I. INTRODUCTION

A. Avista's Requested Rate Increase is Excessive and Ill-founded. It Should Be Firmly Rejected By the Commission.

The Company's rate filing includes a broad array of proposals to improperly increase revenue requirement. At the same time, Avista seeks to avoid scrutiny of improper and imprudent costs and to shield relevant revenues from consideration. The Commission should reject the rate increase request and instead order a reduction in rates.

Avista has proposed an excessive rate of return. While the record demonstrates that recent return on equity awards are in the 10% to 11% range, the Company has sought a rate of return of 12.25%.

The Company has attempted to shield the $143 million in revenues it received from Portland General Electric contract monetization, pretending that the old contract is still in place.

The Company has soaring administrative and general costs. Total A&G costs are up over 121% in the past decade. Its administrative and general salaries are up 239% since the last rate case in 1985. It granted the new CEO a multi-million hiring package, and seeks to include this in rates.

Avista seeks to assign a seriously disproportionate share of these high A&G costs to the regulated utility, even though it is non-regulated activities which have been growing at a greater rate.

The Company has ignored past Commission decisions and directives with respect to its proposed Power Cost Adjustment, resurrecting a deficient 1988 proposal without even including the cost of capital offset that the Commission determined was an essential component of a power cost adjustment mechanism.

Avista's filing ignored past Commission directives with respect to the calculation of normalized hydroelectric power costs.

There is strong evidence that Avista was aware during the Centralia sale case that replacement power costs would be more expensive than Centralia, yet the Company failed to provide that information to the Commission. It now seeks to recover over $4 million of increased power supply cost.

The Company has ignored past Commission directives on the calculation of electric cost of service studies, engaging in an undocumented and unprecedented effort to assign 70% of already excessive administrative costs to the residential class.

Avista has ignored past Commission directives on rate design, proposing to abandon the "baseline rate" design which the Commission ordered in 1980, and has reaffirmed in every proceeding since that time.

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While the public was initially told this was a 10.4% electric rate increase proposal, in fact the lopsided rate spread and regressive rate design meant that the average residential consumer would see an 18% rate increase. This was a common complaint in the consumer letters contained in Exhibit 744.

The Company's Chief Executive Officer seems to be completely out of touch with his customers and his service territory. Mr. Matthews testified that the need for a rate increase of this magnitude is "generally understood by our customer base." (Exhibit T-14, p. 9). In fact, the vast majority of the letters received by the Commission in this proceeding opposed the increase. To cite one sample letter:

> This is not a rate increase born out of the normal cost of doing business, but lack of planning and error of judgment. (John O. Wittenberg Jr., Spokane) (Exhibit 744, p. 6)[1]

It is important that the Commission send a strong message in its decision on this rate case, not only to Avista, but also to all regulated utilities in Washington, that excessive and ill-founded filings of this nature are unacceptable. Public Counsel recommends that the Commission adopt a fair rate of return, disallow improper and imprudent expenses, fully credit ratepayers with the value the Company received from PGE for Rathdrum, adjust the Company's dramatically increased administrative costs, reject its proposed power cost adjustment, and reject its anti-consumer and regressive rate design proposals.

B. Public Counsel Recommends that Avista's Rates Be Reduced Substantially

As this brief will discuss in greater detail below, Public Counsel in this proceeding recommends that the Commission reduce Avista's electric rates by $32,755,000. This recommendation is based upon Public Counsel's own adjustments, in combination with adoption of certain recommendations of Staff. We believe that adoption of this rate decrease will result in

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[1] For additional samples of customer comments, see Section XIII. Public Participation.

rates that are fair, just, reasonable, and sufficient.

C. General Legal and Ratemaking Principles

The WUTC is authorized by RCW 80.01.040(3) to regulate in the public interest the rates, services, facilities, and practices of electrical and gas companies. This delegation to the Commission of ratemaking authority over investor-owned electric and gas companies is a broad one. *People's Organization for Washington Energy Resources (POWER) v. Washington Utilities and Transportation Commission*, 104 Wn. 2d 798, 808, 711 P.2d 319 (1985).[2] The statutory mandate to the Commission is to set rates that are "just, fair, reasonable, and sufficient." *Id.*; RCW 80.28.010(2); *see also* RCW 80.28.020.

As the Washington Supreme Court has observed:

> "[t]he paramount objective of the Legislature in creating the Commission, now the WUTC, 'was to secure for the public safe, adequate, and sufficient utility services at just, fair, reasonable, and sufficient rates.'" *Id.,* 104 Wn. 2d at 808 (*quoting State ex rel. PUD 1 v. Department of Public Service*, 21 Wn. 2d 201, 209 (1944)).

The burden of proof is on the utility requesting the rate increase to show that it is just and reasonable. RCW 80.04.130(2); *see, e.g., U S West Communications, Inc., v. WUTC*, 134 Wn. 2d 74, 84, 949 P.2d 1337 (1997). The Commission can, where the evidence warrants, and upon proper notice, order a reduction in a utility company's rates even in cases where the utility initially filed the request for a rate increase. *See* Amended Notice of Hearing, April 28, 2000, pp. 1-2; *U S West Communications, Inc*, 134 Wn.2d at 80, 127 (1997).

II. THE PGE/RATHDRUM TRANSACTION

A. Avista Improperly Failed to Incorporate the PGE Contract Monetization in its Rate Filing

Perhaps the single most troubling element in the Company's rate filing is its failure to

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[2] This broad authority is part of the Commission's general power under Title 80 to administer "the pervasive regulatory schemes that affect almost every phase of activity of the businesses under its authority." *Tanner Electric Cooperative v. Puget Sound Power & Light Co.*, 128 Wn. 2d 656, 682 (1996).

disclose or properly account for the "monetization" of the contract with Portland General Electric (PGE) for peaking capacity. As witnesses Mr. Buckley and Mr. Schoenbeck succinctly stated:

> The Company's direct case did not contain one single word relating to the contract buyout or the receipt of net $143.4 million. Nor was the transaction memorialized in any of the workpapers provided by the Company. (Buckley, Exhibit T-540, p. 13).
>
> The Company's pre-filed direct testimony in this proceeding does not mention one word about these transactions." (Schoenbeck, T-718, p. 11)

This decision to withhold information about the transaction was apparently made at the very highest levels of management. As Mr. Buckley showed, in a May 11, 1998 internal memo, Company staff recommended to Gary Ely, Jon Eliassen, and Ron Peterson that: "At a minimum, the Commissions and staffs should be informed of the contract buy-down and our proposed accounting and ratemaking treatment." (Exhibit T-540, p. 15) Each of these individuals was an officer of Avista Corporation in 1998. (Exhibit 5, p. 70) The Commission was not so informed, nor did the Company seek an accounting order.

B. The Link Between the PGE Contract and Rathdrum

While the contract itself does not explicitly entitle PGE to the output of the Rathdrum power plant, we refer to this as the PGE/Rathdrum contract because the capacity sales contract was cited by Avista as the justification for constructing the Rathdrum plant outside of the normal scrutiny required by the Commission's Least Cost Planning rule, WAC 480-100-251. This linkage remains essential to the Company's rate filing: the Company has presented no other evidence whatsoever in this proceeding that the construction of Rathdrum was needed, cost-effective, or prudent.

For example, in the order granting approval for the construction of Rathdrum, the Idaho Public Utilities Commission stated:

> "The electric power and energy generated from the project will become part of Water Power's resource pool and will assist Water Power in satisfying its

> obligation to furnish wholesale power to Portland General Electric (PGE) in accordance with the Agreement for Long-Term Purchase and Sale of Firm Capacity executed on June 24, 1992." (Exhibit 171).

Similarly, a study measuring the cost-effectiveness of Rathdrum contained in Exhibit 171[3] has dozens of tables, and these are simply entitled:

> The Washington Water Power Company
> Business Analysis Department
> PGE Capacity Sale - Rathdrum Idaho Site

This linkage between the PGE contract and Rathdrum is important because the Company is seeking inclusion of the Rathdrum investment in rates in this proceeding. In order to justify this addition, the Company is under an obligation, under the Commission's Fifteenth Supplemental Order in Docket UE-921262 (a Puget proceeding to which WWP was a party) to demonstrate the prudence of this investment. The only evidence in this record supporting the prudence of the Rathdrum investment is that provided by Staff and ICNU which shows the revenues from PGE make this investment desirable.

Mr. Buckley states that treatment of the PGE contract revenues as proposed by Staff "resolves all of Staff's concerns with respect to the acquisition of the Rathdrum facility". (Exhibit T-540, p. 23) It is really impossible to separate the two issues. If this is the way that "prudence" is being resolved, that resolution needs to include a flow-through of the benefits to ratepayers, not just the costs as proposed by the Company.

We then turn to the treatment of the PGE revenues, including both the contract payments and the one-time $143.4 million "monetization" of the buy-down. Under decades of regulatory history, revenues from off-system power sales have been used to reduce the share of total power costs borne by ratepayers. This proceeding is no different, and Mr. Norwood has proposed that

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[3] As an aside, we would note that one of the tables in Exhibit 171, entitled "Cost of Capital Sensitivity," indicated a "Projected Long Term Cost of Capital" of 8.72%. This is slightly <u>lower</u> than the cost of capital proposed by Public Counsel witness Hill in this proceeding, and a "Projected Future Idaho" cost of capital of 7.99%, which is much lower than either Staff or Public Counsel is recommending in this proceeding.

twenty specific line items representing off-system sales transactions be considered in setting power cost for ratemaking purposes in this proceeding. These range from $75,000 up to $24 million in magnitude. (Exhibit 152, p. 3 (containing list))

This debate revolves around the Company proposal to credit ratepayers with $18 million for the PGE capacity sale, the amount in the original contract. (Exhibit 152, p. 3, l. 89) As Mr. Buckley and Mr. Schoenbeck testify, this figure of $18 million in Mr. Norwood's exhibit is simply wrong. The Company will *not* receive this amount of money for this transaction on a going forward basis. The contract has been amended, and those changes are known and measurable. The $18 million in annual revenues have been replaced with a $143 million one-time cash payment, plus a $1.8 million annual payment. (Exhibit T-540, p. 13)

The Company's presentation of this line item is not the way other power sales are treated in the Company's own power supply exhibit. Mr. Norwood's exhibit 152 includes both transactions like this one, which are "profitable", and transactions like the five-year sale to Clark PUD, which turn out (in retrospect) to be "unprofitable". The prudence review process, looking at whether the decisions were prudent given the circumstances at the time the decisions were made, is a part of the Commission's history. This transaction happens to be one of the "profitable" ones. If the "unprofitable" deals are going to be flowed through on an "actual" basis, it is certainly appropriate that the profitable deal be treated equitably.

The issue is how best to reflect this change in circumstances. The Company's proposal is to pretend it never happened, and to simply list the pre-amendment relationship. That proposal is misleading – to the degree that ICNU actually recommends disallowance of the Company's regulatory fees as a penalty.

With one exception, discussed below, Public Counsel supports the Staff proposal for treatment of the PGE contract payment and the Rathdrum plant. Staff's proposal consists of the following elements:

1) Apply a portion of the cash payment to pay off the Rathdrum lease;

2) Apply a portion of the cash payment to zero out the Wood Power contract reformation cost;

3) Apply a portion of the cash payment to cover the "stub" of the Potlatch contract, so that permanent rates can be set based on the post-contract situation;

4) Apply a portion of the cash payment to eliminate the DSM regulatory asset;

5) Apply the remainder as a rate base reduction, amortized over the 16-year remaining life of the (reduced price) in the renegotiated contract.

(Parvinen Direct Exhibit T-608, p.15)

Public Counsel takes exception to the Staff proposal to allow the Company to retain the benefits of the $143.4 million cash payment since the funds were received. Staff has not required the Company to credit ratepayers with the interest on this up to the date when new rates will take effect. As Mr. Parvinen notes, he has treated the first year of the amortization as already past, and is crediting only a portion of the gain to ratepayers. (Exhibit T-608, p. 15).

Mr. Buckley quantified the amount that was being conceded to the Company as $12.6 million. (Exhibit T-540, p. 19, and Exhibit 561) Mr. Buckley described this as giving the Company a portion of the net benefit of the transaction. Public Counsel does not concede that the Company should receive this benefit. If the Company had been forthright about this transaction, our position might be different. Had they notified the Commission at the time the transaction was proposed, accounted for the transaction in accordance with accepted Commission principles that flow the benefit of off-system power sales to consumers, included a full description of the transaction in their testimony, and proposed a proper level of rates based upon the revised transaction, we might be willing to allow the Company the initial 21 months of benefit of holding the "cash" as proposed by Mr. Buckley. The Company did not do any of these things. If the Commission allows the Company to retain $12.6 million in benefit from this transaction, it will be utility shareholders who benefit from management's extremely

questionable practices. This sends the wrong signal to the regulated firm -- evade regulation and you will profit.

The Commission has allowed many other contract reformation agreements to go into effect, and has allowed the utilities a reasonable share of the benefits of those contract reformations. Examples include Wood Power (WWP), Tenaska (Puget), and Encogen (Puget). Because of the efforts to shield this transaction from scrutiny, we believe that Avista should receive no benefit.

We recommend that the $12.6 million interest be added to the amount proposed by the Staff. The rate base reduction proposed by Mr. Parvinen at Exhibit 609, column (nn), line 30, should be increased by 66.99% (the Washington portion) of $12.6 million, or $8.041 million. Public Counsel's calculation of the appropriate adjustment is shown as Adjustment P-21 and fully set out in Appendix D.

Mr. Schoenbeck's notion of imposing a penalty on the Company for its efforts to avoid consideration of this transaction is intuitively appealing. He proposes disallowance of the Company's $489,225 in regulatory fees as a penalty. (Exhibit T- 718, p. 15) Clearly the Company's efforts to conceal this contract led to an increase in regulatory costs, as the Staff had to ferret out data that should have been provided at the time the transaction was proposed, and included with the pre-filed testimony. While Public Counsel agrees that the Company should face consequences for this action, we do not recommend disallowance of the regulatory fee. The Staff proposal, plus our modification to include the $12.6 million interest on the amount received, gets the Company to zero (i.e. flows through the benefits of the transaction to ratepayers in the same manner as other power contracts). The Commission should also view the improper regulatory treatment of the PGE contract as an additional justification for disallowance of the requested equity "kicker" for good management.

III. RATE OF RETURN

A. Legal Principles

A utility is entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk. *Duquesne Light Company v. Barasch*, 488 U.S. 299, 310, 312, 109 S.Ct. 609, 102 l. Ed. 2d 646, 98 P.U.R. 4th 253 (1989); *Federal Power Commission v. Hope Natural Gas Co.*I, 320 U.S. 591 (1944); *Bluefield Water Works Improvement Co. v. PSC of West Virginia*, 262 U.S. 679 (1923). Further, so long as the "end result" is not confiscatory, "no single method need be followed by the Commission in considering the justness and reasonableness of rates." *Duquesne*, 488 U.S. 299, 316 (quoting *Wisconsin PSC v. FPC*, 373 U.S. 294, 309 (1963)).

These principles have been recognized by the Washington Supreme Court as applicable in the context of ratesetting by the WUTC. *POWER v WUTC*, 104 Wn. 2d 798, 813 (1985). This return, however, must reflect "efficient and economic management:"

> The return should be reasonable to assure confidence in the financial soundness of the utility, and should be adequate, *under efficient and economical management*, to maintain and support its credit and enable it to raise money necessary for the proper discharge of its public duties.

Id. (emphasis added).

B. Overview of Rate of Return

With regard to the cost of capital and the appropriate overall return for ratemaking purposes in this case there are two primary issues: capital structure and the cost of equity capital. Other rate of return issues include the inclusion of flotation costs, the Company's request that the allowed return be increased by 25 basis points to account for management efficiency, and the request for a Kettle Falls "bonus."

1. <u>Capital Structure</u>.

In this proceeding, there is no substantial conflict between the parties regarding

the cost of fixed-income capital -- capital whose cost rate is contractually set (e.g., preferred stock, preferred securities, long-term debt and short-term debt). The only disagreement with regard to the cost rates of fixed-income capital is related to the time period from which those costs are taken. All parties agree that all fixed-income capital costs should be those of Avista's utility operation. The fundamental disagreement between the parties with regard to capital structure -- and the issue which has the largest impact on the overall recommended return -- is the amount of each type of capital to include in the ratemaking capital structure.

The Company recommends that rates for Avista's Washington jurisdictional utility operations be set using a hypothetical capital structure. The capital structure ratios recommended by the Company for ratemaking purposes are based on the 1998 year-end capitalization of a sample of companies selected by Dr. William Avera, Avista's cost of capital expert. The ratemaking capital structure recommended by the Company consists of 47% equity capital and 53% long-term debt and preferred securities (the company includes no short-term debt in its recommended capital structure). (Exhibit 102, Schedule WEA-5)

The capital structure recommended by Public Counsel is based on Avista's actual utility-only capital structure. That capital structure is representative of the manner in which Avista management has elected to capitalize its utility operations over the past few years and, importantly, the manner in which it expects to capitalize those operations in the future. Public Counsel's expert, Mr. Stephen Hill, calculated the Company's utility-only capital structure in the same manner that Avista, itself, made that calculation in its most recent rate proceeding in Idaho. (Exhibit 119) A six-quarter average of Avista's utility-only capital structure consists of approximately 39% common equity and 61% long-term debt, preferred securities and short-term debt. That capital structure is also very similar to the manner in which the electric utility industry is currently capitalized -- 40% common equity and 60% fixed-income capital (Exhibit T-623, Schedule 2).

As pointed out in the Direct Testimony of Public Counsel witness Hill (Exhibit T-622,

pp. 21, 22), because common equity, on a pre-tax, ratemaking basis, is approximately twice as expensive as debt capital, the capital structure differences between the Company and Public Counsel alone account for an $8.6 million difference in annual revenue requirements for the Company.

