BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-991606
DOCKET NO. UG-991607

REBUTTAL TESTIMONY OF THOMAS D. DUKICH
REPRESENTING AVISTA CORPORATION

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

A. My name is Thomas D. Dukich. My business address is East 1411 Mission Avenue, Spokane, Washington. I am the Director of Rates and Tariff Administration. I have held this position for 19 years and have personally been involved in nearly all the Company's filings before the Commission during this time.

Q. Have you previously filed direct testimony in this proceeding?

A. Yes.

Q. What is the scope of your rebuttal testimony?

A. I will provide an overview of the Company's rebuttal case with emphasis on areas where the Company finds staff and intervenor testimony particularly lacking in foundation or substance. I will introduce each Company witness submitting rebuttal testimony.

My testimony also responds to the testimony of staff and intervenor witnesses regarding the Kettle Falls equity adder, the Company's proposed 0.25% equity adder for efficient and innovative management, and the rationale for requesting recovery of ice storm costs.

Q. Are you sponsoring any exhibits with your rebuttal testimony?

A. Yes, Exhibit No. ___ (TDD-1) through Exhibit No. ___ (TDD-5), as marked for identification.

Q: Do you have any opening comments before turning to the specific issues you wish to discuss?

A: Yes. I am surprised by the acrimonious tone of certain staff and intervenor testimony. I am also surprised by the extreme nature of certain staff and intervenor proposals. Many of the recommendations seem somewhat reckless or out of proportion in relation to the proposals in our direct case.

My guess is that the perception of Avista's intentions with regard to the Monetization of the PGE sale has caused a level of resentment that has led staff and intervenors to make recommendations they otherwise may not have made. I also sense a level of discomfort with the approach Avista has taken in order to assure its survival as an independent utility.

For the Company's part, it is difficult for us as Avista employees not to take staff and intervenor recommendations for a rate decrease somewhat personally and as "negative feedback" regarding the work we have done since the last general case some 13 years ago. The staff's electric revenue recommendation is $40 million lower than the Company's original request. On the face of it, it is simply hard to believe the Company would not require some rate relief when inflation alone has gone up almost 50% since our last general rate request.

All that said, the Company is now in the position of having to decide how to deal with the situation that has developed. To vigorously respond risks creating a more contentious situation. To ignore or not vigorously respond risks fostering the perception that a proposal may have merit. Or it risks not fulfilling a responsibility to the Company's customers, employees, and shareholders.

In the end, we have little choice but to challenge what we consider to be poorly reasoned proposals and unfair accusations and to match the intensity with which they were presented in the first place. However, we do so with some regret.

Q. What specific issues do you wish to address?

A. The Company considers the following as extreme positions that ought to be totally rejected by the Commission. I note the approximate revenue impact of the issue in parentheses following the heading.

PGE Monetization Transaction ($11 Million). In simple terms, the net result of the PGE transaction is that customers receive the 176 MW Rathdrum Turbine "for free". For it's effort in planning, building, and operating this resource, the Company would not earn any return in exchange for the huge value created for customers. In effect, staff's proposal also punishes the Company by using a portion of the proceeds to reduce rate base by $48 million thus also decreasing Avista's long-term earnings potential. In addition to the reduction in annual revenue requirement of approximately $11 million, the staff proposal would result in a write-off of $9 million.

This becomes the "reward" for Avista's innovative planning and off balance sheet financing of a long-term, 176 MW resource that is being provided at no cost to customers. In fact, customers have been clearly "profiting" from Rathdrum in the amount of $9.1 million per year. This would continue under the Company's proposal. It is inconceivable to me how staff's position could be viewed as balancing the interest of shareholders and customers. It is a one sided, pure advocacy position that penalizes the Company. It is a position that was put forth accompanied with rancor and unfounded accusation. The Commission should reject the staff's proposal, and a similar one from ICNU, and approve the ratemaking treatment put forth in Mr. Norwood's testimony.

Centralia Replacement Power Costs ($4 Million). Staff recommends that the Commission disallow the expense associated with replacing the power that was lost because of the sale of Centralia, even though the sale and its many associated impacts were extensively litigated in Docket UE-991255. There is simply no question that replacement power costs and their timing were among those issues extensively examined and litigated. To now disallow the <u>costs</u> that were necessary to achieve the $19 million customer gain on the sale of Centralia is cherry picking at its very worst. The Commission should reject the staff recommendation and accept the costs testified to by Mr. Norwood.

Market Transaction Adjustment ($3.5 Million)

Staff has proposed an adjustment to <u>guarantee</u> $3.5 million of margins <u>annually</u> to customers related to commercial trading activity. ICNU has proposed an adjustment to <u>guarantee</u> $4.2 million. These amounts are proformed in with no support demonstrating that such net margins have occurred in the past. Even if the Company stopped trading altogether because it was too risky or it didn't have the capital, customers would still get these margins via reduced rates--the margins are proformed in so it doesn't matter even if there are zero trades. All the risk goes to shareholders, none of the risk goes to customers, yet customers reap substantial <u>guaranteed</u> rewards.

