income for each respective state. State income taxes are like federal income taxes in that they are a cost associated with making the sale of the Centralia Plant.

Idaho state income taxes are directly assigned to Idaho since the Company has electric operations in that state and the Idaho jurisdiction is willing to take a direct assignment of the Idaho state income tax. The Montana, Oregon and California state income taxes need to be allocated to the Washington and Idaho jurisdictions using the production/transmission ratio, just like the sales proceeds and other costs associated with the sale are allocated.

Q Absent the Centralia Plant sale transaction, does the Company pay Montana state income tax and how is the tax allocated?

A The Company does pay Montana state income tax because of the

Company's ownership of the Noxon Rapids hydro generation facilities. Montana state income tax is allocated to Washington and Idaho using the production/transmission ratio.

Q Does the Company have electric customers in Oregon and California?

A No. The Company only has gas customers in Oregon and California. It would not be appropriate to assign state income taxes associated with the Centralia sale to gas customers in Oregon and California.

Q Does the gain calculation and allocation of the gain between shareholders and customers follow the methodology set forth in the Commission's orders?

A Yes. The calculation and allocation of the gain between customers and shareholders follows the Commission's orders and uses the same methodology that the Company used in its "Attachment A" that the Commission affirmed in its Fourth Supplemental Order in Docket No. UE-991255 with the above discussed refinement for state income taxes.

Q Would you please explain why it is appropriate to offset a portion of the Centralia gain with Ice Storm 1996 costs?

A Yes. Mr. Dukich's rebuttal testimony again addresses the reasons that Ice Storm costs, as necessary costs of restoring service to customers, should be recoverable. Offsetting a portion of the Centralia gain with Ice Storm costs is an excellent way to provide recovery of the costs without increasing retail rates. The gain on the sale of the Centralia Power Plant is the type of event that does not occur on a regular basis. Likewise, the storm damage costs from Ice Storm 1996 relate to an unusual event. Mr. Norwood's rebuttal testimony proposes that the significant benefit associated with PGE deferred revenues be used to offset Ice Storm costs. The Company is not proposing to recover Ice Storm costs more than once. The Company is offering two alternative approaches to offset costs associated with Ice Storm 1996. If either of the two offset approaches is accepted by the Commission, the Ice Storm costs included in Mr. Falkner's Injuries and Damages Adjustment should be removed.

Q Would you please comment on Mr. Martin's proposal to update the allocation percentage to apply to the Centralia gain?

A Yes. The allocation factor used in the Centralia sale dockets to allocate the gain on the sale between Washington and Idaho was 66.99% for Washington and 33.01% for Idaho. The allocation factor used is the production/transmission allocation factor for the 1998 test period that is also being used in this proceeding. The allocation factor has been accepted by the Idaho Public Utilities Commission to allocate the Centralia gain. There is no reason to update the factor. Updating the factor would result in a reduction in the gain allocated to Washington operations, as the new factor for Washington is 66.14%. Mr. Martin's proposal to update the allocation factor should be rejected. In addition, once the allocation factor is decided, it should remain fixed. The allocation factor applicable to the gain should not vary from year to year. It should not be updated. If the Commission decides that 66.19% is the appropriate allocation factor for determining the Washington share of the gain, then that allocation factor should remain in effect until the end of the amortization period applicable to the gain.

Q Would you please comment on Mr. Martin's proposal to establish a Centralia bill credit equivalent to the DSM tariff rider?

A Yes. First of all, Mr. Martin proposes that a separate item should show on the bill for a Centralia bill credit. If there is to be a Centralia bill credit, the Company sees no need to separately state the credit on the customer's bill. Such a rate adjustment is no different than other rate adjustments and no rate adjustments other than municipal taxes are separately stated on the customer's bill. Further, separately stating rate adjustments may require costly changes in the Company's billing system.

Secondly, there is no rational basis for setting a Centralia bill credit equivalent to the DSM tariff rider rates. The Company would not object to having a separate tariff to pass through the remaining portion of the Centralia gain after the Ice Storm offset. However, the separate tariff rates should be based on a stated amortization period for the Centralia gain and not tied to the DSM tariff rider rates.

Q Does this conclude your direct testimony?

A Yes, it does.

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EXHIBIT NO. ___ (RLM-1)

WITNESS: RONALD L. MCKENZIE, AVISTA CORP.

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EXHIBIT NO. ___ (RLM-2)

WITNESS: RONALD L. MCKENZIE, AVISTA CORP.