With regard to capital structure, the Commission Staff, through its expert, Dr. Lurito, recommends the use of Avista's consolidated capital structure for rate setting purposes. That capital structure consists of approximately 42% common equity and 58% fixed-income capital. (Exhibit T-632, p. 1) While that capital structure contains less equity and is, thus, more economical than that recommended by the Company, it is a product of the risks of Avista's consolidated operations. There is no disagreement that the Company's consolidated operations, which include unregulated operations (primarily Avista's energy trading business), carries higher investment risk that the Company's utility operations alone. (Tr. 1820, l. 12 - 1821, l. 4) While that capital structure might be appropriate for Avista's consolidated operations, it is not appropriate for the purpose of setting rates for the Company's lower-risk regulated utility operations. As shown in the testimony of Public Counsel witness Hill, (Exhibit 623, Schedule 2) Avista management has elected to capitalize their utility operations more cost-effectively with more debt and less equity than is utilized to capitalize the combined consolidated operations of the Company as a whole.

2. Cost of Equity.

All of the rate of return experts in this proceeding use the Discounted Cash Flow (DCF) analysis of the market data of a sample group of firms similar in risk to Avista's utility operations to estimate the cost of equity capital. Staff witness Lurito and Public Counsel witness Hill rely on a traditional "single-stage" DCF analysis to estimate the cost of equity. Company witness Avera, on the other hand, elects to utilize a non-traditional "multi-stage" DCF analysis in which he makes detailed assumptions regarding investor expectations at a specific time in the future.

One of the key assumptions made in Dr. Avera's multi-stage DCF analysis is that the investor-expected growth rate for a portion of current utility operations will be equivalent to that of unregulated firms. For that reason, the Company witness includes what he estimates to be investors' growth rate expectation for unregulated firms in his DCF estimate for his sample group of utilities. The inclusion of that higher growth rate increases the results of his DCF analysis. Dr. Avera claims, however, that the companies he analyzed were selected to be similar in risk to Avista's utility operations (Tr. 704, ll. 5-25; 717, ll. 17-25; 1839, l. 20 - 1840, l. 11), which are a traditional, fully-integrated utility operation. Therefore, a primary point at issue with regard to the cost of equity capital is Dr. Avera's use of a multi-stage DCF analysis. Both Public Counsel and Staff witnesses testify regarding the shortcomings of multi-stage analyses, generally, and Dr. Avera's particular version of that analysis, in particular. Public Counsel witness Hill concurs with the decision recently rendered by the Idaho Public Service Commission in Avista's most recent rate case -- Dr. Avera's multi-stage DCF "put too much weight on deregulated operations". (Exhibit 119, IPUC Order No. 28097, p. 23, Exhibit T-622, pp. 61, 62).

While Staff elects to rely exclusively on a DCF analysis, Public Counsel witness Hill and Company witness Dr. Avera rely on other equity cost estimation methods as checks of the DCF results. Mr. Hill relies on Capital Asset Pricing Model (CAPM), Modified Earnings Price Ratio (MEPR) and Market-to-Book Ratio (MTB) analyses. The results of Mr. Hill's corroborative equity cost estimates tend to confirm the accuracy of his DCF analysis and indicate that the cost of equity capital of a utility operation similar in risk to Avista's utility operations ranges from 10.50% to 11.25%, with a mid-point of 10.875%. (Exhibit T-622, pp. 44-52)

Dr. Avera relies on several different types of Risk Premium analyses. As Mr. Hill points out (Ex- T-622, pp. 63-67) and as Dr. Avera confirms (Exhibit T-135, pp. 59, 60), he has previously recommended that regulators not rely on those same Risk Premium studies as a primary determinant of the cost of equity capital. Dr. Avera's recommended cost of equity is 12.25% (including 25 basis point for flotation costs and a 25 basis point equity adder).

Both Staff and the Company include 25 basis points in their cost of equity recommendations to account for historical flotation costs (Tr. 809), a decidedly backward-looking adjustment. Neither party takes into account the Company's recent stock buy-back program (which should, theoretically, create a negative flotation cost). (Exhibit T-622, p. 45, 46) Although the Company, on rebuttal, introduced the possibility that stock may be issued in the future, any such issuance appears to merely be a replacement of common stock balances drawn down in the conversion of convertible preferred stock. (Tr. 1887, ll. 12-16) Public Counsel witness Hill provides several reasons in his Direct Testimony why no specific adjustment to "account" for flotation costs is necessary. (Exhibit T-622, pp. 45-47)

As noted in Exhibit 124, an increase in the allowed equity return of 25 basis points will cause rates to increase approximately $1.28 million annually. On that basis, the difference in equity return recommendation between Company witness Avera (12.25%) and Public Counsel witness Hill (10.875%), 137.5 basis points, implies a difference in revenue requirement due to cost of equity alone of $7.04 million annually (137.5 basis points x $1.28 mill./25 basis points).

C. Capital Structure Should Be Based on Avista's Actual Utility Capital Structure

The capital structure which appears on the consolidated books of account of Avista Corporation includes the capital attributable to both its regulated utility and its unregulated operations. (Exhibit T-622, p. 17) At year-end 1999, the Company's consolidated equity ratio was 43.2% of total capital. However, that common equity ratio includes the Company's equity investment in its unregulated operations as well as its regulated operations. In order to determine a utility-only capital structure, it is necessary to remove the unregulated investment that appears on the consolidated balance sheet. Only in that way can the actual capital costs pertinent to the operation of the Company's gas and electric utility be determined.

As Public Counsel witness Hill explained in response to questions by the Administrative Law Judge (Tr. 1753, l. 12 - 1755, l. 17), the vast majority of the debt which appears on Avista's

consolidated balance sheet is utility debt. For example, Exhibit 122 (Avista's balance sheet at 9/30/99) indicates that out of a total debt balance of $786.794 million, only $8.894 million, or 1.1%, is attributable to unregulated operations. That small amount of debt, of course, is removed from the consolidated balances in order to determine the utility-only capital structure (Exhibit 623, Schedule 2, p. 2). However, the fact that the non-regulated debt which appears on Avista's consolidated balance sheet is a very small portion of total debt, in combination with the fact that all preferred stock on Avista's balance sheet is that of the utility, indicates that the vast majority of the Company's net investment in unregulated operations -- as it appears on the consolidated balance sheet -- is supported only by common equity. In order to calculate the Company's utility-only capital structure, Avista's net investment in unregulated operations (which appears on the asset side of the consolidated balance sheet) must be subtracted from the consolidated common equity balances.

Avista's utility-only capital structure over the past six quarters (9/98 through 12/99, inclusive) averaged 38.97% common equity, 2.52% preferred stock, 7.93% preferred securities, 46.03% long-term debt and 4.55% short-term debt. That capital structure provides a reasonable basis for ratemaking because it is representative of the manner in which the Company is actually capitalized and will more directly produce rates which are cost-based as opposed to some other (Avista consolidated or hypothetical) capitalization. Also, this capital structure is very much in line with capital structures for combination electric and gas utilities. The industry-average equity ratio, as reported by Public Counsel witness Hill (and unrebutted by any party) is currently 40%, and as admitted by Company witness Eliassen in cross-examination is projected to range from 39.9% to 41%. (Exhibit 523, Tr. 1870-1871)

The reasonableness of the Company's actual, utility-only capital structure for ratemaking purposes is also supported by other factors. First, the current average capital structure of the group of electric and gas combination companies selected by Company witness Avera is approximately 39% (Exhibit T-622, p. 15, Exhibit 623, Schedule 2, p. 1) -- virtually identical to

the manner in which Company management has elected to capitalize Avista's utility operations. That evidence is unrebutted. Second, the Company requested its rates be based on its utility-only capital structure in its most recent rate proceeding in Idaho (Exhibit 119, Tr. 779, ll. 7-10).

Moreover, despite the claims by Dr. Avera in rebuttal that the utility-only capital structure recommended by Public Counsel was "hypothetical" (Exhibit T-135, p. 48), or that the derivation of that capitalization was somehow unrealistic due to the "assumption" that the majority of Avista's unregulated investment as it appears on the balance sheet is comprised primarily of common equity (Exhibit T-135, p. 49), the Company was unable to support those claims. Company witness Eliassen admits that Mr. Hill's calculation of Avista's utility-only capital structure is accurate. (Exhibit 524) Dr. Avera admits that Mr. Hill's calculation of a utility-only capital structure in this proceeding is based on "similar calculations" to those performed by Dr. Avera in his testimony in Avista's recent rate proceeding in Idaho, where he presented a utility-only capital structure for ratemaking purposes. (Exhibit 139)

Public Counsel asked Dr. Avera for specific detail to support his claim that Mr. Hill's calculation of Avista's utility-only capital structure was somehow in error due to an incorrect "assumption" regarding the amount of unregulated equity capital appearing on the balance sheet. The Company simply refused to provide any information (Exhibit 141). When asked by Public Counsel to delineate any differences between the manner in which Mr. Hill had calculated Avista's utility-only capital structure and the manner in which the Company calculated that parameter in its recent rate case in Idaho, the Company responded that "…public counsel has all the information and data needed to do the requested calculation" -- a pointed non-response. (Exhibit 523) When pressed on the witness stand to identify <u>any</u> differences between the manner in which Public Counsel calculated Avista's utility-only capital structure in this proceeding and the manner in which the Company calculated that same parameter in Idaho, Mr. Eliassen admitted that there were no differences. (Tr. 1880, l. 9 through 1881, l. 10) In sum, the manner in which Public Counsel has calculated the utility-only capital structure of Avista is accurate and,

in fact, utilizes the very same calculation methodology as that employed by the Company in Idaho last year when they requested rates in that jurisdiction be set using a utility-only capitalization. Dr. Avera's rebuttal testimony is without merit when it states that Public Counsel's position on this issue represents a "hypothetical" capital structure which makes unrealistic "assumptions" regarding the manner in which Avista's unregulated operations are capitalized.

One other criticism raised by Company witness Eliassen regarding the Public Counsel's use of a utility-only capital structure is that that capital structure recommendation is only representative of a "point-in-time" and not appropriate for the utility over a longer term. However, under cross examination, Mr. Eliassen admitted that: 1) Mr. Hill's capital structure recommendation was the product of a six-quarter average, not a point-in-time; 2) the Company's utility operations have been capitalized with less than 40% equity capital over the past three years; and 3) the Company expects to capitalize its operations in a similar manner in the coming year. (Tr. 1873, l. 2, through 1876, l. 16) Therefore, the Company has elected to capitalize its utility operations over at least a four-year period (1997 through 2000, inclusive) with a capital structure similar to that recommended by Public Counsel in this proceeding. Therefore, its negative characterization of that capital structure recommendation as a capitalization existing only briefly (i.e. at a point-in-time) is inaccurate.

Mr. Eliassen also discusses a potential equity issuance as if to imply that that added equity would significantly increase Avista's utility-only equity percentage. However, during cross-examination, Public Counsel established: 1) those shares have not yet been authorized to be issued by Avista's board (Tr. 1890, ll. 4-9); 2) those shares are for the purpose of funding employee stock option plans (Tr. 1889, ll. 1-13); and 3) those shares would simply replace the common equity shares lost in the converting of the convertible preferred stock back to common stock (Tr. 1887, ll. 11-20). Moreover, even at its six-quarter maximum (i.e. prior to the Company's common stock buy-back program and the conversion of the convertible preferred

stock) in March 1999), the percentage of common equity capital in Avista's utility-only capital structure was 40.5%. Two quarters prior to that time it was 38.4%. (Exhibit 623, Schedule 2, p. 2) Again, Public Counsel's recommendation of a ratemaking equity ratio of approximately 39% is shown to be reasonable and the Company's eleventh-hour suggestion that they might, in the future, issue equity capital would have no impact on the reasonableness of that recommended capital structure.

The Company, through cross-examination of Public Counsel witness Hill (Tr. 1724) attempted to show that the total debt-to-capital ratio implicit in Public Counsel's capital structure recommendation (approximately 51.5%) is outside the range recommended by Standard & Poor's (S&P) for A-rated energy companies. The implication was that Public Counsel's capital structure recommendation would inhibit the Company's ability to attain investment-grade bond ratings. However, those concerns are without merit for several reasons.

First, as Mr. Hill pointed out during his cross-examination, the Company had referenced a debt-to-capital ratio benchmark appropriate for a "Business Risk" position of five, and Avista had recently been "demoted" to that position by S&P due to the poor operating performance of its energy trading business and, moreover, the utility operations alone would have a lower "Business Risk" ranking. Standard & Poor's published maximum debt-to-capital ratio for a single-A bond rating and a "Business Risk" position of five, as pointed out by the Company in the cross of Mr. Hill, is 47%. (Exhibit 630) However, for a "Business Position" of three, that maximum total debt ratio rises to 53%. And for a "BBB" bond rating (Avista's current bond rating), S&P's maximum is 61% for a "Business Risk" of three. The Public Counsel's capital structure recommendation for Avista's regulated utility operations then falls within the guidelines set out by S&P for either a single-A or triple-B bond rating.

Second, as Company witness Avera himself points out in Rebuttal (Exhibit T-135, p. 22), "mechanical computations of … financial ratios" do not determine bond ratings. Third, Dr. Avera only last year advocated a ratemaking capital structure for Avista in Idaho which had more

debt and less equity than that recommended by Public Counsel in this proceeding. (Tr. 785, ll. 17-25) Fourth, the average equity ratio of gas and electric combination utilities is currently 40% (Ex T-622, p. 18) and the average equity ratio of Dr. Avera's sample of similar-risk firms is 39% of total capital (Ex 623, Schedule 2, p. 1). In sum on this point, neither the Company's bond ratings nor its ability to attract capital are in danger due to Public Counsel's capital structure recommendation as evidenced by S&P's published bond rating benchmarks, the Company's own testimony in prior proceedings and the average capital structures of similar companies.

With regard to the capital structure recommendation of Public Counsel, short-term debt is included and is appropriately considered for ratemaking purposes in this proceeding. The Company has consistently used that form of capital over the past three years and has increased its use of short-term debt more recently. (Exhibit 623, Schedule 2, p. 3) Company witness Eliassen indicated that the Company "definitely" uses short-term debt as a financing mechanism (Tr. 1862, ll. 6-11). Also, as Public Counsel witness Hill explained during cross-examination, short-term debt is investor-supplied capital and because capital dollars in the corporate treasury cannot be traced as to their source, all forms of capital -- including short-term debt -- should be considered when determining the firm's overall cost of capital. Finally, although the Company appears to take issue with the Public Counsel's inclusion of short-term debt in the ratemaking capital structure, Dr. Avera also includes short-term debt in his calculation of the overall cost of capital. (Exhibit 102, Schedule WEA-2, p. 2) Mr. Hill provides additional reasons in his Direct Testimony for the inclusion of short-term debt in a ratemaking capital structure. (Exhibit T-622, p. 16)

Finally, the Company's recommendation that its rates be based on a hypothetical capital structure is inappropriate and should be disregarded by the Commission. The hypothetical capital structure requested by Avista is not representative of the manner in which Avista management has elected to capitalize its utility operations. For that reason -- no matter what the component costs -- the resulting overall cost of capital will not be representative of the capital

cost of Avista's utility operations. Moreover, the hypothetical capital structure requested by Avista is not even representative of the current capital structure on which it is supposedly based. As Mr. Hill points out -- and the Company fails to rebut -- the companies in Dr. Avera's similar-risk sample group are currently capitalized with 39% equity. (Exhibit 623, Schedule 2, p. 1) Public Counsel does not object on a theoretical basis to the use of a hypothetical capital structure if it can be shown that a firm's actual capital structure is aberrant, economically inefficient or affords some cross-subsidization of unregulated operations by regulated ratepayers. (Exhibit T-622, pp. 19-20) However, the Company has provided no evidence that any of the conditions warranting the use of a hypothetical capital structure exist.

The 47% equity ratio contained in the hypothetical capital structure requested by Avista in this proceeding is substantially different from the 37.5% equity ratio requested by Avista in its recent rate proceeding in Idaho. Moreover, as Mr. Hill demonstrates (Exhibit 623, Schedule 2, p. 4) the impact of that inter-jurisdictional capital structure "flip-flop", holding all capital costs constant, would be to increase rates to Avista's Washington ratepayers by over $8 million annually.

In sum, the Company's requested hypothetical capital structure is unnecessary for economic efficiency purposes, is contradicted by the Company's prior rate requests in another regulatory jurisdiction and, if incorporated into rates, would unnecessarily increase rates. The Public Counsel's capital structure recommendation, on the other hand, is based on Avista's actual utility capital structure, which is similar to other similar-risk firms, protects the financial status of the firm and enables the continued attraction of capital, appropriately balances the interests of stockholders and ratepayers by ensuring that rates are based on the actual capital costs incurred.

D. Cost of Equity and Corroborative Analyses

1. The Macroeconomic Environment.

Prior to estimating the cost of equity capital, Mr. Hill provides an overview of the macro-economic environment in which the capital markets are currently operating. That overview indicates that, despite the recent run-up in short-term interest rates by the Federal Reserve, capital costs continue to remain relatively low by historical standards. Moreover, there are indications in the available market data and investor advisory publications that the equity cost estimate recommended by Public Counsel in this proceeding, 10.875%, is reasonable and well within the range of returns required by investors for investing in a combination gas and electric utility operation. Finally, the current economic projections indicate that the current low capital cost environment is expected to continue to exist in the near-term future. (Exhibit T-622, pp. 5-14).