Commercial trading transactions are speculative in nature. They are purchases made to turn around and resell, not to serve retail end-use customers. They are not dependent upon the Company's rate based generating resources and are unrelated to

transactions to serve retail load or long-term wholesale obligations. Shareholder capital is used and placed at risk through the commercial trading, customers are never at risk for a loss.

These proposals by ICNU and Staff totally violate a reasonable formulation of the risk and reward principle. They are both coercive and punitive because the margins that are due customers are profomed in without reference to any trading. The Commission should reject these proposals as totally without merit.

Consistent Theories on Amortization ($9.3 Million). Staff recommends an accounting treatment for the amortization of certain account balances where it reduced revenue requirement but did not apply the same principle in their proposal on the PGE monetization transaction. The net effect is that the Company would be required to provide benefits to customer far in excess of the balance on the Company's books. In fact, if staff's treatment is accepted by the Commission, the Company may be required to book a $9 million dollar write off, earn no return on Rathdrum, while simultaneously providing a $143 million benefit that came about from the innovative actions of management and employees. This outcome is perverse. Staff's asymmetrical accounting treatment should be rejected.

Six Times Per Year Meter Reading and Billing ($2.8 Million). This is a retrogressive proposal from Mr. Lazar. The thinking embedded in the proposal contradicts the past 20 years of cultural and business trends toward more detailed information being available quicker as opposed to Mr. Lazar's proposal to make information less available to customers with a delay. Exhibit No. ___ (JLT, pages 19-23)

This proposal also contradicts a long-standing principle embedded in PURPA: timely customer information on usage is key to conservation and bill savings. This in fact is the primary basis for strict rules on master metering that have been adopted by this Commission. Mr. Lazar fails to note in his testimony that Puget Sound Energy (Puget or PSE) has recently announced that it will convert to automated meter reading and in all likelihood will now read meters on a monthly rather than on a bimonthly basis as they have in the past.

Mr. Lazar certainly has the right to suggest that this issue be studied by the Company to assess possible cost savings, cash flow impacts, etc. But any estimated savings then need to be balanced against customers' desire to maintain current billing information and the policy impacts codified in PURPA. Then the concept should be tested in the real world since it represents such a major shift from Avista's past history.

It is absurd for Mr. Lazar to propose what in effect is a disallowance of $2.8 million in meter reading and billing costs as though these cost have been found by this Commission to be imprudent. He then proposes to also proform in his speculative assumption that there will be a 45% saving as though it were known and measurable to the future. I would characterize his proposal as reckless. Perhaps it is his way of bringing attention to this issue. Whatever the case, Mr. Lazar's proposal should be rejected. Mr. Hirschkorn addresses this issue in more detail in his testimony.

Eliminating Depreciation Expense for Hydro Plants ($2.7 Million).

Mr. Lazar proposes to eliminate current depreciation expense for Avista's hydro plants because he believes the current market value of these plants is greater than the book

value. Exhibit No. ___ (JL-T, pages 10-14.) This proposal is fraught with problems and inconsistencies and is punitive to the Company. It also represents a change in generally accepted accounting principles and regulatory theory.

If the depreciation is based on market value why isn't the Company allowed to earn on the market value? Mr. Lazar claims he is not preventing the Company from the right to achieve a "return of assets" by only deferring the return of assets to some unspecified later time. And yet, Mr. Larzar states that he is not suggesting that the hydro assets ever be sold.

There are other unanswered questions. What are the cash flow implications for the Company and for customers? How would this affect the Company's reinvestment in infrastructure?

Mr. Lazar creates the impression that the current approach creates stranded benefits that are inaccessible to customers, that all go to shareholders. He ignores the fact that most of the benefits went to customers in the case of the Centralia sale.

The bottom line is that this proposal from Mr. Lazar may be provocative but it is not well thought out. It deprives the Company of its right to a return of its investment. If Mr. Lazar wishes this Commission to deviate from generally acceptable accounting principles he should present a comprehensive depreciation and financial study justifying this shift in regulatory philosophy. Mr. Lazar's proposal should be rejected. Mr. Falkner provides a more detailed and technical discussion of this issue in his testimony.

Limit Salary Increases to Inflation Plus Customer Growth ($5.3 Million).

Ms. Mitchell shows that Mr. Lazar's assertion regarding the increase in salary expenses over the last 10 years is clearly in error. Mr. Lazar incorrectly compares

overhead-loaded labor in later years with unloaded labor in earlier years. There is no factual foundation for Mr. Lazar's proposal to disallow salary expense. Base salaries are growing just as Mr. Lazar wants them too—at approximately the rate on inflation plus customer growth. His proposal should be rejected.