2. Market-based Estimation Methodologies for Comparison.

In estimating the cost of equity capital of Avista's electric and gas utility operations, the Public Counsel witness employed four market-based methodologies: the Discounted Cash Flow (DCF) analysis, the Capital Asset Pricing Model (CAPM) analysis, the Modified Earnings-Price Ratio (MEPR) analysis, and the Market-to-Book Ratio (MTB) analysis. Each of those four econometric cost of equity estimation models were applied to the market data of a sample group of combination electric and gas utility companies selected to be similar in risk to Avista's utility operations.

Mr. Hill selected firms that were predominantly utility operations, had not undergone a recent dividend reduction, were not in the process of merging or being acquired, had investment-grade bond ratings that bracketed the bond rating of Avista, and had not experienced (or were not projected to experience) recent shifts in book value. From the universe of combination gas and electric companies followed by Value Line, seven firms met those criteria. Many of those firms were also selected by Company witness Avera for analysis. Three of the firms selected by Dr. Avera were eliminated from Mr. Hill's sample group because of recent dividend reductions and two were eliminated due to mergers.

The market data of Avista was not utilized to determine the cost of equity applicable to the Company's regulated utility operations due to the substantial size of Avista's unregulated energy trading and other operations. A cost of equity capital based on Avista's market data would include the additional risk and required return attributable to the Company's unregulated operations and would not be applicable to the Company's regulated utility operations. (Exhibit T-622, pp. 26, 27).

3. Discounted Cash Flow.

In calculating his DCF cost of equity estimate, Public Counsel witness Hill used a traditional, constant growth or single-stage DCF analysis. In order to calculate the dividend yield portion of his DCF cost of equity estimate, Mr. Hill divided the next period projected dividend

by the recent six-week daily average stock price for each company under review. The long-term sustainable growth rate for each of his similar-risk sample companies was calculated by considering both the historical and projected underlying fundamentals of dividend growth for each firms under study as well as historical and projected earnings, dividends and book value provided by investor advisory services. The growth rate derivations for each company were presented in detail by Mr. Hill in Exhibit 626 (Appendix C attached to his Direct Testimony). Mr. Hill's DCF analysis indicated an average cost of equity capital for the combination electric and gas sample group of 11.08%. (Exhibit T-622, pp. 24-32)

4. Capital Asset Pricing Model

Mr. Hill's CAPM analysis utilizes recent six-week average U. S. Treasury Bill and T-Bill futures rates to determine the risk-free rate of return required by investors. T-Bills are the investment instrument which is closest to theoretically risk-free rate called for in the CAPM. Longer-term T-Bonds are not appropriate because they normally include maturity risk that the shorter-term U.S. Government security does not have, and, thus cannot be termed "risk-free."[4]

The beta coefficients used for the firms in Mr. Hill's sample group are those published in Value Line. The average beta for the firms under study is 0.51, which means that if the stock price of the market increases 10%, the stock price of the firms in Mr. Hill's sample group can be expected to increase about 5%, or half as much. The beta coefficient indicates that the firms under study have market prices which are substantially less volatile than that of the stock market generally and, thus, impart less risk to the equity holder. The market risk premium (the long-term historical return difference between the market and T-Bills) used by Mr. Hill ranges from 7.4% to 9.4%. The 7.4% risk premium is based on the geometric average historical return and

[4] It is interesting to note, as shown in Dr. Avera's response to PC DR 212b (Exhibit 150), that if long-term U.S. T-bonds had been used in Mr. Hill's CAPM analysis the results would have been lower than those presented by Mr. Hill: 9.4% to 10.35% versus the 9.68% to 10.70% shown in Mr. Hill's Direct Testimony (Exhibit T-622, p. 39, ll. 15-18). Therefore, the use of the correct risk-free rate, T-Bills, produces a conservative (i.e., high) estimate of the CAPM cost of equity capital.

the 9.4% risk premium is based on the arithmetic average historical return. As Mr. Hill discusses in his testimony there is support in the financial literature for reliance on both measures of the historical market risk premium and his CAPM analysis utilizes both. (Exhibit T-622, pp. 36-38) Mr. Hill's CAPM results range from 9.68% to 10.70%, with a mid-point of 10.19%—substantially below his DCF results.

5. Modified Earning Price Ratio.

Mr. Hill also employs a modified earnings-price ratio analysis which is based on the premise that the expected return on equity (ROE) and the earnings-price ratio both approximate the cost of equity capital when the market price of a utility stock approaches its book value. When the market price is above book value, the expected ROE exceeds and the earnings-price ratio understates the cost of equity capital. When utility market prices fall below book value, the result is reversed. Therefore, when market prices are different from book value, the average of those two parameters—the earnings-price ratio and the expected ROE—provides a corroborative estimate of the cost of equity capital. (Exhibit T-622, p. 39-41) Moreover, as Mr. Hill explained during cross-examination, that tendency of those two parameters to "orbit" around the cost of equity capital is displayed in his MEPR analysis shown in Exhibit 623, Schedule 10. (Tr. pp. 1730, 1731) Mr. Hill's MEPR results range from110.9% to 11.37%.

The final corroborative analysis used by Mr. Hill is a Market-to-Book ratio analysis which is based on the DCF formula but used point-in-time projections one year and three-to-five years in the future. Unlike the DCF, which utilizes long-term sustainable growth rate estimates, the MTB analysis uses specific spot projections of an investor advisory service to estimate the cost of equity. In that way the MTB analysis offers information not available in the DCF and provides corroborative input to the analysis. Mr. Hill's MTB results range from 10.49% to 11.05%, a range lower than his DCF results.

6. Summary of Cost of Equity Estimation Results

The results of Mr. Hill's DCF analysis indicate an average cost of equity for the

companies under study of 11.08%. The corroborative analyses (CAPM, MEPR and MTB) indicate an average cost of equity range of 10.60% to 10.85%--entirely below Public Counsel's DCF result. These results imply a range of equity costs of 10.5% to 11.25%, with a mid-point of 10.875%.

E. Flotation Costs

An explicit flotation cost adjustment is unnecessary and would serve only to inflate the cost of equity capital. (Exhibit T-622, pp. 45-47) Avista's current stock price, even with recent reductions, remains well above book value, which means that every time a share of stock is issued, the book value of the current shareholders is increased. There is no need, therefore, to "compensate" stockholders for a benefit received by issuing stock.

Further, despite the Company's rebuttal claims that they intend to issue stock, the board has not approved any such issuance. (Tr. 1884-1890) Therefore, any flotation cost which might result from any future issuance is currently unknown and unmeasurable. In addition the flotation cost adjustment sought by the Company is intended to recover historical flotation costs (Tr. 809), an adjustment which would clearly be retroactive ratemaking and improper. Finally, Mr. Hill indicates that the vast majority of "flotation costs" are underwriters fees which are understood by investors and accounted for in the price they provide for an initial issue of utility stock. Additional adjustments for that same cost are redundant. Mr. Hill also notes that his DCF growth rate estimate contains an upward adjustment to the growth rate to account for the sale of stock at prices above book value and no other adjustment is warranted. Finally, Mr. Hill cites research which indicates that flotation costs are unnecessary. (Ex. T-622, pp. 45-47)

F. Utility-Only Structure and the Sample Group

Mr. Hill also considers other factors which impact the company's investment risk prior to selecting a point-specific equity return recommendation within his estimated range. For

example, Mr. Hill explicitly considers the capital structure of the firms in his sample group in relation to Avista's utility-only capital structure. In that analysis, he notes that while Avista's common equity ratio is somewhat below the average of his sample group, the total equity ratio and, therefore, the total debt to capital ratio of his sample group and Avista's utility-only capital structure are quite similar. That fact indicates there is little difference in the financial risk between Avista and his sample group of utilities. Mr. Hill also considers operational risk factors such as generation mix (lower than average for Avista) and power clause mechanisms (higher than average for Avista) and concludes that an appropriate point-estimate in the 10.5% to 11.25% reasonable range of equity capital costs for similar-risk firms is the mid-point or 10.875%. (Exhibit T-622, pp. 49-52; Tr. 1704, l. 6 - 1706, l. 14)

G. Management Efficiency "Adder"

Public Counsel witness Hill also considered Avista's request for a 25 basis point "adder" to the allowed return on equity to account for management efficiency. The Company is requesting that it be granted a .25% addition to the rate of return because of asserted extraordinary management prowess. The record, including evidence offered by Mr. Lazar, demonstrates that, if anything, the opposite is the case.

Mr. Lazar relied on testimony offered by Mr. Dukich in the Centralia proceeding which showed that Avista had the highest non-production O&M expense of any investor-owned utility in the region. (Exhibit T-691, p. 24) Mr. Dukich responded in this proceeding that the purpose of his testimony was to demonstrate that the high costs experienced by Avista were correlated with the relatively rural nature of its service territory. (Exhibit T-84, p. 23)

Mr. Dukich apparently failed to examine the data which he presented and which Mr. Lazar relied upon. At page 24 of his testimony, Mr. Lazar lays out all of the data presented by Mr. Dukich. It shows that Avista has the highest non-production O&M expenses of any of the utilities identified by Dukich. Idaho Power, Pacificorp, Sierra Pacific and Tucson Electric all

have even lower system densities than Avista, but all have lower non-production O&M expenses. In fact, Sierra Pacific has non-production O&M expenses which are fully one-third lower than Avista's, even though its service territory is more rural. (Exhibit T-691, p. 24)

Mr. Dukich attempted to resurrect his argument by pointing to the Fitch study (Exhibit 89), arguing that the Fitch study shows that Avista's costs per kwh are very low. He further asserts that the Fitch study "far exceeds the analytical rigor" of the study (prepared by Mr. Dukich himself) upon which Mr. Lazar relied. Nothing could be further from the truth. The record demonstrates, however, that the Fitch study is so fraught with computational errors that it is meaningless.

The Fitch study takes the Company's distribution costs, which apply only to its retail customers attached to the distribution system, and divides these by the Company's total retail and wholesale kilowatt-hour transactions. (Tr. 2057). The result is a valueless set of numbers.
The results of the Fitch study are not useful or persuasive for several reasons. First, there is a mismatch between the numerator and the denominator, with costs attributable only to retail loads being divided by a hugely inflated denominator. Second, because each of the utilities in the Fitch study has a different mix of wholesale and retail loads, the numbers cannot be compared with one another in any meaningful way. Third, Avista sharply curtailed its wholesale operations, and the figures shown in this study have little meaning with respect to the more limited retail operations of this Company on a going forward basis. The Fitch data is not correlated in any way to the level of costs that Avista is requesting be allowed in rates in this proceeding. Finally, there are much more reliable figures in this record identifying the costs of this utility.

Public Counsel asked Ms. Knox, the Company's cost of service witness, to calculate the exact same unit costs set forth in the Fitch study. The results of that analysis (Exhibit 90) compared with the Fitch study (Exhibit 89) are quite striking:

Transmission O&M Expense: Fitch, 0.07 cents, vs. Knox, 0.177 cents.

Distribution O&M Expense: Fitch, 0.06 cents/kwh, vs. Knox, 0.38

	cents/kwh
Distribution Customer Service:	Fitch, 0.08 cents/kwh, vs. Knox, 0.146 cents/kwh
Common and General:	Fitch is 0.24 cents/kwh, vs. Knox, 0.399 cents/kwh.

Ms. Knox's exhibit is what the Company is requesting that the Commission approve. It yields a total O&M expense of 4.627 cents/kwh. When capital costs are included, the total rate request comes to 5.6 cents/kwh. (Exhibit 493, p. 1) The Fitch study adds up to only 3.09 cents/kwh.

Public Counsel would gladly stipulate to a rate level for Avista which is a 10.4% increase above the 3.09 cents/kwh total that Fitch measured for the test. That would mean a decline in rates from over 5 cents/kwh to less than 3.5 cents/kwh, a larger decline than that actually proposed by Public Counsel here. However, the point of this exercise is that the Fitch study is meaningless because it divides retail distribution and customer service costs by the sum of wholesale and retail kilowatt-hour sales, producing results which cannot reasonably be compared between companies.

The foregoing discussion demonstrates that Avista's non-production O&M costs are higher than both more urban and more rural utilities, and utterly discredits the Fitch study that Mr. Dukich relies on in his rebuttal testimony. Other facts in the record likewise lead to the conclusion that the Company's management has not displayed the "excellence" sufficient to justify an incentive return:

a) Avista earnings are at zero for this year (Exhibit 17, p. 31) and were low last year.

b) The Company's retained earnings are evaporating. At the end of 1997, the Company had $172 million in retained earnings. Despite a cut in the dividend initiated by the new management, it had dropped to $120 million at the end of 1998 (Exhibit 3), declined further to $87.5 million in 1999 (1999 Form 10-K, Exhibit 400, p. 41) and will further decline this year (zero earnings; continuing dividends) because of the Company's power speculation (Exhibit 17, p. 4).

c) As shown by Staff case, the utility rate of return is quite healthy.

Therefore, the cause of this declining financial health can be fairly attributed to the diversified operations initiated by the new management.

d) The Company did not have a system of checks and balances in place on its power trading activities, as evidenced by the fact that trading went "in excess of management guidelines" and took "improper risk" as described by the Company (Exhibit 17, p. 8).

H. Kettle Falls Bonus

Avista has asked that it be allowed a 2% bonus on the return on equity applicable to the Kettle Falls project, pursuant to the direction of RCW 80.28.025. This is not appropriate. Kettle Falls does not meet the statutory standard of cost effectiveness set by this law, and the Company is not entitled to a bonus return.

1. The statutory standard.

Unlike the test of prudence that this Commission has applied to generating plant additions, which asks whether the decision to build was reasonable given what was knowable at the time that decision was made, the statutory standard of RCW 80.28.025 is an *ex post* analysis. It requires that the resource be cost-effective when it is placed in the rate base.

The statutory standard of RCW 80.28.025 is quite clear:

> Measures or projects encouraged under this section are those for which construction or installation is begun after June 12, 1980 and before January 1, 1990, and which, at the time they are placed in the rate base, are reasonably expected to save, produce, or generate energy at a total incremental system cost per unit of energy delivered to end use which is less than or equal to the incremental system cost per unit of energy delivered to end use from similarly available conventional energy resources which utilize nuclear energy or fossil fuels and which the gas or electric company could acquire to meet energy demand in the same time period.

Kettle Falls does not meet this standard, and the Company has presented no evidence that it does.

Kettle Falls was placed in rate base in Cause U-83-26.[5] The complete Commission decision in that case is in this record as Exhibit 522. Mr. Lazar presented detailed testimony

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[5] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-83-26, Fifth Supplemental Order (1984) (hereinafter cited as "U-83-26").

showing that Kettle Falls was not cost-effective as of 1983 when it was placed into rate base. (Exhibit T-691, pp. 14-19; Exhibit 695). The Company's rebuttal testimony, presented by Mr. Dukich, only pointed to the Commission's finding that the original cost of the plant was reasonable when the original estimate was made. Mr. Dukich did not address at any time whether the plant was cost-effective when it was placed in the rate base, which is the statutory test for this bonus rate of return.

The Company would have the Commission ignore this standard. Mr. Dukich suggests that because the Commission accepted that the original cost estimate for Kettle Falls was found by the Commission to be a "reasonable" amount for the resource at the time the decision was made to proceed with the project, that this amount somehow meets the statutory test. That utterly fails to recognize the explicit language of the statute, that the test is applied when the plant enters rate base, not when the decision to construct is made by management.

2. Kettle Falls was not cost-effective when it was placed into rate base.

The Company presented no evidence whatsoever of what the power from Kettle Falls cost when it entered rate base, nor of what the cost of alternative resources were at that time. Mr. Lazar presented three specific analyses of the cost-effectiveness of Kettle Falls. (Exhibit 695). Two of these were comparisons as of the time it entered rate base. Both of these comparisons showed that the plant was not cost-effective when it was placed into rate base.

The cost of Kettle Falls in the first year of operation, when it entered rate base, was 125.85 mills/kwh (Exhibit 695, p. 1). The Company did not rebut this figure. It is hard to imagine how the Company could assert that this plant was or is cost-effective at a cost of over twelve cents per kilowatt-hour. And, to be fair, the Company has not directly made such an assertion, instead relying on an *ex ante* test of prudence, not the *ex post* test of cost-effectiveness imposed by the statute.

The first comparison Mr. Lazar made in Exhibit 695 was to the actual price obtained by Pacific Power in its sale of energy and capacity from Colstrip to Black Hills Power and Light

Company in 1984. This transaction is for a similar amount of electricity, and was a long-term sale. This sale transaction was at a price of 36.78 mills/kwh, or less than one-third of the cost of power from Kettle Falls when it entered the rate base. The Commission examined this transaction at precisely the same time as the Kettle Falls plant entered rate base. Both WWP's U-83-26[6] case involving the placement of Kettle Falls into rate base and Pacific's U-83-57[7] case involving the sale of Colstrip capacity and energy were filed in 1983 and decided in 1984. This is the best evidence in this record as to the cost-effectiveness of Kettle Falls, and the plant fails that test quite dramatically.

Mr. Lazar's second market comparison in Exhibit 695 was to the cost of purchasing capacity and energy in the open market beginning when Kettle Falls came into service. While the data provided by the Company only covered the period 1986 to 1998, the average cost over this period was only 25 mills/kwh, or one-fifth of the cost of Kettle Falls.

Avista presented no evidence whatsoever that Kettle Falls was cost-effective at the time it was placed in the rate base. Mr. Dukich's testimony essentially asserted that because the Department of Revenue granted the tax credit for Kettle Falls, and because the Commission allowed 90% of the Kettle Falls investment into rate base, it must somehow meet the statutory test. The test that Mr. Dukich asserts is that the Commission determined that 90% of the investment was prudent. (Exhibit T-84, p. 25) That is the "what did management know when it made the decision" test for prudence, not the "cost-effective when it entered the rate base" test called for by the incentive rate of return statute.

The fact that the Company never requested this incentive return when the discussion of Kettle Falls was fresh and such a request would have been timely is instructive. In cross-examination, Mr. Dukich acknowledged that the Company had not requested the bonus rate of

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[6] *See Id.*

[7] *Washington Utilities and Transportation Commission v. Pacific Power & Light Co.,* Docket No. U-83-57, Second Supplemental Order (1984) (hereinafter cited as U-83-57).

return in 1983, when the plant entered rate base (Tr. 2073), even though he asserted that the Company was aware of the availability of this incentive (T-84, p. 27). In fact, the Company never requested this incentive in its 1984 rate case, Cause U-84-28[8], its 1985 rate case, Cause U-85-36[9], or its 1986 rate case, Cause U-86-99[10] (Tr. 2074). Not until now, some 17 years after the plant entered service, has the Company ventured to ask for this incentive payment. Mr. Lazar's testimony shows the reason for this reticence: Kettle Falls power costs three to five times as much as alternatives that were available at the time it was placed in the rate base.

3. Kettle Falls is still not cost-effective; the statutory standard is not met and the equity bonus should be denied

Mr. Lazar's third market comparison looked at the present time, which is different from the statutory standard. He compared the cost of power from Kettle Falls to the estimate of Centralia replacement power presented by Avista witness Johnson in the recently completed Centralia proceeding, Docket UE-991255.[11] At Exhibit 695, he showed that the Kettle Falls power today (after 17 years of depreciation, and a sharp decline in the fair rate of return) still produces power that costs about one and a half times as much as alternatives which the Company identified a few months ago.

Kettle Falls was not cost-effective according to the statutory standard when it entered rate base. It is not cost-effective today. The Company has utterly failed to demonstrate that it is entitled to an incentive rate of return on this high-cost resource. The request should be denied.

I. Public Counsel Critique of Dr. Avera's Testimony

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[8] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-84-28, Second Supplemental Order (1985) (hereinafter cited as U-84-28).

[9] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-85-36, Third Supplemental Order (1986) (hereinafter cited as U-85-36).

[10] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-86-99, Second Supplemental Order (1987) (hereinafter cited as U-86-99).

[11] *In the Matter of the Application of Avista Corporation for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant*, Docket No. UE-991255 (1999) (hereinafter cited as UE-991255).

1. <u>Avista cost of capital</u>.

In estimating the cost of equity capital, Avista's witness, Dr. Avera, relies on a multi-stage DCF analysis and several risk premium analyses. As discussed in detail in the Direct Testimony of Public Counsel witness Hill (Exhibit T-622, pp. 52-72) those analyses are flawed and result in an overstatement of the Company's cost of equity capital.

Dr. Avera's multi-stage DCF is derived from what he terms the "general form" of the DCF, which he admits has not customarily been used to estimate the cost of capital in rate cases. The reason that that form of the DCF has not been used, according to the Company witness, is that the multi-stage form of the model requires an increased number of assumptions and more computational difficulties (Exhibit T-101, p. 39). As Mr. Hill points out, Dr. Avera's multi-stage DCF requires many, very specific assumptions regarding events that will happen at specific times in the future and the computational difficulty requires a trial-and-error computer algorithm. (Exhibit T-622, pp. 57-59)

For example, Dr. Avera attempts to predict the per share dividend amount, every year, for each of the firms in his sample group from now until 2008. In so doing, the Company witness makes many assumptions about changes in payout ratios and the mix of regulated and unregulated operations in each company. In attempting to predict events in 2008, Dr. Avera assumes all of the companies will be 50% utility and 50% unregulated, will have exactly the same dividend payout ratio, the unregulated portion of every company will be successful and will grow at a rate equal to the current 5-year earnings growth projection for the stock market generally. In addition, Dr. Avera predicts the stock price for each company in 2008, which is based on a traditional DCF analysis[12]. (Exhibit T-622, pp. 58, 59) The delicate nature of the myriad assumptions made by Dr. Avera in order to reach a final equity cost estimate, makes his result tentative, at best. The unreliability of the Company's multi-stage DCF is underscored by

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[12] As Dr. Avera stated during cross, if one is able to accurately predict the future (e.g., stock prices eight years hence) "there are rich rewards available for him on Wall Street" (Tr. 1828).

the fact that—despite Dr. Avera's bold dividend growth predictions for three of the companies in his sample group (Connective, SEMPRA and Sierra Pacific), those firms all cut their dividend subsequent to Dr. Avera's analysis. His DCF estimate which includes very specific dividend growth assumptions for those companies as well as the others in his sample group cannot be correct, because his assumptions have already been violated (Exhibit T-622, p. 59).

In addition, the selection of the particular type of multi-stage DCF, and the assumptions included in it (which are, of course, all-important to the outcome) have changed over time. Had he utilized the same multi-stage DCF analysis he used in prior testimony, his DCF cost of equity estimate would have been much lower (Exhibit T-622, pp. 59, 60). Dr. Avera admits that his multi-stage DCF has "evolved" over the years, evoking a "consistency is the hobgoblin of small minds" defense (Exhibit T-135, p. 59, ll. 21, 22), however the fact that his methodological change results in an increased multi-stage DCF result casts doubt on his "new" results. In addition, Dr. Avera relied on a FERC gas pipeline decision as support for his methodological changes, but, as Mr. Hill notes (Exhibit T-622, p. 60), contemporaneously with Dr. Avera's 11.50% multi-stage DCF result produced in Avista's Idaho proceeding, FERC staff rate of return analysts were estimating the equity capital cost of electric utilities to be approximately 9.4%.

Finally on this point, as discussed above, Dr. Avera presented this same type of multi-stage DCF analysis in Avista's recent Idaho rate proceeding. The Idaho Commission reviewed it and concluded that it did not provide an accurate estimate of the equity cost of the Company's utility operations because it "put too much weight on deregulated operations without assuring that regulated operations are not paying an excessive share of investor growth expectations for deregulated operations." (Exhibit 119, IPUC Order No. 28097, p. 23).

As Dr. Avera pointed out on several occasions, his sample group of utilities was chosen to be similar in risk to Avista's jurisdictional utility operations (Tr. 704, ll. 5-25; 717, ll. 17-25; 1839, l. 20 - 1840, l. 11). There is currently no legislation pending in Washington to deregulate

the utility industry.[13] Therefore, Dr. Avera's multi-stage assumptions that fully 50% the DCF growth rate should be equal to the projected earnings growth of market indexes is clearly not applicable to a group of firms that were selected to be similar in risk to Avista's regulated Washington operations. Also, as Mr. Hill points out at pages 61 and 62 of Exhibit T-622, Avista's own growth rate projections indicate that its utility operations are expected to continue to grow at rates which are similar to the 3.5% rate Dr. Avera uses for traditional utility growth. In sum, the Idaho Commission's concerns regarding Dr. Avera's multi-stage DCF growth rate assumptions are well-founded and those assumptions, which impute far higher growth rates than Avista's own S.E.C. reports to investors, serves to overstate the cost of equity estimate.

2. Risk Premium.

Dr. Avera presents a smorgasbord of risk premium studies in the second portion of his cost of equity analysis. However, in prior testimony before Federal regulators, Dr. Avera, in reviewing the reliability of the very same risk premium studies, concluded that there would be "no confidence" that equity cost results derived from those studies "would be reasonably accurate over a particular time period." (Exhibit T-622, pp. 63-67) In his Rebuttal, Dr. Avera avers that his opinions regarding the usefulness of risk premium studies have not changed (Exhibit T-135, p. 59, ll. 23-25).

Dr. Avera, in applying his Risk Premium studies, also relies on what he believes to be an inverse relationship between the level of interest rates and the risk premium. In other words, because the studies which he reviews were undertaken in the past, and because interest rates are currently lower than they were in the past, the risk premiums should be adjusted upward. Mr. Hill notes in his testimony that Dr. Avera had done no statistical analysis of the autocorrelation of his data to determine if those data produced reliable results (Exhibit T-622, p. 69). In addition, although Dr. Avera, in Exhibit 102 (Appendix C), references a more recent study of the

[13] As Chairwoman Showalter noted (Tr. 1802, ll. 13-15) there has arguably been declining interest in that notion over the last four years.

inverse bond yield/risk premium relationship, he does not include that study in his analysis. Dr. Avera even stated in cross-examination that that study had not been published "the way the other studies were." (Tr. 745, ll.14-20) However, as Mr. Hill points out in Exhibit T-622, p. 70, the risk premium study Dr. Avera elected not to include was published in *Financial Management* (as were many of the studies on which he elected to rely), focused on utility cost of equity (unlike the studies on which he elected to rely), and produced a cost of capital indication of 10.63%.

3. Avera Rebuttal.

At page 15 of his Rebuttal (Exhibit T-135), Dr. Avera commented that single-A utility debt costs reached 8.8% in May. Exhibit 137 shows that more recent debt costs have declined, as Mr. Hill correctly noted to approximately 8.3%. At page 33 of his Exhibit T-135, Dr. Avera discusses projected earnings growth rates for electric utility operations cited in an A.G. Edwards publication. Dr. Avera takes those growth rates and adds them to the dividend yield of Mr. Hill's sample group in an attempt to show that Mr. Hill's DCF results are understated, based on an investor publication on which Mr. Hill has also relied. However, as shown in Exhibit 142, pp. 5 and 17, if the earnings growth rates projected by A.G. Edwards for its electric utility universe (4% to 6%) is properly matched to the dividend yield for those companies, 5.8%, the result is a DCF-type cost of equity range of 9.8% to 11.8%. The mid-point of that range, 10.8%, is very nearly equal to Mr. Hill's equity cost estimate in this proceeding. Again, Public Counsel's equity return recommendation in this proceeding is shown to be supported by market-based data available to investors, while the 12.25% recommendation of Dr. Avera is not.

At page 36 of his Rebuttal, Dr. Avera indicates that the constant growth DCF can only be considered "an abstraction of reality." When asked to list all of the equity cost estimation methodologies which were not abstractions from reality, Dr. Avera listed none (Exhibit 143).

At pages 38 and 39 of Exhibit T-135, Dr. Avera cited Professor Myron Gordon's seminal text regarding the DCF in utility regulation. Dr. Avera implies that Professor Gordon endorses

the multi-stage DCF. Dr. Avera is incorrect. As shown in Exhibit 145, the final conclusion of Professor Gordon's consideration of multi-stage DCF is that such a model "eliminates neither the random nor the systematic error under the estimating models available to us." In other words, the multi-stage DCF does not provide any more accurate estimates than the traditional, constant-growth DCF which, in Dr. Avera's own words, contains fewer assumptions and is less complicated computationally.

In attempting to rebut Mr. Hill's DCF growth rate analysis of Constellation Energy at page 40 of Exhibit T-135, Dr. Avera refers only to Value Line's earnings growth projections for that company (11%). As shown in Exhibit 146, Value Line's dividend growth rate projection for that same company is only 0.5%, making an 11% growth rate an unreasonable representation of the long-term dividend growth expectations called for in the DCF model.

At page 61 of his Rebuttal testimony (Exhibit T-135), in order to corroborate his own testimony, Dr. Avera attempts to take a risk premium offered by Professor Gordon in a 1982 research paper and apply that 4% risk premium for a period "prior to the seventies" to current interest rates to produce a cost of equity estimate. However, upon closer examination of the underlying data, we discover that Dr. Avera has failed to take into account the phenomenon on which he bases a substantial portion of his risk premium analysis—the inverse relationship between risk premiums and interest rates. Exhibit 147 ("Problems in CAPM Estimation of the Cost of Equity Capital", p. 186) shows that the average "AAA" utility bond yield was 5.15% "prior to the seventies." Exhibit 137 shows that, today the yield on "AAA"-rated utility debt is 7.82%—267 basis points higher that in the period in which Gordon estimated a 4% risk premium. Therefore, according to Dr. Avera's own testimony (Exhibit 102, Appendix C, Table 2, p. 1) an increase in bond yields of 267 basis points would cause a reduction in risk premium of 1.27% (2.67% x 0.4775). A 4% "pre-seventies" risk premium then becomes a 2.73% current risk premium (4% - 1.27%). That current 2.73% risk premium, according to Avera's own risk premium methodology, added to a current cost rate for "AAA"-rated utilities, 7.82%, produces a

cost of equity estimate of 10.55%. Viewed in this light, Public Counsel's 10.875% equity cost recommendation in this proceeding may even be too generous.

At page 62 of his Rebuttal, Dr. Avera cites a recent Order from the Oregon Public Utility Commission in support of an inverse relationship between risk premiums and interest rates. It should be noted that in the cited Order (see Exhibit 148, p. 23) the resolution of the market risk premium issue was that the Oregon Commission selected 8.5% as the appropriate CAPM market risk premium. In this proceeding Mr. Hill used a market risk premium range of 7.4% to 9.4%, with a mid-point of 8.4%, nearly identical to the value selected by the Oregon Commission. In addition, Dr. Avera fails to point out that in that decision, the Oregon Commission removed unregulated equity investment from the ratemaking capital structure (Exhibit 148, p. 6) and awarded an equity return of 10.2% (Exhibit 148, p. 24).

J. Public Counsel Recommends An Overall Cost of Capital of 8.82%

A 10.875% equity return allowance, operating through Avista's utility-only capital structure and recent embedded cost rates implies an overall cost of capital of 8.82%.

Moreover, Mr. Hill shows that his recommended overall return will afford the Company's utility operations an opportunity to achieve a pre-tax interest coverage of 3 times. That level of pre-tax coverage is similar to the average coverage levels experience by Avista over the past five years. (Exhibit T-622, pp. 51, 52; Exhibit 623, Schedule 12) This is a just and reasonable level for Avista's rate of return.

IV. POWER COST ADJUSTMENT

A. Avista's Power Cost Adjustment (PCA) Proposal Ignores The Commission's PCA Parameters

Avista has requested the implementation of a power cost adjustment mechanism (PCA) in this proceeding. It has been opposed by Staff, through the testimony of Mr. Buckley, by ICNU through the testimony of Mr. Schoenbeck, and by Public Counsel through the testimony of Mr. Lazar. No other party has supported this proposal.

In Cause U-88-2363-P[14], the Commission considered the Washington Water Power's request for a PCA, and denied that request. The Commission cited the following shortcomings with the Company's proposals: 1) It was too sensitive to hydro conditions[15]; 2) An adjustment in price might occur at a time not synchronized with a change in costs[16]; and 3) There was no cost of capital adjustment.[17]

The Company's proposal, contained in Mr. Johnson's testimony, Exhibit T-420, contains

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[14] *In the Matter of the Washington Water Power Company's Petition for Approval of an Accounting Order Permitting Implementation of a Power Cost Adjustment (PCA) Mechanism,* Docket No. U-88-2363-P, First Supplemental Order Denying Petition (1989) (hereinafter cited as U-88-2363-P).

[15] *Id.* at 1.

[16] *Id.* at 6.

[17] *Id.* at 1.

the same shortcomings that the Commission found as flaws in its 1988 proposal for a PCA: sensitivity to hydro conditions, the potential for a rate change to be unsynchronized with a cost change, and the lack of a cost of capital reduction.

On rebuttal, the Company filed a revised PCA proposal in Mr. Johnson's Exhibit T-426, which narrowed the issues to be calculated to two: the level of hydro generation, and the Mid-Columbia Price Index The company's revised proposal is equally unacceptable. First, it continues to exclude a cost of capital adjustment. Second, the proposal to rely on the Mid-Columbia Price Index would need to be supported by some evidence that this is, in fact, a price that Avista should be expected to receive or pay from surplus market activities. The record is silent on the applicability of the Mid-Columbia Index to Avista's power transactions, but plentiful on Avista's ability to "beat" the market because of the flexibility of its hydroelectric resources. (See discussion, Section V.D. Major Power Supply Issues). Third, by removing all other issues, the proposal becomes extremely sensitive to hydro conditions, one of the original criticisms of the 1988 proposal. Finally, the Company's proposal could lead to "gaming" the methodology by assigning profitable transactions to its non-utility operations, and unprofitable transactions to the utility.

B. Avista's PCA Proposal Contains No Cost of Capital Adjustment

In the original 1988 PCA proposal, the Commission explicitly found that a cost of capital adjustment was essential, and had not been provided:

> Does the PCA proposal include a downward cost-of-capital adjustment? The Commission finds that the proposed PCA fails this criterion. The Company did not provide the Commission with a specific proposal on how ratepayers would achieve a cost of capital benefit. Company witness Eliassen testified that WWP would, eventually, not need as much equity in its capital structure if the PCA was approved. This is an interesting suggestion, but the Commission finds that it is not sufficiently specific. More to the point, the determination of an appropriate capital structure, including any implications that a PCA might bring, needs to have the benefit of a full record developed

in a general rate case.[18]

The Company ignored this requirement in its PCA application in this case.

It is instructive to compare the equity ratio in the capital structure approved by the Commission in the rate decision prior to the 1988 PCA decision with the capital structures proposed by the parties in this proceeding:

Equity Capitalization Ratios

Cause U-85-36, Third Supp. Order, p. 41[19]	37.05%
Company Proposal (Eliassen Rebuttal, Exhibit T-520)	47.00%
Staff (Lurito, Exhibit 634)	42.00%
Public Counsel (Hill. Exhibit 623)	38.97%

Clearly, every cost of capital witness in this proceeding has proposed a higher equity ratio than the Commission found reasonable in the Company's last rate case, a case in which the Commission stated that a downward adjustment would be needed to accompany implementation of a PCA. Mr. Avera has proposed a full 10 percentage point increase in the allowed common equity ratio. The cost of capital proposals by all of the parties are inconsistent with implementation of a PCA.