In his discussion Mr. Lazar notes that Mr. Matthews' pay is higher than Governor Locke's. This sounds suspiciously similar to the kind of "evidence" emanating from late night talk shows, e.g., why does the rapper Puff Daddy or David Letterman make more than the President of the United States? Avista witness Ms. Feltes offers a more enlightened discussion of compensation policies and how they relate to recruiting new talent to Avista.

Return on Equity and Capital Structure ($13 Million). Mr. Lurito for staff and Mr. Hill for Public Counsel recommend ROEs for Avista that are lower than any comparable group discussed in either of their testimonies.

The average earned ROE for the eight utilities in Mr. Hill's group is 12.06%. Exhibit No. ___ (SGH-1,Schedule 10) The average for the five in Mr. Lurito's group is 11.3%. Exhibit No. ___ (RJL-T, page 16) The average allowed ROE for Mr. Lurito's group is 11.4%. Mr. Hill testifies that a for a group of 49 combination gas and electric utilities the average earned ROE was 12.1% and that Value Line reports an expected book equity return in 1999 and 2000 ranging from 12% to 12.5%. Exhibit No. ___ (SHG-T, pages 10 and 11) The average of these groups is 11.82% using a 12.25% midpoint for the Value Line figures.

Why are Mr. Lurito's and Mr. Hill's recommended ROEs for Avista well below 11% when all comparable groups are currently earning significantly more than this? Because, as Avista witness Mr. Avera explains, both Mr. Lurito and Mr. Hill committed logical and conceptual errors in the application of financial models. The Commission should reject their recommendations and accept an ROE return comparable to the recommendation of Mr. Avera.

The fact that both Mr. Lurito and Mr. Hill made the same error is not surprising. They probably did not arrive at their respective recommendations independently as evidence by their identical ROR recommendations down to the one-hundredth of one percent. This may explain Mr. Lurito's seemingly arbitrary decision to recommend a 42% equity component for Avista's capital structure when the average of his comparable group is 44.4%. Exhibit No. ___ (RJL-T, page 27.)

Perhaps he needed it to match his ROR with Mr. Hill's.

Q. You have omitted from your initial discussion other important issues, e.g., ice storm cost recovery, 40-year versus 60-year water records for hydro normalization, the Kettle Falls equity adder, etc. Why is that?

A. Other Witnesses, as discussed below, will address these and many other issues in much more detail. The point I was making in my earlier discussion was that the staff and intervenors have, in many instances, failed to support provocative positions with any credible evidence or sound analysis.

Q. Before introducing other witnesses do you have any other general comments?

A. The Company is also troubled by another aspect of staff and intervenor proposals. They suggest a degree of micro managing the utility at a level we have not witnessed before. This is evidenced by detailed proposals for the use of PGE monetization funds, including buying out the Rathdrum lease, "suggestions" on how billing should be done, that we only need to attract talent that matches what PUDs do, critiques on incentive systems rather than concentrating on whether over-all salaries are reasonable, etc. It seems to us that innovation and motivation is best promoted by allowing management to retain the greatest possible degree of financial and operational flexibility within the bounds of what produces just and reasonable rates and overall fair and reasonable returns.

Q: Would you please introduce the remaining witnesses that will present rebuttal testimony.

A: Yes. In addition to Mr. Matthews and myself, the following rebuttal witnesses are presenting testimony on behalf of the Company:

William E. Avera: Mr. Avera, has been retained primarily to respond to the testimony of Mr. Lutrito and Mr. Hill.

Jon Eliassen: As Vice President and Chief Financial Officer, Mr. Eliassen takes issue with the capital structure proposed by staff and intervenors and testifies to the capital needs of the Company in the coming years and the financial structure necessary to meet those needs.

Kelly Norwood: Mr. Norwood responds to the power supply components of staff and intervenor testimony.

Bill Johnson: Mr. Johnson responds to the assertions of staff and intervenors with regard to the Company's proposed Power Cost Adjustment and offers an even simpler modified version of the PCA to address the concerns of staff.

Ron McKenzie: Mr. Mckenzie testifies to the amount and the treatment of the Centralia gain and to the impact of replacement power.

Don M. Falkner: Mr. Falkner addresses the proposed revenue requirement adjustments presented by staff and intervenors. Mr. Falkner also presents a side-by-side comparison of the proposed revenue adjustments from all the parties in this case.

Bob Anderson: Mr. Anderson was heavily involved in the Company's hydro relicensing effort. He responds to the staff proposal to disallow certain relicensing costs.

Karen Feltes: Ms. Feltes is the Director of Human Resources for Avista. She provides rebuttal testimony in response to various proposals and assertions of staff and intervenors with regard to compensation policies and practices and talent recruitment.

Kathy Mitchell: Ms. Mitchell provides rebuttal testimony in response to compensation issues as well as pointing out numerous accounting and conceptual errors made by staff and intervenors.

Bruce Folsom: Mr. Folsom's testimony addresses the issues raised by intervenor SNAP.

Tara Knox: Ms. Knox will respond to staff and intervenor testimony regarding the various cost of service studies conducted to date.

Brian Hirschkorn: Mr. Hirschkorn responds to the testimony of staff and intervenors with regard to rate spread and rate design issues including the appropriate level of the residential basic charge. Mr. Hirschkorn also addresses proposals regarding changes in the meter reading and billing schedules.

Q: Turning to other issues you mentioned at the beginning of your testimony, would you please comment on staff's testimony regarding ice storm costs recovery?

A: First, I think it is very important to note that no witness has questioned the legitimacy or prudence of the $12 million of costs incurred to restore service after the ice storm of 1996. These costs were legitimate business expenses that were necessary to meet the Company's public service obligation to restore service as quickly and as safely as possible.

The issues seems to be that staff believes that the Company did not ever intend to collect these costs in a rate proceeding. As evidence of this, staff cites the 1996 10-K and a Company press release where former CEO Mr. Redmond is quoted as saying the Company will not seek recovery in rates of the cost of ice storm.

I attended the strategy meeting with Mr. Redmond and others where the Company's position with regard to cost recovery was discussed and finalized. So did Mr. Falkner. It was clear to me at the time that the Company would treat ice storm costs exactly as it is doing in this case. As I recall, it was even mentioned at the meetings that Puget had recently received accounting treatment similar to what we would be proposing and that our prospects of recovery through such a mechanism would be good.

The proposal for cost recovery was memorialized and is clearly outlined in the Company's "Ice Storm '96 Overview" report that was personally signed by Mr. Redmond and submitted to this Commission just two months after service was restored. Exhibit No. ___ (TDD-1)

What staff did not take into account in its recommendation is the context of either the Company's press release or the 10-K. With regard to the press release, it was issued in the midst of extensive media coverage that was, unfortunately, tinged with a degree of controversy. There were questions being asked by the media about whether the company would file a rate case to seek recovery of the cost associated with the storm. The Company had no intention of doing so <u>at that time</u> nor did it intend to file for a rate surcharge. In the midst and in the immediate aftermath of the crisis of ice storm, over one-third of the Company's Washington customers were without electricity and many were without heat in freezing temperatures, questions were not always answered in a way that insured that no nuances or subtlety was missed. The essential question was, would there be an immediate impact on rates? The essential answer was no.

With regard to the 10-K, it made sense to report to the financial community that the Company could not guarantee rate recovery in the near-term. Hence, the decision was made to reflect the impact for financial reporting purposes in 1996. This was necessary since recovery would be proposed through an averaging mechanism such as injuries and damages and the Company had no immediate plans to file a rate case.

In sum, I believe the intent of the Company is clear from the "Ice Storm '96" report personally signed by Mr. Redmond and submitted to the Commission. And all indications are that the costs related to ice storm were prudently incurred for customer benefit in pursuit of the Company's desire to meet it's public service obligation to restore

power as quickly and as safely as possible. It is reasonable then for the Commission to allow full recovery of these costs since there is certainly no reason to have these costs exclusively borne by the Company's shareholders.

Cost recovery is especially appropriate in the current case since it can now be accomplished without burdening the revenue requirement. The gain from the Centralia sale can be used to totally offset these costs.

Q: Messieurs Lurito, Schoenbeck, and Hill credit Avista's low rates almost exclusively to Avista's substantial hydro generation. Recent management gets little or no credit. Mr. Lazar argues the same but also adds that slow customer growth has helped Avista keep its rates low. Would you please comment?

A. First of all, I would like to point out that no staff or intervenor witness denied that Avista has had among the very lowest rates in the US over the last 10 years and will continue to do so even <u>after</u> the proposed increase.

Secondly, only 45% of Avista's owned resources are hydro-based resources. Nineteen percent (19%) are thermal and 10% are contract hydro not owned by the Company. Twenty six percent (26%) are market purchases that are also available to all other utilities in the region as well—it's the same market.

Thirdly, Messieurs Lurito, Schoenbeck, and Hill literally offer no analysis to back up their assertions. In fact, there is good evidence that having a large hydro base does not automatically determine what might have happened to rates over the past 10 years?

Q: Please elaborate.

A. No one would deny that BPA has access to the largest hydro base in the region and certainly one of the largest in the US. I compared BPA's rates to Avista's since Avista's last general rate case in 1987.