The Company asserted that Dr. Avera's proposed capital structure was reflective of an assumption that the PCA would be approved, because it asserted that his comparable companies have adjustment mechanisms. (Exhibit T-101, p. 57, ll. 12-15) The record simply does not support this assertion.

First, Mr. Schoenbeck's Exhibit 720 goes through each of Dr. Avera's "comparable" companies, and demonstrates that only one currently has a PCA, and that one is expected to last for only a short time.

Second, Mr. Hill selected some comparable companies, the majority of which do not have ongoing power cost adjustment mechanisms:

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[18] U-88-2363-P, *supra* note 14, First Supplemental Order, p. 9.
[19] U-85-36, *supra* note 9, Third Supplemental Order, p. 41.

> Finally, with regard to the issue of a power clause adjustment mechanism, the majority of the companies in my sample group either do not have such mechanisms or will be eliminating them within the year." (Exhibit T-622, p. 51)

Third, the Idaho Commission, which approved a PCA, has also approved an equity capitalization ratio of only 37.42%, significantly lower than Mr. Hill and Dr. Lurito have proposed. (Exhibit T-622, p. 23) This is evidence that approval of a PCA should be accompanied by a cost of capital reduction to a level much lower than that proposed by Staff and Public Counsel. The Company has proposed a much higher equity capitalization ratio than the Idaho Commission approved, but points to Idaho as the model for its proposed PCA.

The Company asks for implementation of a PCA and yet it asks for a higher cost of capital than approved in Idaho or Washington in the past. Each of the parties has proposed an equity capitalization ratio which is higher than the Company had in its last rate case (prior to the proposed PCA), and higher than the Idaho Commission has approved (after the implementation of the Idaho PCA). Those equity capitalization ratios are sufficient to support the Company's financing without a PCA in place.

C. The Mid-Columbia Price Index Should Not Be The Only Indicator of "Fair Market Value."

The second problem with the Company's proposed PCA is its reliance on the Mid-Columbia Price Index as the only indicator of "fair market value" to be used to compute the adjustment in rates under the Power Cost Adjustment. There is no evidence in this record anywhere that the Mid-Columbia Index is the proper measure of the change in short-term power costs that the Company would experience in response to a change in hydro conditions. To the contrary, there is a great deal of evidence that the flexibility of Avista's hydroelectric resources provides it considerable insulation from market prices.

First, the Company has used a multi-tier pricing scheme for market prices in computing normalized power costs; this "Dispatch Simulation Model" is described by Mr. Norwood at T-151, beginning at Page 6. Second, the Company testified that the considerable costs it expended

for relicensing of its hydro projects were justified, in large part, by the flexibility to meet peak demands which it retained. This is discussed by Mr. Anderson at T-345, at page 5. This flexibility was cited by Mr. Buckley in his analysis of the "hydro flexibility" adjustment to normalized power costs, in T-540, beginning at page 37. In response to a question from Chairman Showalter, Mr. Buckley admitted that he had underestimated this benefit by some $4.4 million (Tr. 1371).

Third, Mr. Hirschkorn presented evidence of how the hydroelectric projects are used to meet peak loads, which occur during high-cost hours of the day. He agreed under cross-examination that this practice reflected power managers seeking to minimize power cost when market prices are highest. (Exhibit 507; Tr. 2227)

There is simply no evidence that the Mid-Columbia Index alone is a valid or accurate indicator of the prices Avista will experience in the market, and therefore no basis upon which to accept this element of the proposed PCA.

D. Avista Has Ignored PCA's Extreme Sensitivity to Hydro

In the 1988 proceeding, the Commission found fault with the Company's proposal, stating that it "may be too sensitive to hydro conditions; that is, it may cause too much rate instability." [20] The Commission cited an analysis showing that rates would have changed many times over a four-year period.[21]

The Company has utterly ignored this concern in its direct and rebuttal testimony. It has presented no exhibit showing how many times rates would change under either its original or its revised proposal. Removing other factors, as the Company did in its rebuttal, only increases the PCA's sensitivity to hydro conditions.

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[20] U-88-2363-P, *supra* note 14.
[21] *Id.*

E. The PCA Has A Potential for Gaming

Mr. Schoenbeck testified to a different problem with the proposed PCA. His testimony addresses the risk that Avista would "game" the mechanism by excluding the commercial trading activities from the PCA calculation. (Exhibit T-718, p. 31) The record is clear that these unregulated activities are riskier than utility operations, add to the cost of capital, have caused devastating impacts on the Company's profitability, and have operated without adequate management oversight. We address each of these issues elsewhere in this brief, where we discuss the fair rate of return, the proposed management incentive bonus payment, and administrative and general cost issues.

Public Counsel is very concerned with the impact of Avista's unregulated activities on the regulated company and its ratepayers. We strongly oppose any mechanism which would foster continued activities which might shift costs from unregulated to regulated operations, or might shift revenues from regulated to unregulated operations. The record in this proceeding creates concern that the proposed PCA mechanism might foster this type of problem.

F. The Commission Should Not Order Implementation of the Proposed PCA.

Public Counsel opposes the implementation of the proposed Power Cost Adjustment. The 8.82% fair rate of return computed by Mr. Hill is based upon an assumption that no PCA is in place. If for any reason the Commission were to approve the PCA, it should lower the rate of return significantly below that recommended by Mr. Hill.

V. MAJOR POWER SUPPLY ISSUES

A. Introduction

Public Counsel has not addressed the full range of power supply issues in our testimony, and we will present argument on only a few of the power supply issues in this case. The specific issues we will address are Centralia replacement power, Potlatch, and Hydro Flexibility; our

position is congruent with Staff's direct case in the first two issues, and different from Staff's direct case on the third. On all other issues relating to power supply, we endorse the recommendations of Staff.

B. Centralia Replacement Power

The Company has requested that its total power supply cost be increased by $4.1 million as a consequence of the sale of the Centralia power plant. (Norwood, Tr. 1590) This is directly contrary to its position in the Centralia proceeding, UE-991255[22], in which it presented evidence that replacement power for Centralia would be lower in cost than the output of the plant itself. (Exhibit C-194; Tr. 229).

The proper response of the Commission to this conduct, in both this and future proceedings is to hold the Company to its analysis, presented in the Centralia proceeding, that the replacement power costs will be no more expensive than continued ownership of Centralia. That can be done by adopting the Staff position on replacement power costs in this proceeding, and directing the Company to file future rate proceedings on the same basis.

This is a complex calculation, since it involves a change in rate base and O&M due to the sale of Centralia, plus increases in purchased power and transmission expense associated with the replacement power. The detailed analysis of this issue was provided by Staff, through the testimony of Mr. Buckley and Mr. Parvinen, and we concur with their numerical analysis.

Public Counsel is particularly concerned about this item, as we sought to bring the Company's position before the Commission prior to the consummation of the Centralia sale, through our motion to reopen Docket UE-991255.[23] The record in this proceeding demonstrates the following:

1) The Company asserted, all through its rebuttal testimony in Docket UE-991255[24], that the replacement power cost for Centralia in the first few years would be lower than the cost of continued ownership.

2) The Company had prepared a detailed analysis in November of 1999, two months before that rebuttal testimony was presented which showed that the replacement power cost would be greater.

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[22] UE-991255, *supra* note 11.

[23] A copy of Public Counsel's Motion to Reopen and the Commission's ruling on the motion are a part of the record in this proceeding. (Ex. 221, Tr. 1144)

[24] UE-991255, *supra* note 11.

3) The Company failed to disclose the November 1999 analysis in the Centralia proceeding, instead relying on a much simpler analysis which showed that replacement costs were lower than Centralia costs.

4) The Company objected to improving the quality of the record in the Centralia proceeding, by opposing our motion to reopen.

In its final order on Centralia, the Commission rejected our motion to reopen, by deferring consideration of the replacement power cost issue to this proceeding, stating:

> …if the Commission concludes that a monetary adjustment is necessary, it can best make that adjustment in Avista's rate case, and that rate case is the proper forum for any further examination of Public Counsel's concerns."[25]

Public Counsel objected to the sale of Centralia because of an expectation of higher long-run power costs.[26] The Company's proposal in this proceeding confirms that expectation, to the point where immediate short-run power costs are also now asserted to be higher. Avista here presents a much more thorough analysis than it presented in the Centralia docket, one that was available at the time of the Centralia docket, and was withheld by the Company in that docket.

In the Centralia docket, the Company's evidence on the cost of replacement power was sponsored by Mr. William Johnson. For the convenience of this record, Public Counsel entered his key exhibits and cross-examination testimony as Exhibits 430 and 431 in this proceeding. Mr. Johnson looked only at the cost of replacement power as of May or June of 1999. That evidence was not updated or amended by the Company in the Company's rebuttal case. (Exhibit 431, Centralia Tr. 265)

The hearings on Centralia were held in January 2000.[27] The Commission's final decision was rendered in April 2000[28], nearly a year after the power cost analysis presented by the Company in that docket. Reproduced here from Exhibit 430 is Mr. Johnson's analysis of the cost of power from Centralia compared with his market forecast of replacement power cost, which he did not update.

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[25] UE-991255, *supra* note 11, Fourth Supplemental Order, p. 8.
[26] *Id.,* Second Supplemental Order, p. 10.
[27] *Id.*, at Second Supplemental Order, p. 3.
[28] *Id.,* at Fourth Supplemental Order.

Market rate projections

Year	Centralia	Low	Medium	High
2000	26.45	25.21	25.12	27.12
2001	28.93	25.55	26.12	28.12
2002	30.33	26.23	27.04	29.22

It is clear that the Centralia replacement power is significantly cheaper over this period than the estimated cost of owning and operating Centralia. In the "high" case, it was slightly higher in year 1, but this was more than offset, even in the high case, by projected savings in years 2 and 3. This was the Company's sworn testimony before the Commission as of January, 2000. Even in the "high" market price forecast, replacement cost was cheaper than Centralia.

In the Centralia case, at the instance of Public Counsel, the Company provided a November 1999 analysis into the record. This was Exhibit 332 in the Centralia docket, now pages 4 and 5 of Exhibit 430 in this docket. These November power cost estimates were significantly higher than those the Company had relied on in its direct and rebuttal testimony, and formed a part the basis of Public Counsel's objection to the Centralia sale. These showed that the present value of Centralia replacement power costs would be about $25 million higher than continued ownership and operation of Centralia over the period 2001 - 2020. However, even in these higher market forecasts, the cost of Centralia replacement power was estimated by the Company to be about $5 million <u>cheaper</u> over the first 3 years than continued ownership and operation of Centralia. This exhibit, dated 1/7/2000, has the initials WGJ in the bottom right hand corner; these are Mr. Johnson's initials, and his Counsel represented that Mr. Johnson prepared this analysis on his computer. (Exhibit 431, Centralia Tr. 277-278)

On November 2, 1999, however, the Company caused to be prepared another detailed analysis of Centralia replacement power costs. Exhibit C-214 is the short-run analysis prepared by the Company, and it is dated November 5, 1999, with Mr. Johnson's initials "WGJ" at the

bottom of pages 1 through 4; (cf. Exhibit 430). Exhibit C-214, pp. 5-6, contains emails dealing with the cost of replacement power, and those are dated September 28, 1999 and November 4, 1999. The actual replacement power contract is dated October 25, 1999. (Exhibit C-214, pp. 7-11) Mr. Johnson testified in January 2000, but none of this information was included in his rebuttal testimony, either at the time it was filed or at the time it was presented. (Centralia Tr. 265, ll. 20-21)

The point of all this is that the Company knew – or certainly had reason to know -- that its testimony in the Centralia docket was obsolete at the time it was presented, and never undertook to correct or update that testimony. In fact, Mr. Johnson stated under oath that his rebuttal testimony and exhibits were true and correct, as of January 2000 when he testified. (Exhibit 431, p. 264)

Finally, the Company has prepared yet another analysis of Centralia replacement power costs in this proceeding, contained in Exhibit C-194. It is instructive to compare the Company's testimony, presented under oath in January 2000, to the estimated costs contained in the Company's rebuttal case in this proceeding, which are set forth in detail in Exhibit C-194. In this exhibit, the Company presents a complex calculation as to the replacement cost of Centralia power, including changes to 13 different line items in Mr. Norwood's Normalized System Power Supply Expenses. (Exhibit C-194, pp. C-1 to C-6, which also carry Mr. Johnson's initials in the footer) This information originally appeared as Mr. Norwood's Exhibit 152. Mr. Johnson's analysis in the Centralia case did not look at the impact of replacing Centralia or the operation of other power supply resources – he looked only at a market price estimate, even though it is now quite apparent that he understood this possible relationship and was busy modeling it as the Centralia proceeding was being decided.

One would expect at least as detailed an analysis of the effect of selling a major generating resource as one receives in support of normalized power costs in a rate proceeding, but that is not what the Commission or parties received. The Company did a simplified analysis

to support the sale, concluding it was in the ratepayer's interest, and a complex analysis after that record was complete, showing that the sale of Centralia was *not* in the ratepayer's interest.

It is difficult to understand why the Company would do a haphazard partial analysis in the Centralia sale proceeding. It is hard not to conclude that it wanted to sell the plant, flow a significant portion of the gain to shareholders, and then let the market take its course on power costs, even if it were to the detriment of ratepayers. Conversely, in the rate case, there is "real money" on the line for replacement power costs, and it has done a detailed analysis supporting higher prices.

C. Potlatch

Staff's proposed means to address this is reasonable. Mr. Buckley assigns a share of the $143.4 million payment received from PGE to offset the last few months of this contract, and then proposes permanent rates based on projected power costs after the expiration of this contract. (Exhibit T-540, p. 20)

Public Counsel does not concede that the 48 mill/kwh Potlatch contract was prudently entered into. Mr. Buckley explained that the Staff has had concerns about the cost-effectiveness and prudence of this resource since inception.

However, there is no record contesting the contract which would justify disallowance. For that reason, we support the Staff proposal to make rates on a permanent basis without this contract, to make permanent rates on a post-expiration basis, and to assign $11.4 million of the PGE Capacity Sale cash payment to offset the shortfall between now and the date of expiration of the contract

D. Hydro Flexibility

Mr. Buckley's power supply analysis assigns a value of $1.6 million to the flexibility provided by the Company's hydroelectric power plants in meeting daily variations in power

demand. (Exhibit T-540, p. 29) The reason for this, as he explains, is that the Company's dispatch model does not differentiate between day and night, using monthly average prices to determine whether the Company will buy or sell, while the Company's actual market operations do reflect the fact that the hydro facilities allow the Company to take advantages of these day to night variations in price.

In cross-examination, Mr. Buckley admitted that his adjustment was too cautious. In response to a question from Chairwoman Showalter, he stated that an adjustment of $6 million would be more appropriate. (Tr. 1371) That analysis was based on Mr. Dukich's rebuttal Exhibit 88.

Mr. Dukich's exhibit is very telling. It states that the value of the hydro system for energy production alone is about $4.6 million per year. (Exhibit 88, p. 4) In addition, the capacity value flexibility is estimated at $2 million. (Exhibit 88, p. 1) This analysis, prepared by the Company on May 31, 2000, was not available to Mr. Buckley when he prepared his analysis.

Mr. Dukich's rebuttal exhibit used a model known as ProSym, a "chronological" production cost model. This model separately computes transactions during high load hours and low load hours (Exhibit 88, pp. 6-124) correcting the very problem that Mr. Buckley criticized the Company's production dispatch model for.

In response to questions from Public Counsel, Mr. Buckley acknowledged that the day to night variation in power cost has become more exaggerated. (Tr. 1348) This is demonstrated by Exhibit 563, which shows on-peak to off-peak variations in power price of up to 130 mills/kwh (May 24), while Mr. Buckley used only a 4 mill/kwh differential between on-peak and off-peak prices. (Tr. 1349)

The Company aggressively defended their very high costs of renegotiating their hydro system licenses based, in large part, on the day to night flexibility that these provide. Mr. Dukich (Exhibit T-84, p. 18), Mr. Anderson (Exhibit T-345), and Mr. Hirschkorn (Exhibit 507, p. 3-4) all testified to various aspects of this flexibility. Quantifying the cost of this was very easy: the

Company is seeking a $14 million rate base addition, plus a $1.8 million per year O&M expense addition for the cost of these renewed licenses. (Anderson, Exhibit T-345, p. 4) Yet when it comes time to quantifying the benefit of these new licenses, the Company was noticeably silent in its power supply testimony, relying on a power dispatch model that does not reflect day to night variations in price.

Fortunately, the record has the benefit of the analysis presented by Mr. Dukich in Exhibit 88, plus Mr. Buckley's testimony to rely upon. We agree with Mr. Dukich's statement on page 18 of his rebuttal testimony:

> 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. 88, the value of just this element of relicensing translates into a savings to customers of between <u>$4.5 to $6.5 million per year for as long as 50 years to come.</u>" (Exhibit T-84, p. 18)

The emphasis was Mr. Dukich's; it was not added. We agree. The $4.5-$6.5 million in benefits should be reflected in the ratemaking process. The Company has not done so. Mr. Buckley has reflected only $1.6 million.

This $4.5 to $6.5 million is only the savings associated with these two hydro projects. As shown on Exhibit 152, the Company has many additional hydro facilities, including Mid-Columbia contracts which are nearly as large as the Cabinet Gorge project itself. For lack of any detailed analysis, we can do no more in this record than to recommend that the upper limit of the range identified in Exhibit 88 be used in this proceeding. The Commission should approve the hydro flexibility adjustment proposed by Mr. Buckley, but the amount of this should be increased from $1.6 million to $6.5 million. This would result in changes to Mr. Buckley's Exhibit 541, lines 2 and 86. Our summary results of operation reflect this in Adjustment P-01. Public Counsel's calculation of the power supply adjustment is set out at Appendix C

VI. PUBLIC COUNSEL ADJUSTMENTS

Public Counsel has not presented a complete review of the Company's rate filing, but

instead has focused on certain aspects of the filing where we felt that the interest of consumer was clearly defined, and might not be addressed in detail by the Commission Staff on the basis of guidance provided in previous proceedings. This section of the brief addresses the specific adjustments recommended by Public Counsel. Public Counsel positions on other adjustments are set out in the sections containing overviews of results of operations for electric and gas.

A. Administrative and General Salaries

On this issue, Public Counsel has proposed an adjustment to electric and gas operating expenses of $4.16 million and $1.06 million, respectively. These adjustments are detailed in Exhibit 692. There are three sources of support in the record for these adjustments. The first is presented by Mr. Lazar, in Exhibit T-691, at pages 4-7. The second is presented by Mr. Damron, in Exhibits 711 and 712. The last is provided by Ms. Huang in Exhibit 574. All of these reach similar conclusions using very different approaches: Avista's Administrative and General costs are excessive.

The Company's approach was to look at the compensation levels for executives in firms with annual revenues of $3 to $6 billion per year. It then assumed that 100% of those salaries were reasonable for inclusion in electric and gas rates, subject only to subjective assignment of portions of these costs to the subsidiaries. The Company's approach is flawed for many reasons. First and foremost, Avista is not in the $3 to $6 billion category. Indeed, to the extent it has curtailed its market trading operations (Tr. 2034-2035), Avista may well be in the under-$1 billion category. The Company's 1998 Form 10-K shows that without these trading operations, Avista is a $409 million utility with $232 million of non-energy operations. (Exhibit 5, p. 47) Second, there is no evidence to support the notion that high executive salaries are appropriate for inclusion in rates. Perhaps these high salaries are needed to attract corporate executives with the talents that shareholders desire, but the skills needed to serve ratepayers are not so expensive. Indeed, utilities of similar size to Avista employ chief executives with salaries which are one-

eighth that of Mr. Matthews. (Exhibit T-691, p. 6) Third, the multi-million dollar bonus paid to Mr. Matthews is simply excessive and, to Public Counsel's knowledge, unprecedented in the context of Washington state utility regulation.

In rebuttal testimony, the Company attempted to show that its A&G salaries had not soared, but was able to do so only by mischaracterizing Mr. Lazar's testimony (Tr. 2204, 2206) and by seeking to have the Commission ignore the $1.7 million in "team incentives" paid to administrative staff.

The issue is how best to bring the Company's per-books A&G salaries into line with what is reasonable for ratemaking purposes. The Commission was presented with two alternative approaches. Ms. Huang made one attempt, adjusting total compensation, disallowing the bonuses and incentives, and reallocating costs between regulated operations and unregulated operations. Her approach would be reasonable except for two issues. First, she assumed that Avista was a company in the $1 to $3 billion category. With the curtailment of some energy trading activities Avista may no longer be that large. (Exhibit 17, p. 58) Second, she assumed that 100% of the "reasonable" salary levels should be allocated between regulated and unregulated activities, when in fact a portion should be allocated to lobbying and not included in operating expenses. Ms. Mitchell confirmed that the executives do spend time on lobbying. (Tr. 2193) Her bottom line was a reduction in A&G salaries of around $3 million.

Mr. Lazar made a separate attempt, taking the last approved Administrative and General expense, and increasing it at the compounded rate of inflation plus growth. This led to a reduction in A&G salaries of $4.16 million for electric and $1.06 million for gas, as set forth in Exhibit 692.[29]

Both of the approaches taken by Mr. Lazar and Ms. Huang are reasonable. Because it is

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[29]The Company's defense of its salary allocations was confused. For example, Ms. Mitchell asserted that 100% of Mr. Fukai's time is spent on utility activities (T-393, p. 5), when in fact the Company's Form 10-K indicates that Mr. Fukai is an officer or a director of one or more of the Company's subsidiaries. (Footnote on page 70, Exhibit 5)

firmly grounded in the Company's pre-diversification era, Public Counsel recommends that Mr. Lazar's adjustments be adopted by the Commission.

B. Corporate Name / Franchise Fees and Royalties

There are two separate issues regarding the corporate name and franchise fees. The first is the Company's request that ratepayers bear the cost of the Company's name change.[30] The second is whether the subsidiaries should contribute franchise fees for the use of the corporate name.

Mr. Matthews clearly testified that the Company's name is valuable, and that they would seek to protect the use of that name (Tr. 136). Public Counsel agrees. The fact that Avista is a large distribution utility with over 100 years of service gives this Company credibility in the marketplace that a new entrant without portfolio does not enjoy. That value is added by the regulated utility, and the regulated utility should be compensated for this value. The name would be valuable regardless of whether or not it had been changed. The Washington Water Power name was certainly as valuable as the Avista name has become.

Mr. Lazar proposed a modest approach, assigning 1% of non-energy revenues and 0.1% of energy trading revenues to the utility for the use of the corporate name. While it is admittedly a non-precedential element of a settlement stipulation, Mr. Lazar cited the example of Washington Natural Gas agreeing to a 1.5% royalty rate for the use of its corporate logo by its non-regulated subsidiaries in Docket UG-931405[31]. (Exhibit T-691, p. 9)[32]

The issue becomes less important to the extent the Company limits its energy trading and regional marketing activities, as it has expressed that it will. Mr. Lazar's exhibit 693 shows that about half of his proposed franchise fees for the use of the corporate name are associated with the

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[30] The Company asserted that consumers confused the company with the Washington Public Power Supply System (Exhibit T-226, p. 27). However, as Mr. Lazar pointed out, WPPSS has already changed its name to Energy Northwest, so that confusion has been eliminated. (Exhibit T-691, p. 8)

[31] *Washington Utilities and Transportation Commission v. Washington Natural Gas Co.*, Docket No. UG-931405 (1994).

[32] Regulators may require "royalty" payments from a subsidiary to compensate a utility parent and its ratepayers for intangible benefits received from the parent including the use of name, logo, goodwill, and availability of finance and personnel. *United Telephone Long Distance v Nichols*, 546 So. 2d 717, 719-720 (Fla. 1989); *In re RochesterTelephone Corporation*, 145 P.U.R. 4th 419 (NYPSC 1993).

National Energy Trading operation. However, to remove this portion of the royalty income to be imputed to the utility also means that the corporate salaries, which are based on $1 to $3 billion of revenues (as proposed by Staff) or $3 to $6 billion of revenues (as proposed by the Company) will have to be drastically reduced for ratemaking purposes. If the high salaries associated with the enlarged operation are accepted as a reasonable base, then the unregulated operations should contribute to the utility for the use of the corporate name.

Public Counsel recommends that the Commission impute a minimum of $2,322,920 of royalty income associated with the non-energy subsidiaries using the Avista name, assuming that the administrative and general salary adjustment we propose is adopted. If a higher level of administrative and general salary level is adopted (such as that proposed by Staff or the Company), consistent with Avista's National Energy Trading revenue level, then the Commission should impute $4,732,840 of royalty income for the use of the corporate name as set forth in Exhibit 693.

The name change expenses are a separate subject. Staff has recommended that these be disallowed. There are two very simple reasons why these costs should not be allowed. First, they are extraordinary and non-recurring. In more than 100 years of history, the Company has only changed its name once. The second reason is that ratepayers clearly got no benefit from the name change.

C. Hydroelectric Production Depreciation Expense

Mr. Lazar proposed that hydro depreciation expense be deferred until the market value of the hydroelectric plants is more closely aligned with the book value of those plants. This adjustment reduces depreciation expense by $2,731,000, as shown in Exhibit 694.

The justification for this can be found in the Commission's own language approving the Centralia coal plant sale. In that case, the Commission found that the sale was consistent with the public interest, not because it was a "good deal", but because the Commission was concerned

that with the potential of deregulation, ratepayers might not be able to get the benefit of the above-book value of the plant. As the Commission stated, in rejecting the multiple analyses in that case which showed that the replacement power costs would likely be greater than the cost of power from Centralia:

> Nor do these analyses take into account potential industry restructuring, which could sever the ratepayers from any cost advantages of Centralia.[33]

The Commission went on, in Centralia, to divide the gain between ratepayers and shareholders, with the first share going to shareholders to reimburse them for undepreciated plant, and the second share to ratepayers to reimburse them for excess depreciation paid. As the Commission stated:

> The fact that the facilities are selling for an amount greater than original cost is evidence that the facilities have an increasing, not a decreasing value, as an asset in a competitive wholesale generation market. This increased value is greater than the depreciation paid by ratepayers. Thus, a portion of the gain equivalent to the difference between net book value and original cost should be returned to ratepayers, as they have, in effect, *overpaid necessary depreciation*.[34]

This language, and the experience with Centralia, is precisely the reason we have proposed this adjustment. It is uncontested that the hydro plants have a value which is about seven times as great as the book value. (Exhibit 694, citing Tara Knox workpapers, p. 59) The fact that this gap exists indicates that ratepayers have already paid far too much for the "depreciation" of these appreciating assets. By accumulating additional depreciation, the Company is simply widening the gulf.

The Commission has already expressed concern that a future Commission may not be able to address this problem. The time to begin addressing the overpayment of actual depreciation is now. Avista should be directed to discontinue accrual of depreciation on the hydroelectric projects for ratemaking purposes until it can demonstrate reasonable congruence

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[33] UE-991255, *supra* note 11, paragraph 63.
[34] UE-991255, *supra note* 11, paragraph 82.

between the book value and market value of the hydroelectric projects.

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D. Meter Reading, Billing, and Bill Insert Expenses

Public Counsel has proposed an adjustment for meter reading and billing expenses as set forth in Exhibit 696. This is a multi-part adjustment, with a reduction to operation and maintenance expense, an increase to provision for uncollectibles, and an increase in the working capital requirement. The effect is to allow the Company sufficient funds to pay for the cost of bimonthly meter reading and billing. The amounts of these adjustments are as follows:

Item	Electric	Gas
O&M Expense	($1,734,838)	($1,091,626)
Uncollectibles	$206,808	$102,882
Working Capital	$4,249,479	$2,114,014

Taken together with the proposed rate of return, these adjustments would reduce revenue requirement by more than $1 million on the electric utility, and more than $700,000 on the gas utility.

The Commission's own rules provide that utilities need only read meters and render bills bimonthly (WAC 480-100-101). Reading meters every month and rendering bills every month is very costly. It costs the Company money, as detailed above. It also costs the ratepayers, in the form of the time required to pay bills more frequently, plus the loss of float during the lag between consumption and billing (the mathematical flip side of the working capital allowance provided above).

Mr. Lazar cited numerous examples of utilities which bill bimonthly, including all of the large public electric utilities in the state. (Exhibit T-691, p. 20). Puget Power, the state's largest electric utility, performed an extensive study on this issue. It concluded that there was a 90% chance that the benefits of switching from bimonthly to monthly meter reading and billing would be negative. Portland General Electric reached a similar conclusion (Exhibit T-691, p. 20)

Avista has done virtually nothing to study this question, other than a survey of current utility practices. (Exhibit 30; Exhibit 512; Exhibit 513] In rebuttal to the proposal, the Company

asserted the results of a survey that about half of its customers opposed a move to bimonthly billing. That survey, contained in Exhibit 508, does not disclose to customers that there would be a cost savings associated with such a change. Mr. Hirschkorn agreed, however, that survey responses can be affected by how the question is asked. (Tr. 2234) The Olympia survey cited by Mr. Lazar asked the right question, and got a meaningful answer: over 80% of customers object to the extra cost of monthly meter reading and billing.[35]

The Company did not present any alternative estimate for the cost savings that could be achieved through bimonthly meter reading and billing. The Commission has already begun addressing excessive meter reading and billing costs for other utilities. In Docket UG-920840[36], the Commission ordered Washington Natural Gas to initiate a joint meter reading program and bimonthly meter reading and billing. In Docket UG-951415[37], the Commission adopted a settlement stipulation which required Cascade Natural Gas to reduce its meter reading and billing costs by at least 30%. The Commission is currently considering Advise No. 2000-12, which provides for internet billing and bill payment for Puget Sound Energy. The excessive meter reading and billing costs should be halted on a going forward basis, and allowing the Company sufficient money to pay for bimonthly meter reading and billing is a good place to start.

If this were the only evidence on the Company's billing practices, it would easily be sufficient to justify allowing only those expenses which are necessary to comply with the Commission's rule on bimonthly meter reading and billing. However, there is also evidence in the record that the Company is using this monthly billing process for promotional purposes which should not be condoned, should not be paid for by ratepayers, and should be halted.

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[35] Mr. Lazar also cited a City of Bellingham survey, in which customers were asked if they were willing to pay the additional costs associated with monthly meter reading and billing. (Exhibit T-691, p. 20) More than 80% said they were not willing to pay the additional $1.00+ per month required. (Exhibit T-691, p. 22) (Tr. 2235-2237)

[36] *Washington Utilities and Transportation Commission v. Washington Natural Gas Co.*, Docket No. UG-920840, Fourth Supplemental Order, p. 43 (1993) (hereinafter cited as UG-920840).

[37] *Washington Utilities and Transportation Commission v. Cascade Natural Gas Corporation*, Docket No. UG-951415, Fourth Supplemental Order Rejecting Tariff Filings and Authorizing Refiling; Order of Consolidation; and Order Approving and Adopting Settlement Agreement (1996) (hereinafter cited as UG-951415).

Exhibit 501 contains the Company's bill inserts for the test period. Many of these have nothing to do with the electric or gas utility operations, and are pure promotional activities for unregulated operations. Examples of the inappropriate bill inserts include:

Unregulated sales of electrical surge protectors

Office space leasing advertising for Steam Plant Square

Unregulated Sales of The Dish television satellite service

Unregulated Sales of toy trucks and stuffed bears

Advertising for a museum

Washington State University football schedule

On cross-examination, Mr. Hirschkorn was quite frank that these were not related to the regulated utility operations, and he had no idea if these non-regulated operations were contributing to the billing and postage expense. (Tr. 1005-1010). If the Commission permits recovery only of necessary, bimonthly meter reading and billing costs, it will reduce by 50% the "envelope space" available for these promotional advertisements. Therefore, our primary recommendation is that the Commission allow only bimonthly meter reading and billing expenses, direct the Company to discontinue promotional advertisements in the billing envelopes, and hold its costs in control.

The Company's rebuttal, by Mr. Dukich and Mr. Hirschkorn, fails to address the underlying proposal made by Mr. Lazar. Mr. Dukich calls it "absurd" (Exhibit T-84, p. 6) that Mr. Lazar is proposing to disallow excessive costs that other utilities demonstrably do not incur. We think quite the opposite. Regarding the company survey referred to above, Mr. Hirschkorn admitted that the question was not asked in a way that would give consumers the information they needed to provide a logical response.

Q (By Mr. ffitch) "You did not indicate to customers in the question that doing so would save them any money, did you?"

A (By Mr. Hirschkorn) "No, we did not."

(Tr. 2234, l. 25 through Tr. 2235, l. 3)

If the Commission decides to allow the current high billing costs to continue, it must somehow deal with the inappropriate advertising the Company is placing in the bills. At a minimum, the Commission should require that these unregulated operations credit the billing process with the value of the advertisements placed in the billing envelopes. Exhibit 501 shows that almost every month's bill includes inappropriate costs. Disallowing half of the postage for these bills would be one way to ensure that captive ratepayers are not subsidizing inappropriate advertising.

VII. STAFF HAS BEEN CONSERVATIVE IN ITS RECOMMENTATIONS

The Company has sought to assert that the Commission Staff has been "extreme" in its direct case in this proceeding. (Dukich, Exhibit T-84, p. 2) In fact, Public Counsel would submit that the record shows quite the opposite -- that the Staff has been conservative, in its recommended treatment of the Company, in Public Counsel's view. This section details the issues where that is the case.

A. Hydro Flexibility

Mr. Buckley has proposed a hydro flexibility adjustment of only $1.6 million (Exhibit T-540, p. 29), while Mr. Dukich has himself testified that just two of the Company's hydroelectric projects provide savings of $4.5 million to $6.5 million per year. (Exhibit T-84, p. 18)

Public Counsel recommends that the upper end of the range testified to by Mr. Dukich be used in this proceeding.

B. PGE Contract Interest

Mr. Buckley identified $12.6 million in interest benefits that the Company has enjoyed on the $143.4 million cash payment it received from PGE, but did not recommend inclusion of this in the benefits of the sale flowed through to ratepayers. (Exhibit T-540, p. 19) He testified that the reason for this was to give the Company a share of the benefit of the transaction. (Exhibit 561)

Because of the Company's efforts to conceal this transaction from the record in this proceeding, Public Counsel believes the Company should get no benefit from this transaction, and the $12.6 million should be applied to reduce the revenue requirement.

C. Executive Compensation

Ms. Huang proposed that the "comparable" executive compensation analysis be based on companies with annual revenues of $1 to $3 billion. (Exhibit T-570, p. 6) The record indicates that the Company is reducing its energy trading. (Exhibit 17) As a result, the Company's annual revenues may well fall below $1 billion/year. (Exhibit 5, p. 47)

Public Counsel recommends that A&G salaries be allowed based on the last rate case plus a factor for inflation and growth in utility operations. This is effectively a pre-diversification level of expenses.

D. Franchise Fees for Name Use

Mr. Schooley has failed to assign any charge to the Company's affiliates for the use of the Corporate name. (Tr. 1520)

Public Counsel recommends adoption of Mr. Lazar's franchise fee adjustment.