Exhibit No. ___ (TDD-2) compares BPA's average percent rate increase to Avista's over the period between 1987 and 2000. The BPA Firm Priority Rate has increased an average of 7.27% while Avista's rates will have increased by an average of only 3.67%, even including the current rate request. If we examine the period 1987 to 1999 that excludes Avista's current rate request, BPA rates have increased over three fold compared to Avista's: an average of 7.35% for BPA and only 2.22% for Avista.

So contrary to the assertions of Mr. Lazar and Mr. Lurito, having a large hydro base does not guarantee having fewer or lower rate increases. The largest hydro operator in the region has had average rate increases three times those of Avista.

Q: Would you also comment on Mr. Lazar's assertion on page 25 of his testimony that the reason Avista's rates are lower than other utilities is because Avista has had a slow-growing customer base compared to say, Puget?

A: Mr. Lazar's "slow-growth theory" is contradicted by the facts. In Exhibit No. ___ (TDD-3), I compare the increases in customer growth between Avista and Puget between 1987 and 1999 and contrast that with the increases in rates for the two companies. Indeed, Puget has added customers at a somewhat faster rate than Avista: 36.7% versus 27.1%. Puget's average rates have gone up significantly faster as well: 19.8% versus 4.0% for Avista. The fallacy of Mr. Lazar's assertion comes to light by examining the ratio of customer growth to rate increases for Puget and Avista.

Puget's percent customer growth has been about 1.4 times Avista's (36.7% ÷ 27.1%) and yet rate increases have been about 5.0 times greater than Avista's (19.8% ÷ 4.0%). If, as Mr. Lazar claims, customer growth differences explain much of the difference between Avista's and Puget's rates then either Pugets's rates should be much lower or, Avista's rates should be much higher based on the historical customer growth ratio between the two companies. Or Puget must have a much higher incremental cost per customer, as Mr. Lazar also asserts.

However, this is also contrary to historical fact. It is not the case that Puget's new customers are more costly than Avista's as claimed by Mr. Lazar on page 25 of his testimony. Exhibit No. ___ (TDD-3), page 2 shows that each incremental customer on Puget's system increased gross plant by $686 whereas each incremental Avista customer increased gross plant by $1026.

Nor do resource acquisition opportunities explain the differences claimed by Mr. Lazar since both Puget and Avista buy from the same open market for energy in order to serve incremental load. In addition, during this period, Puget received $<u>417 million in Residential Exchange benefits</u> that are included in my Exhibit No. ___ (TDD-3). Avista had zero. Exchange benefits have the effect of leveling generation costs differences between Puget and Avista.

In summary, contrary to Mr. Lazar's speculation, an examination of the historical facts comparing Puget and Avista indicates that Avista's lower rates cannot be explained away by vague references to different customer growth rates and higher incremental cost to serve because of undergrounding, etc. There is more to it. We believe that Avista's lower rates are due to the commitment to cost containment, efficiency, and innovation.

The various independent studies I have cited support this contention.

Q. Would you please comment on the Company's request for a 0.25% equity adder to recognize management efficiency and innovation in light of staff and intervenor testimony.

A: Staff, through the testimony of Mr. Lurito, states that the only possible rationale for allowing the equity adder for management efficiency and innovation is to "accomplish a transfer of wealth from consumers to management." Exhibit No. ___ (RJL-T, page 31)

His assertion is a red herring. I presume that Mr. Lurito considers me to be "management", but I must confess that I am at a complete loss to understand the exact mechanism regarding how this "transfer of wealth" will inevitably occur according to Mr. Lurito. Mr. Lurito then turns the discussion of the adder into a discussion of management recruitment and labor markets. He misses the point. Perhaps I was not clear enough in my direct testimony.

The crux of the matter is as follows. The requested equity adder represents approximately $1.28 million in revenue. Proforma rate year revenues in this case are approximately $250 million. The equity adder is equivalent to a 0.5% efficiency or productivity gain from the accomplishments enumerated in my direct testimony. There is simply no question that the activities and innovations listed in my testimony have produced benefits far in excess of the amount requested via the adder. Several of these activities, <u>by</u> <u>themselves</u>, <u>stand-alone</u>, have generated this much saving for customers.

For example, the DSM Tariff Rider was designed to completely expense DSM activities partly in order to save customers the rate of return component that had historically been earned by investors. In fact, Washington statutes even allow for an additional equity incentive for DSM as noted by Mr. Lazar.

Since 1995 over $16 million of Washington DSM has been funded through the Tariff Rider, none of it capitalized. Had it been capitalized and rate based, the return component would have increased revenue requirement by approximately $2.5 million in the first year. The average increase would have been $1.4 million per year for 14 years, the lifetimes now used for DSM assets. The increase in revenues would have totaled $19.25 million. Because of Avista's innovative approach to DSM funding, also supported by the Commission, customers are currently saving an average of $1.4 million per year or an amount in excess of the equity adder just for this one activity.

In addition, there are numerous elements of hydro relicensing that, just by themselves, are saving an amount far in excess of the equity adder. For example, the license issued by the FERC has allowed the Company to retain the peaking and load following capabilities of the Noxon Rapids and Cabinet Gorge hydroelectric projects. As Shown in Exhibit No. ___ (TDD-4), the value of just this element of relicensing translates into a savings to customers of between $4.5 to $6.5 million per year for as long as 50 years to come.

As I outlined in my direct testimony and on cross-examination, I believe there are very sound business and public policy reasons to recognize these accomplishments through a mechanism such as the equity adder or its equivalent. That is why we are requesting that the Commission affirmatively recognize Avista's accomplishments with an

equity adder of 0.25%.

Q. How does Mr. Lurito view the Company's accomplishments and the benefit they have provided to customers?

A. Mr. Lurito does not believe that the Commission should "acquiesce" to the Company's request but he does not deny Avista's many accomplishments. Exhibit No. ___ (RJL-T, page 30) He does however refer to them as a "litany", a word usually associated with complaints according to Webster's Collegiate Dictionary. It is hard for me to understand why Mr. Lurito wishes to cast the Company's accomplishments in negative terms.

Mr. Lurito implies on page 33 of his testimony that existing investors and their elected board of directors have little, if anything, to do with the success of the Company. The Company, Mr. Lutrito cynically suggests, is an "irrelevant player". I don't believe it's incorrect to say that existing investors are owners of the Company. Why is it inappropriate to reward the "owners" of a company and at the same time send a positive message to employees who are collectively responsible for Avista's achievements? Mr. Lurito prefers to view this as a "one-time windfall" in keeping with the dismissive and negative tone of his rhetoric.

Q. What about the assertion from intervenors that all the credit for low rates should go to past Avista's management?

A. It is true that Avista's past management should be credited with foresight, as several witnesses note. However, Avista's recent management should also be credited with completing the relicensing of over 764 MW of hydro resources in an economic,

innovative and historically unprecedented fashion that has gained nationwide recognition for collaboration and timeliness. The innovative and unprecedented nature of Avista's relicensing effort has not been contested by any witness in this case. The relicensing effort will benefit customers for 50 years or more to come. The very resources that help to keep rates low have been preserved at very economic levels at a time when the region is grappling with fish and tribal issues. Recent management is responsible for the success of this effort and deserves the credit.

It is interesting to note that Tacoma City Light's Cushman project is still in the midst of hydro relicensing 14 years after beginning the effort. Their Nisqually River project took 9 years. Seattle City Light's 689 MW Skagit River project was in process for 18 years. Grant County PUD has just started its relicensing effort for the 1,945 MW Priest Rapids hydro project but was dealt a set back recently when the FERC rejected the use of the alternative hydro relicensing process pioneered by Avista. The FERC said Grant was not likely to able to bring parties to agreement through the collaborative process. Mr. Hill states that it's just a matter of "being in the right place at the right time." Exhibit No. ___ (SGH-T, page 49.) Mr. Hill is apparently very unaware of the major effort it takes to preserve economic hydro resources for current and future customers.

Recent management should also be credited with building the 176 MW Rathdrum Turbine that most certainly has helped to keep rates low during the past 13 years. Customers were credited with a net of $9 million of capacity sales revenue from Rathdrum while also retaining a portion of the output as a peaking resource to serve retail load.

Customers have benefited from this resource at no cost.

In fact, as shown in Mr. Buckley's Exhibit No. ___ (APB-5, page 55), customers "made money" on Rathdrum. <u>Customers</u> were credited with $18.5 million of revenue from the sale of 150

MW of capacity to PGE and assigned only $9.4 million of expense for a net annual gain of $9.1 million per year. And, there was still 26 MW of capacity left over to serve retail load. In essence, customers were buying capacity for $5.20 per kw-month and reselling it for $10 per kw-month. The "profit" was credited to customers and reflected in Results of Operations Reports submitted to this Commission.

Recent management is also to be credited with the renewal of the DSM Tariff Rider that continues to produce the customer bill savings I previously discussed.

Q. How do you respond to Messieurs Lazar, Hill, and Lurito's claim that your testimony focuses primarily on the fact that Avista has relatively low rates.

A. Both staff and intervenors have chosen to falsely claim that the Company's management incentive proposal relies primarily on Avista's low rates. As a matter of fact, most of the accomplishments I listed in my direct testimony were not based on having the very lowest rates in the US. For example:

- In 1998, Avista was recognized by McGraw-Hill for business excellence and innovation. Specifically, Avista was recognized for "creatively and successfully pursuing market opportunities by leveraging astute business strategies and outstanding technical and engineering capabilities in risk management, retail products and services and environmental stewardship."