E. Billing Envelopes

Mr. Schooley did not make any adjustment for the merchandising activities of the Company carried out through the billing envelope, such as assigning a portion of billing costs to

the unregulated operations, even though he admitted in cross-examination that "[T]here appear to be a number of items which could be considered promoting products that are not utility related." (Tr. 1523) Chairwoman Showalter identified several examples of what may be promotional advertising. (Tr. 1526)

Public Counsel recommends adoption of Mr. Lazar's meter reading and billing adjustment, which reduces the amount charged to ratepayers for these activities; the effect is similar to assigning a portion of these costs to non-utility activities.

F. Centralia Gain – State Income Tax

The Staff has relied on the Company's calculation of the Centralia gain, and thereby allowed the Company to charge Washington ratepayers for state income tax associated with the Centralia sale, even though Washington has no income tax. (Exhibit T-601, p. 3)

Public Counsel objects to the inclusion of state income tax due in other states in Washington rates. The amount of this adjustment is $337,676, as shown by Mr. McKenzie at page 2 of Exhibit 449.

G. Executive Lobbying

The Staff has assigned no lobbying expense to the corporate executives, either in the testimony of Ms. Huang on administrative salaries (Exhibit T-570, or in the testimony of Mr. Schooley on political activities (Exhibit T-595)). The Company, through Ms. Mitchell, acknowledged that the corporate executives may spend time on lobbying activities, as well as acknowledging that Public Counsel was not provided the opportunity to review Mr. Matthews' time records, and that she herself had not either. (Tr. 2193)

Public Counsel recommends that the Commission require in future rate filings that each corporate officer be required to identify the portion of their time associated with lobbying as defined in RCW 42.17.020(27), including but not limited to meetings with legislators, meetings

with lobbyists, or meetings with bodies engaged in the adoption of rules, rates, or standards which would affect the Company.

H. Gain on Real Estate

Mr. Parvinen did not do an analysis of the Company's gain on sale of real property, despite this having been a contested issue in many previous cases, and the fact that the Commission has given clear direction of the type of audits to be prepared. (Tr. 1559) Exhibit 620 shows that the Company sold millions of dollars worth of property in recent years.

Public Counsel recommends that the gain on sale of real property since the previous rate case continue to be deferred for treatment in a future rate case. In that future rate case, Staff should be directed to prepare an analysis of the gain on sale of that property, and propose a disposition of that gain consistent with the Commission's decisions in Cause U-85-53[38] and U-89-2688-T[39], and the settlement of the appeal in U-89-2688-T[40].

By pointing out these areas where we feel Staff has been less than aggressive with the Company, Public Counsel does not mean to be critical of the quality of the Staff's work in this proceeding. The purpose of this discussion is to place Staff's position in perspective and to respond to Avista's characterization of the Staff case as "extreme."

VIII. OVERVIEW OF ADJUSTMENTS TO ELECTRIC RESULTS OF OPERATIONS

The salient legal principle to be applied in reviewing a regulated utility's expenses and recommended adjustments to results of operations is whether those expenses provide a benefit to ratepayers. Expenses are not recoverable merely because utility-related and prudent. Unless

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[38] *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Co.*, Docket No. U-85-53 (1986) (hereinafter cited as U-85-53).

[39] *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Co.*, Docket No. U-89-2688-T (1990) (hereinafter cited as U-89-2688-T).

[40] *Id.*

there is benefit to ratepayers, such expenses must be borne by the shareholders. *US West Communications, Inc. v. WUTC*, 134 Wn. 2d 74, 126-127.

Appendix A is a summary of all adjustments to electric operations advocated by Avista, the WUTC Staff and Public Counsel. Columns (B) and (C) summarizes Avista's position at rebuttal, filed 6/2/00. Columns (D) and (E) set forth Public Counsel's position in brief.

A. Restating Adjustments - Uncontested

Other than column numbers, neither the Company nor the WUTC Staff used adjustment number identifiers for their restating adjustments, but did so for the pro forma adjustments. The adjustment numbers for restating adjustments were added by Public Counsel herein for ease of reference. The adjustments discussed below are stated at Washington levels unless otherwise indicated.

RA-01 Deferred FIT Rate Base

RA-02 Deferred Gain on Office Building

RA-03 Colstrip 3 AFUDC Elimination

RA-04 Colstrip Common AFUDC

RA-05 Kettle Falls Disallowance:

> Public Counsel adopts this uncontested adjustment. However, Public Counsel does contest the Company's proposed incentive return on equity of 2.0% on that portion of Kettle Falls investment allowed in rate base. (See discussion, Sec. III. Rate of Return

RA-06 Clearwater Hydro

RA-07 Weatherization and DSM Investment

RA-08 Customer Advances

RA-09 Settlement Exchange Power

RA-10 Eliminate B&O Taxes

RA-11 Pro Forma Property Taxes

RA-12 Uncollectible Expense

RA-13 Regulatory Expense Adjustment

RA-15 FIT (Federal Income Taxes)

RA-17 Eliminate A/R Expenses

RA-18 Office Space Charged to Subsidiaries

RA-19 Reclassify DADs/MOPs Revenues

B. Restating Adjustments - Contested

RA-14 Injuries and Damages: The Company's adjustment decreases NOI by $1,514,000. This adjustment relates to injuries and damages not covered by insurance. The Company uses a 6-year rolling average to normalize these costs for ratemaking purposes. The Company's adjustment contained amounts related to the settlement of the 1991 Firestorm litigation, and the 1996 Ice Storm costs.

The WUTC Staff (Mr. Schooley) accepted the "normal" 6-year rolling average adjustment for injuries and damages but challenged the inclusion of legal fees related to the 1991 Fire Storm but allowed the costs of the settlement unrecovered by insurance as part of the 6-year average adjustment. Staff argues that legal fees are an on-going expense, which remain relatively consistent from year to year and hence no special treatment of the legal fees is necessary.

The WUTC Staff (Mr. Schooley) also challenged the inclusion of any part of the 1996 Ice Storm costs because the event was extraordinary and nonrecurring in nature and hence, prospective rates should not reflect these costs. (See Exhibit T-226, page 14-16 (Falkner), Exhibit T-268, pages 6-9 (Falkner), and Exhibit T-595, pages 3-7 (Schooley), see also TR 2140-2143)

Public Counsel adopts the WUTC Staffs' position and adjustment regarding these issues. The WUTC Staff adjustment decreases NOI by $32,000. The Company challenged the WUTC Staffs' position regarding Fire Storm legal fees in rebuttal but provided no real demonstration

that the legal fees associated with the Fire Storm were so extraordinary that a special normalized treatment was justified. Public Counsel would also note that the event appears to be a prior period item that is nonrecurring and therefore should not be included in prospective rates. The same is true with the Ice Storm costs. These costs are a nonrecurring prior period event that should not be recovered in prospective rates, unless the Commission has previously permitted a special accounting treatment for such costs. The Company is given an opportunity to achieve a fair return, but to, in essence, guarantee a fair return in the manner proposed by the Company is retroactive ratemaking.

RA-16 Pro Forma Restated Debt Interest: The Company's original adjustment decreased NOI by $2,128,000. In rebuttal the Company's adjustment was revised to a decrease in NOI of $2,492,000. The WUTC Staff proposes a decrease in NOI of $3,110,000. (See Exhibit T-226, page 16 (Falkner), Exhibit T-268, page 3, line 12 and page 5, line 7 (Falkner), Exhibit T-608, page 10 (Parvinen), Exhibit 612 (Parvinen), Exhibit T-703, pages 5-6 & page 8 (Damron), and Exhibit 706, page 18 (Damron), Exhibit 708, page 14 (Damron))

The Pro Forma Debt adjustment is a standard ratemaking adjustment that has been adopted by the Commission in innumerable prior rate cases. The adjustment should be made in this case. Public Counsel proposes that the pro forma rate base of $612,060,000 be used in the calculation. (App. A, l. 55, Col. E) Public Counsel proposes that the weighted cost of debt of 4.37% proposed by Mr. Hill be used in the calculation. Mr. Hill's weighted cost of debt includes Long-Term Debt, Short-Term Debt and Preferred Securities.

C. Additional Restating Adjustments Proposed by Public Counsel

Adjustments RA-01 through RA-19 are proposed, modified or rejected in the Company's and the WUTC Staffs' pro forma analysis. Public Counsel proposes 5 additional restating adjustments:

RA-PC-01 Administrative & General Expense Adjustment: Public Counsel, through

Mr. Lazar, proposes to increase NOI by $2,702,000. This adjustment is made to address the inordinate growth in Administrative & General Expenses, which is addressed in both Mr. Lazar and Mr. Damron's testimonies. Mr. Lazar testified that A&G Salaries cannot be justified by either inflation or customer growth.

The WUTC Staff, through Ms. Huang, proposes three pro forma adjustments, P-07 Pro Forma Labor/Benefit Adjustment, P-15 Staff Bonuses Adjustment and P-18 Staff Relocation Expense adjustment. Collectively, these three labor related adjustments increase NOI by $1,460,000. To avoid disallowing the same expenses twice, if the Commission adopts WUTC Staffs' adjustments, then Mr. Lazar's adjustment RA-PC-01 should be reduced by the same amount. In brief, Public Counsel is therefore showing the impact of Mr. Lazar's adjustment PA-PC-01 as an increase to NOI of $1,242,000 ($2,702,000 minus $1,460,000 = $1,242,000). (See Exhibit T-691, pages 4-7 (Lazar); Exhibit 692 (Lazar); Exhibit T-703, pages 11-17 (Damron), Exhibits 711 & 712 (Damron), Exhibit T-268, page 2, line 4 (Falkner), and Exhibit T-393, pages 13-14 (Mitchell), see also Tr. 2168-2171 & 2190-2194, Tr. 2201-2207)

The Company has not justified the level of A&G Salaries for the test period. Public Counsel adjustment RA-PC-01 should be adopted by the Commission.

<u>RA-PC-02 Franchise Fees for Use of Corporate Name</u>: Public Counsel, through Mr. Lazar, proposes to increase NOI by $1,450,000. The adjustment is made to compensate the Company's regulated operations for the use of the Corporate name by nonregulated affiliates. (See Exhibit No. T-691, pages 7-9 (Lazar), Exhibit T-268, pages 17-19 (Falkner), see also TR 2143-2155) (See discussion, Section VI. Public Counsel Adjustments).

<u>RA-PC-03 Production Depreciation Expense</u>: Public Counsel, through Mr. Lazar, proposes to increase NOI by $1,776,000. (See Exhibit T-691, pages 10-14 (Lazar), Exhibit T-268, pages 26-29 (Falkner)). The adjustment is reasonable and appropriate and is supported by a

prior Commission decision in UE-991255[41] regarding the sale of the Centralia plant. Adjustment RA-PC-03 should be adopted by the Commission.

RA-PC-05 Meter Reading & Billing: This adjustment increases NOI by $993,000 and increases rate base by $4,249,000. Public Counsel, through Mr. Lazar, challenges the level of test period meter reading and billing expenses. (See Exhibit T-691, page 19-23 (Lazar), Exhibit T-506, page 1-2, 5-8 (Hirschkorn)). The Company has not demonstrated that the level of test period meter reading and billing expenses are reasonable. In addition, nonregulated operations should pay its fair share of the expenses of billing that allow them to advertise through customer billings. The adjustment proposed by Mr. Lazar is reasonable and appropriate and is allowed by the Commission's regulations in WAC 480-100-101. Adjustment RA-PC-05 should be adopted by the Commission.

RA-PC-06 Remove Name Change Amortization: This adjustment increases NOI by $69,000 by removing the amortization of the name change costs, which the Company proposes to include in test period expenses. The Company proposes to amortize the cost of their recent name change over five years. Through their adjustment P-09 Pro Forma Misc. Adjustment, the Company includes, among other things, one-fifth of the cost of the name change. Public Counsel, through Mr. Lazar, challenges the inclusion of costs incurred by the Company to change its name from Washington Water Power to Avista. WUTC Staff witness, Mr. Schooley also recommends the disallowance of these same costs. (See Exhibit T-691, pages 7-8 (Lazar), Exhibit T-268, page 16 (Falkner), Exhibit T-595, pages 14-15 (Schooley)).

The adjustment is reasonable and appropriate. The position taken in Adjustment RA-PC-06 should be adopted by the Commission. However, to avoid a double disallowance, Public Counsel shows Adjustment RA-PC-06 as zero, and in the alternative concurs with the WUTC Staffs' proposed Adjustment P-09 Pro Forma Misc. Adjustment, which is the same adjustment

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[41] UE-991255, *supra* note 11.

with the same proposed treatment as that proposed by Mr. Lazar regarding the recent corporate name change.

D. Pro Forma Adjustments – Uncontested

There are 20 pro forma adjustments proposed by the parties of record. In addition, Public Counsel proposes that the Commission make one further adjustment, P-21. The following adjustments are uncontested by Public Counsel:

P-PC-03 Pro Forma Depreciation Adjustment

P-05 Pro Forma Commercial Trade Adjustment:

> Public Counsel does not contest the Company's revised adjustment as proposed by ICNU.

P-08 Pro Forma Revenue Adjustment

P-10 Pro Forma MOPS

P-17 Staff Lease Expense Adjustment

P-19 Staff Lost Revenue Fuel Efficiency Adjustment

E. Pro Forma Adjustments – Contested

P-01 Pro Forma Power Supply 7/00-6/01. Public Counsel did not offer a power supply witness. However, based upon a review of the record, Public Counsel generally adopts and supports the position of the WUTC Staff with respect to Centralia replacement power issues and Potlatch (see discussion Section V). With respect to hydro flexibility, Public Counsel recommends a larger adjustment than Staff (see discussion, Sec.V.D.) On the issue of normalization of hydroelectric generation, while Public Counsel does not oppose the stipulation between Staff and the Company for purposes of this case (Exhibit 740), our position is based on the fact that the stipulation appropriately leaves intact the precedent established by this Commission in Docket UE 920499 adopting the 40-year rolling average methodology. (Tr. 1771-1772).

P-02 Pro Forma Potlatch 7/00-6/01: Consistent with Public Counsel's position regarding the Power Supply Adjustment P-01, Public Counsel adopts and supports the position of the WUTC Staff regarding this adjustment. (See discussion, Sec. V, Major Power Supply Cost)

P-04 Pro Forma Hydro Relicensing Adjustment: Public Counsel supports the position of the WUTC Staff. "Mere guesses" as to the prospective level of operating expenses, do not qualify as known and measurable expenses. The known and measurable principle has been

applied by the Commission in innumerable prior rate cases. Further, the Company has not demonstrated a need for a special balancing account. It has been the practice of the Commission to allow a regulated utility to deferred certain major costs for future recovery if they cannot be reasonably anticipated and embedded in current rates. This protects the utility from major losses. However, to move to a system of ratemaking that virtually guarantees the Company recovery of all costs is inappropriate.

P-06 Pro Forma Nez Perce Adjustment: Public Counsel supports the adjustment proposed by the WUTC Staff. The Company witness admits that all issues were resolved in the settlement agreement, hence it is implicit that the issues involving Idaho were also resolved by the agreement. It is therefore appropriate that Idaho customers bear a fair share of the burden of these settlement costs.

P-07 Pro Forma Labor/Benefit Adjustment: The Company proposes to decrease NOI by $386,000 to reflect changes in salary levels as well as normalize test period benefit costs. This adjustment is sponsored by Company witness Mitchell. The WUTC Staff, through Ms. Huang, challenges the adjustment and proposes instead a decrease in NOI of $82,000.

Public Counsel supports Ms. Huang's analysis and adopts this adjustment. It is clear from the analysis of Mr. Damron and Mr. Lazar, that Administrative and General expenses have increased dramatically with the recent increase in non-regulated operations. This is occurring on an industry-wide basis. The non-regulated operations of the Company must bear the burden of these increases in cost. As discussed in regards to Public Counsel's proposed adjustment RA-PC-01, we have reduced the impact of our adjustment by the collective impact of the WUTC Staffs' adjustments P-07, P-15 and P-18, which are all adjustments related to labor and employee benefits. This is done to avoid a double disallowance of the same expenses.

P-09 Pro Forma Miscellaneous Adjustments: The Company proposed to increase NOI by $679,000, which eliminated but leaves one-fifth of the cost of their recent corporate name change and Y2K costs, i.e., the Company proposes to amortize these costs over 5 years. The

WUTC Staff proposes to increase NOI by $849,000 by eliminated all of the costs associated with the corporate name change and Y2K costs, i.e., the WUTC Staff proposes to eliminate the Company's proposed amortization of these costs. Public Counsel, through Mr. Lazar, also challenged the inclusion of the name change amortization and proposed the same adjustment. See Public Counsels' discussion of the Corporate Name Change costs under proposed Public Counsel adjustment RA-PC-06. (See Exhibit T-226, pages 25-28 (Falkner), Exhibit T-268, page 16 (Falkner), Exhibit T-691, pages 7-8 (Lazar), Exhibit No. T-595, pages 13-15 (Schooley))

Public Counsel adopts the proposed adjustment of the WUTC Staff. There is no benefit to ratepayers of the corporate name change, and the Y2K costs are certainly nonrecurring and should not be reflected in future rates.

P-11 Company Replacement Power: The WUTC Staff has proposed to handle the Centralia issues as a separate tariff credit to customers' bills. Public Counsel supports the WUTC Staffs' proposal and, therefore, does not adopt this proposed Company adjustment.

P 12 Company Gain Amortization: The WUTC Staff has proposed to handle the Centralia issues as a separate tariff credit to customers' bills. Public Counsel supports the WUTC Staffs' proposal and, therefore, does not adopt this proposed Company adjustment.

P-13 Company Ice Storm Offset: The WUTC Staff has proposed to handle the Centralia issues as a separate tariff credit to customers' bills. Public Counsel supports the WUTC Staffs' proposal and, therefore, does not adopt this proposed Company adjustment. Further, the WUTC Staff dealt with the 1991 Ice Storm issue in its adjustment RA-14, Injuries and Damages, which Public Counsel also supports.