- Avista was ranked number one in overall customer service performance in a 1998 Theodore Barry survey. The Company surpassed 33 other energy providers for the lowest annual customer service expense, while receiving one of the highest customer satisfaction ratings in the survey group.

- Call Center Magazine selected Avista's call center as the 1998 Call Center of the Year, nation wide.

- Avista implemented the first Customer Choice pilot programs in the region.

- The National Fuel Funds Network ranked the Company's Project Share as high as fourth out of 193 utilities in the country, in terms of funds raised per customer.

- The IRT Results Center, an independent research firm, characterized the DSM Tariff Rider as "one of North America's leading strategies for funding energy efficiency and…is the most sophisticated model of its kind and a powerful harbinger of what may well become the future predominant energy efficiency services funding mechanism...".

- In 1999, Avista's Web site was voted the best utility Web site by Utility Communications International in competition against the largest utilities in the nation.

- Avista is the only company in the state of Washington to have received four Environmental Excellence Awards from the State Ecological Commission.

- A 1999 study published by Fitch Investors Services provides another indication of Avista's efficiency <u>independent of low rates</u>. The Fitch study includes a comparison of the <u>embedded costs</u> of transmission service, the embedded costs of distribution service, and embedded common and general costs among utilities. <u>Avista ranked either first or second lowest among other Western utilities for each cost category</u>, as shown in Exhibit No. ___ (TDD-5).

The independent study by Fitch was not included in my direst testimony. I've included it in my rebuttal testimony because it is directly responsive to assertions made by Mr. Lazar regarding Avista's cost efficiency for non-generating cost. This study was included in my testimony in the Sale of Centralia Docket (UE-991255). This was not mentioned by Mr. Lazar. The 1999 Fitch study contradicts Mr. Lazar's claims and far exceeds the analytical rigor of any of the studies he offers as evidence.

Q. Besides referring to the results of the above Fitch study, how else do you respond to the claim by Mr. Lazar, and repeated by others without any independent analysis, that Avista is one of the least efficient utilities in the region, excluding generation costs?

A. First of all, Mr. Lazar has committed several major errors in his data analysis. He incorrectly represented historical salary figures and he and Mr. Damron have misrepresented

A & G Expense figures because they have failed to take into account that rate base items have been converted to leases and now are recorded as expense versus capital.

Secondly, as I will discuss in detail momentarily, Mr. Lazar has failed to disclose the context of the data that I presented in my testimony in Docket UE-991255. The data used by Mr. Lazar are confounded and are not valid representations of cost efficiency.

Thirdly, Mr. Lazar's opinions as to why Avista's rates are low compared to Puget's, for example, simply do not stand up to scrutiny, as I will show.

Lastly, Mr. Lazar's "study" is quite simply an outlier. There is overwhelming evidence to support the claim of Avista's efficiency from numerous published studies with vastly more analytical rigor than anything offered by Mr. Lazar in his testimony, the just mentioned Fitch study for example.

Q. Turning now to the data presented by Mr. Lazar's on page 24 of his testimony. Exhibit No. ___ (JL-T) Mr. Lazar claims that you are the source of this information. Is that correct?

A. Technically, yes. I presented this information to rebut assertions similar to those being made by Mr. Lazar. He has quite conveniently failed to note this in his testimony. He also failed to note that I presented this information <u>along with a correlation</u>

<u>analysis</u> that shows these data are confounded and not meaningful for the purpose claimed by Mr. Lazar. They are not valid representations of non-production costs because they are confounded by customers per distribution line mile. As I indicated in my Centralia testimony:

> "While benchmarking creates some interesting comparisons between companies, it is important to be mindful of factors that may mislead or confound the comparison. For

> example, in a comparison of non-production costs, the difference in population density from one company's service territory to another may cause materially different costs per customer by various cost categories. Puget Sound Energy has approximately 65% more customers per distribution line mile than Avista Utilities, and over twice the number of customers per transmission line mile, which could result in major differences in transmission and distribution costs on a per customer basis. In fact, as shown in Exhibit No. 319, there is a substantial correlation between customers per distribution line mile and non-production costs (r = 0.73). In this instance, non-production cost can be said to reflect customer density per line mile rather than efficiency as claimed by Mr. Wolverton."
>
> "Avista has consistently ranked high in independent studies of economic efficiency and business excellence. I have cited four such studies in Exhibit No. 320, which provide a more comprehensive indication of comparative efficiencies. A 1999 study published by Fitch Investors Services provides another indication of Avista's efficiency. <u>The Fitch study includes a comparison of the embedded costs of transmission service, the embedded costs of distribution service, and embedded common and general costs among utilities. Avista ranked either first or second lowest among other Western utilities for each cost category</u>, as shown in Exhibit No. 321." (Emphasis Added)

Q. Do you have any comment with regard to the staff and intervenor's positions regarding the Company's request for an equity adder for Kettle Falls?

A. Mr. Lurito applies the same rationale regarding the Kettle Falls equity adder as he did for the management efficiency equity adder. Exhibit No. ___ (RJL-T, Page 33) He offers nothing new. Consequently, the same criticism applies.

Mr. Lazar for Public Counsel and Mr. Parvinen for Staff, on the other hand,

present a detailed response to the Company's proposal to apply the 2% equity adder only to the <u>remaining</u> Kettle Falls investment.

I will address Mr. Lazar's proposal first. Exhibit No. ___ (JL-T, pages 14-18) Basically, Mr. Lazar wishes to <u>re-argue</u> the cost effectiveness of Kettle Falls both in terms of today's energy market and in terms of the market that existed in the early 1980s. Mr. Lazar also reargues the determination by the Department of Revenue that Kettle Falls does qualify for a tax credit under the renewable energy provisions of RCW 82.16.055. These re-arguments are irrelevant. Both the Department of Revenue and the WUTC in Docket U-83-26 have already ruled with regard to Kettle Falls. All we need do now is look to those ruling and RCW 80.28.025 for guidance.

This is essentially what Mr. Parvinen attempts to do in his testimony. Exhibit No. ___ (MPP-T, pages 16-18) Mr. Parvinen admits that there is no direct evidence that would exclude Kettle Falls as qualifying for the adder but only indirect evidence: the Commission did not allow 100% of Kettle Falls in rate base, but only 90% or the amount the Company's Board originally approved. This appears to be the dispositive fact for Mr. Parvinen.

I don't believe Mr. Parvinen makes a very strong case. I believe a stronger and simpler case can be made for qualifying Kettle Falls for the adder. The 90% level of Kettle Falls that was ultimately allowed in rate base was at the level the Commission considered prudent. This 90% level was also equivalent to the least cost alternative according to the Commission. That's one of the main reasons they ruled it was prudent. All we need to do is look at seven or so sentences in the U-83-26 order to draw this conclusion. (Emphasis

is added in the following)

On page 13 of U-83-26, the Commission states: "Even accepting the alleged errors in the original cost study and making adjustments for them, the Kettle Falls Project was still the lowest cost means of meeting the forecasted need." In the following paragraph the Commission continues: "The Commission is of the opinion that the decision to initiate the

Kettle Falls project, even considering the alleged flaw in the cost study, <u>was prudent</u>." Then on page 15 the Commission states: "The expenses of the project <u>as originally estimated</u> appeared to be in and of themselves reasonable." And finally, the Commission concludes on page 16: "The Commission is of the opinion that ratepayers <u>should pay only for the cost of the project as originally estimated</u>. This cost is the basis for the initial decision found to be prudent by the Commission. The remaining costs shall be borne by the company. The effect of this decision is that $80,555,706 of the total project cost of $89,299,000 will be used to calculate the allocation between jurisdictions."

The net effect was that the Commission allowed into rates only the level that was considered to be the least cost alternative and that turned out to be 90% of the total cost ($80, 555,706 ÷ $89,299,000). The $80, 555,706 is from the original cost study referred to on page 13 of the Commission's order and that expenditure was considered to be prudent and "the lowest cost means of meeting the forecasted need." This is the level that was allowed in rates and it determined what customers paid: "the lowest cost means of meeting the forecasted need." To my mind, the Commission order qualifies Kettle Falls for the equity adder.

Other considerations were addressed in my direct testimony and I won't repeat them here. They are also addressed in the Department of Revenue Decision that has already been introduced as an exhibit in this case. However, before I leave this issue there are several assertion made by Mr. Lazar that deserve contradiction.

I was present during many of the Company planning meetings for Kettle Falls and was also involved in the Company's 1983 rate case hearings where the rate basing of Kettle Falls was addressed. I can personally attest to the fact that the Company was aware of the availability of the 2% equity adder for renewables such as Kettle Falls, contrary to Mr. Lazar's speculation on page 15 that the Company was not even aware of this legislation.

On page 18 of his testimony, Mr. Lazar contends that the Company has kept the tax credit resulting from qualifying for RCW 82.16.055 because it has not filed to reduce rates by the amount of the credit. Therefore, the Company has already received an incentive award. This suggestion insults common sense.

First, the tax credit is significantly less than the equity adder. Secondly, tax credits will ultimately be passed through to customers and in one important way that is already happening. Customers are credited with the reduced tax in the Company's results of operations report that is submitted to the Commission. And finally, is it unreasonable and wasteful to file all new tariffs that would change rates by less than one-one hundredth of a cent.

Q. Does this conclude your rebuttal testimony?

A. Yes.