P-14 Staff Restate Excise Tax: The WUTC Staff proposes to increase NOI by $548,000. The WUTC Staff, through Mr. Parvinen, proposes an adjustment with two parts. The adjustment reflects an adjustment from an accrual to the actual excise taxes paid for the test period. It also reflects the removal of the Franchise Fees paid to the cities of Millword and Colville for the electric operations and cities of Spokane and Millword for the gas operation (see

Gas adjustment RA-15, Restate Excise/Franchise Taxes). The Company indicated that it accepted the WUTC Staffs' adjustment to adjust the expense accrual to actual. However, the Company proposes to increase NOI by only $443,000. The Company does not adopt that part of the WUTC Staffs' adjustment related to Franchise Fees. This was discussed briefly on the record under cross-examination of Mr. Falkner at TR 2139-2140. (See Exhibit T-608, pages 10-11 (Parvinen), Exhibit T-268, pages 9-11& 32 (Falkner))

Public Counsel adopts the uncontested adjustment made by the WUTC Staff. The Commission should adopt its standard policy regarding Franchise Fees in this case.

P-15 Staff Bonuses Adjustment: The WUTC Staff, through Ms. Huang, proposes to increase NOI by $1,435,000. The Company rejects the adjustment. Ms. Huang proposes that all Team Incentive Bonuses be disallowed, but Pacesetter bonuses be allowed. She testifies that the Team Incentive Bonuses are extremely high in the test year compared to prior years, are paid at management's discretion and are geared to ultimately provide greater shareholder value. "The plans are not customer-service oriented and do not benefit regulated customers. Shareholders should bear these costs, not captive ratepayers." (See Exhibit T-268, page 32 (Falkner), Exhibit T-570, page 13-15 (Huang), Exhibit T-393, pages 9-11 (Mitchell), see also TR 2187 & TR 2196-2198, TR 2208-2209)

Public Counsel adopts the WUTC Staffs' proposed adjustment. It is highly inappropriate to pay large bonuses only during a test year and expect ratepayers to pick up the full check. For ratemaking, the assumption is that once adjusted, the test period is representative of prospective conditions. There is no way to predict what bonuses management might pay at their discretion in the future. Further, an expense must be prudently incurred to the benefit of ratepayers to qualify as a ratemaking expense. If bonuses produce nothing, they are of no benefit to ratepayers. If bonuses do produce higher productivity, then the Commission should find that the bonuses are rightfully offset by productivity. A pro forma adjustment is an adjustment for known and measurable changes that are not offset by other factors. (WAC 480-09-330(2)(b)(ii) The WUTC

Staffs' adjustment is appropriate.

As discussed in regards to Public Counsel's proposed adjustment RA-PC-01, we have reduced the impact of our adjustment by the collective impact of the WUTC Staffs' adjustments P-07, P-15 and P-18, which are all adjustments related to labor and employee benefits. This is done to avoid a double disallowance of the same expenses.

P-16 Staff Miscellaneous Restating Adjustments: The WUTC Staff proposes to increase NOI by $370,000 in this adjustment. The Company accepts a portion of the adjustment and proposes to increase NOI by $202,000. In this adjustment, the WUTC Staff makes a number of standard ratemaking adjustments. They remove Political Advertising and Lobbying Expenses, promotional advertising, misallocation or misposting of expenses belonging to subsidiary operations, non-recurring expenses and duplicated expenses. (See Exhibit T-595, pages 16-20 (Schooley), Exhibit 600 (Schooley), Exhibits 29, pp. 246-249, 251, 253, 254, and 259 (referenced in Schooley's testimony), Exhibit T-268, page 32 (Falkner), see also TR 2192-2193)

Public Counsel adopts the WUTC Staffs' proposed miscellaneous restating adjustment. Public Counsel notes, however, that this adjustment is conservative, given Staff's failure to exclude expenses for promotional bill inserts and lobbying activities of certain company officials. (See discussion, Section VI.D. Public Counsel Adjustments).

P-18 Staff Relocation Expense Adjustment: The WUTC Staff, through Ms. Huang, proposes to increase NOI by $108,000. She explains that the relocation expense level before and after the test period are much lower. She therefore adjusted the amount to a more normal level of expense. (See Exhibit T-570, page 16 (Huang), Exhibit T-268, page 32 (Falkner), Exhibit T-393, pages 11-13 (Mitchell),see also TR 2187-2198)

Public Counsel adopts the WUTC Staffs' proposed adjustment. For ratemaking, the assumption is that once adjusted, the test period is representative of prospective conditions. There is no showing on the Company's part that the test period level of expenses is representative. As discussed in regards to Public Counsel's proposed adjustment RA-PC-01, we

have reduced the impact of our adjustment by the collective impact of the WUTC Staffs' adjustments P-07, P-15 and P-18, which are all adjustments related to labor and employee benefits. This is done to avoid a double disallowance of the same expenses.

P-20 Staff PGE Contract: The WUTC Staff, through Mr. Buckley and Mr. Parvinen, recommend an increase in NOI of $2,990,000 and a reduction in rate base of $43,852,000 regarding the PGE Contract Renegotiation. The Company made no adjustment regarding this matter and was, in fact, conspicuously silent in its direct case regarding the receipt of $143,400,000 from PGE as a result of the renegotiation of the contract. Mr. Buckley discusses this issue in his direct testimony, Exhibit T-540, pages 12-19, and summarizes his calculations in Exhibit 543. These amounts are then taken by Mr. Parvinen and molded into a final adjustment. Mr. Parvinen's direct testimony in Exhibit No. T-608, pages 14-15, discusses this issue and adjustment.

The Company, through Mr. Norwood, rejects the WUTC Staffs' proposed adjustment. (*See* Exhibit T-540, pages 12-19 (Buckley), Exhibit T-608, pages 14-15 (Parvinen), Exhibit T-203, pages 2 & 6-22 (Norwood))

Public Counsel supports this Staff adjustment, but argues that the benefit of the interest income should be passed on to customers. (See next adjustment).

P-21 Amortize PGE Contract Interest: This proposed adjustment is related to adjustment P-20 and increases NOI by $385,016 and decreases rate base by $8,144,574. As identified on the record in Exhibit 561, identified by Mr. Buckley, there is $12,600,000 in interest income that would have accrued at the Company's present cost of capital on the proceeds from the PGE Contract Renegotiation since the new contract was made in December 1997. Public Counsel uses the appropriate allocator for Production and Transmission of 66.990%, which identifies the Washington portion of the PGE Contract Interest as $8,440,740. Public Counsel proposes to amortize this Washington share of the interest income over 14.25 years, consistent with the proposed remaining amortization period used by the WUTC Staff in

adjustment P-20. Further, Public Counsel recommends that the average unamortized amounts of interest be deducted from the rate base. The proposed calculation of this adjustment is appended to this brief as Appendix D.

Public Counsel disagrees with ICNU's proposal for an eight-year amortization period.

F. Conclusions

Revenue (Excess) or Deficiency: Appendix A, l. 54, column (D), reflects excess electric revenues of $32,755,000.

Conversion Factor: Public Counsel adopts Staff's conversion factor.

IX. ELECTRIC RATE SPREAD AND RATE DESIGN

A. The Commission Should Adopt The Joint Position of Public Counsel, Staff and ICNU On Rate Spread

Public Counsel, Staff, and ICNU jointly sponsored testimony on electric rate spread in this proceeding. (Exhibit 675) We have proposed that the commercial classes, Schedules 11 and 21, receive a smaller than average hike, and that all other classes pay the same percentage increase. Public Counsel recommends that the Commission adopt this position.

Such agreement is almost unprecedented, given the long history of disagreement between Staff and Public Counsel, on the one hand, and ICNU on the other, regarding the underlying principles of cost allocation. The Commission should give very substantial weight to the joint testimony.

Avista's proposal is to move one-third of the way toward the results of the cost of service study submitted by Ms. Knox. We object to that proposal for the following reasons:

The study submitted by Ms. Knox does not represent an appropriate definition of "unity" and should not be use for rate spread purposes.

Ms. Knox did not update her study to reflect the substantial changes in revenue requirement reflected in the Company's rebuttal case. Even if she had, it would not reflect the final

position on revenue requirement that the Commission will approve. The adjustments proposed would not affect the cost study uniformly.

The Commission has consistently rejected proposals to move mechanically in the direction of cost of service study results, citing the many other factors which should be considered in ratemaking.

Several of the proposed adjustments would not affect all classes equally.

In the absence of a valid cost study, a uniform percentage increase is the accepted practice.

B. Rate Spread Discussion

1. Ms. Knox's study is not a reasonable definition of "unity".

Because the cost study presented by Ms. Knox is not an appropriate definition of "unity" it should not be used for rate spread decisionmaking. Ms. Knox applied a methodology for allocation of Administrative and General costs which has never been considered before, and is directly contrary to the methods the Commission has previously approved in electric and natural gas proceedings. (Tr. 897-898)

Ms. Knox's study assigns about two-thirds of total A&G expense to the residential class. (Exhibit 462, part 2, p. 9, line 440) This is vastly out of proportion to the share of company sales and revenues which this class represents – only about 42%. Thus, this approach has the effect of shifting costs sharply towards the residential class.

Ms. Knox readily admitted that the cost of service method the Commission approved for Puget in Cause UE-920499[42] would have assigned a much lower share of these costs to the residential class. (Tr. 898) Similarly, she acknowledged that the methodology that Avista itself used in the gas cost of service study would have assigned much less cost to the residential class. (Tr. 903-904)

As shown in Exhibit 472, changing the A&G cost allocation method proposed by Ms. Knox to the one previously approved by the Commission has a very significant impact on the rate

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[42] *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Co.*, Docket No. UE-920499 (1993) (hereinafter cited as UE-920499).

case, reducing the A&G expenses assigned to the residential class by $4.5 million, and reducing the rate base assigned to the residential class by $10 million. These are very significant changes, and make the entire study unreliable.

2. Ms. Knox did not update her study.

In its rebuttal case, the Company changed its requested rate increase from 10.4% to 7.2%. This reflected major changes in several areas, as detailed in the testimony and exhibits of Mr. Falkner. Key among these changes was a change in the depreciation rates, which primarily reflected a decreased level of depreciation for distribution plant. Since the residential class is the largest user of distribution plant, these changes would have disproportionately benefitted the residential class had she updated her study. The failure to update this study means that the original study, submitted by Ms. Knox, does not now reflect the Company's proposed revenue requirement.

Had the Company corrected the Administrative and General cost methodology, and updated the study to reflect the adjustments that the Company accepted in its rebuttal testimony, we believe that the revised study would have been completely consistent with the proposal on rate spread contained in the Joint Testimony of Staff, Public Counsel, and ICNU.

3. The Commission has consistently rejected mechanical application of cost study results

Even if the Commission had a cost of service study in which it had great confidence reflected the relative costs of serving different classes, the Company's proposal to move mechanically toward the result of that study ignores the many other principles of rate making that the Commission has historically relied upon.

The Commission's consideration of cost of service studies began in Cause U-78-05[43], and has been refined in numerous proceedings since that time. In the original decision, the Commission made it clear that it would not apply the results of studies mechanically:

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[43] *In the Matter of Investigation on the Commission's Own Motion: Into Rate Design and Rate Structures for Electrical Service of Pacific Power & Light Company, Puget Sound Power & Light Company and the Washington Water Power Company, and the Alterations, if any, That Should be Ordered to Such Rate Design and Rate Structures, and Into the Adequacy of Existing Rules of the Commission Relating to Electrical Companies and Amendments or Additions Thereto That May be Appropriate Regarding Master Metering, Information to Consumers, Advertising, and Termination of Service,* Docket No. U-78-05 (1980) (hereinafter cited as U-78-05).

> We shall continue to design rates in a considered manner; we shall continue to exercise our own judgment, based upon evidence and arguments in a particular cause, as to an appropriate rate spread according to conditions present in the prudent management of each of the three regulated electric utilities. There may be times when implementation of designs strictly based upon a given embedded cost study may not, in our judgment, be in the ultimate best interests of the utility, its customers or the public of the state. We shall avoid the mechanical applications of results of a given study and instead, as required by law, exercise our own considered judgment based upon the evidence in each proceeding to establish just and reasonable rates.[44]

In this case, the Company would have the Commission mechanically apply the results of its obsolete and flawed study. The Joint Testimony, on the other hand, provides that the relative rate adjustments proposed by the Company be adopted, but scaled down (or inverted) depending on the level of rate increase allowed.

The irrationality of the Company's proposal is clearly demonstrated by Mr. Hirschkorn's rebuttal Exhibit 507. With an assumed 4% overall increase, the Company would propose that residential consumers receive more than twice the average, or 8.5%, while commercial customers would get a rate decrease. To allow any customers a decrease in the context of an overall increase requires a much more substantial evidentiary record than the flawed and obsolete cost of service analysis presented by Ms. Knox. In the case of a zero percent increase, the Company would propose that residential rates be increased by 5%, and commercial rates be decreased by 5.8%. Conversely, the Joint Testimony would pass through zero, with no class receiving a rate adjustment in that case.

4. <u>Several adjustments would not affect classes uniformly.</u>

Several of the adjustments proposed by the parties would not affect the classes uniformly. If these adjustments are adopted in full or in part by the Commission, a revised cost study would show a very different result than that proposed by Ms. Knox.

Staff and Public Counsel have proposed large adjustments to administrative and general salaries through the testimony of Ms. Huang and Mr. Lazar. (Exhibit T-570 and T-691) In Ms.

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[44] *Id*., Decision and Order, p. 6.

Knox's cost study, Exhibit 462, about two-thirds of A&G expense was assigned to the residential class, so even if her cost methodology were used, a reduction in A&G expenses would most significantly change the residential rate of return.

Public Counsel has proposed an adjustment to residential meter reading and billing expense in the amount of $1.5 million for the electric system. This adjustment is to reflect the savings from bimonthly, instead of monthly, residential meter reading and billing. There is no adjustment proposed for the non-residential classes. The effect of this adjustment would be to sharply raise the residential rate of return, regardless of what cost allocation methodology is used.

5. In the absence of a valid cost study, a uniform percentage increase is the accepted practice.

The Commission's consistent and clear position has been that were a valid cost study is not available, a uniform increase is appropriate. For example, in Avista's last general rate case, the Commission stated:

> The Commission finds none of the cost of service studies presented totally acceptable. All have made a meaningful contribution to the Commission's ultimate determination. The Commission declines to adopt any particular method for performing cost of service studies.[45]

In that docket, the Commission ordered a uniform percentage increase in rates to all classes except street lighting, which all parties agreed was overpaying.

There is no valid cost study in this proceeding. First, Ms. Knox's study uses a never-before considered approach to allocating administrative costs, one which shifts costs sharply to the residential sector. Second, Ms. Knox did not update her study when the Company filed its rebuttal testimony. Third, several of the adjustments proposed by Staff and Public Counsel would affect the classes non-uniformly, so even if Ms. Knox had updated her study, it would not accurately reflect adjusted costs.

It is important to consider what is really necessary to establish fair, just, and reasonable

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[45] U-85-36, *supra* note 9, Third Supplemental Order, p. 45.

rates based on a cost of service study. In Cause UE-920499,[46] the Commission did rely on the results of a cost study for rate spread purposes. The Commission first made explicit decisions on the cost allocation methodology (Ninth Supplemental Order), then made explicit decisions on the revenue requirement (Eleventh Supplemental Order), and then directed Puget to re-run the cost of service model with both the methods approved and the costs approved. Rates were then shifted in accordance with these results (with a much higher than average increase for industrial customers, moving them towards but not all the way up to the actual cost of providing service.) In this case, there is neither a methodological record, nor sufficient time remaining to do this multi-step process.

In this proceeding, the Joint Testimony does not propose a uniform increase, but rather a rate spread which is somewhat favorable to commercial customers, and somewhat less disfavorable to residential and industrial customers than the Company's proposal.

6. Conclusions on rate spread

The Company has failed to meet its burden of proof on its unprecedented method for allocating administrative costs. It has failed to update its cost study to reflect its much-reduced rebuttal revenue requirement. It has failed to demonstrate that a rate increase to the residential class is reasonable in the context of a rate decrease overall. Conversely, the Joint Testimony examines a "range of reasonableness" into which the results of various cost studies fall, and proposed a rate spread which implements reasonable rates.

If the Commission orders a decrease in rates, as Staff and Public Counsel propose, it should order that commercial rates for Schedules 11 and 21 be reduced by 1.33 times the average decrease, and that other rates be decreased by a uniform amount. If the Commission orders an increase in rates, as the Company proposes, it should assign those increases in the proportions shown in Exhibit 676.

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[46] UE-920499, *supra* note 42.

C. Residential Rate Design

Avista has proposed a 66% increase in their monthly electric customer charge and flattening out their three residential rate blocks into two. Both of these proposals are contrary to adopted Commission policy, contrary to the legislative intent of the state to encourage energy conservation, unsupported by cost analysis, and inappropriate.

1. Historical background

In the Commission's generic rate design proceeding, Cause U-78-05[47], the Commission adopted the principle of "Baseline Rates."

At the time of that decision, in 1980, the Commission noted that there were multiple justifications for baseline rates, including marginal cost theory, embedded cost theory, elasticity of demand, and the social concept of lifeline rates. The Commission specifically found that a baseline rate should meet the "essential needs" of residential consumers, in the range of 400 - 600 kwh per month. The Commission explicitly found that electric heat was not an "essential need."[48]

Following that decision, in Cause U-80-13[49], Washington Water Power proposed a two-block rate, with an inversion at 600 kwh. Staff and intervenors in that proceeding proposed a three-block rate, with usage levels of 600 kwh and 1300 kwh, and the Commission adopted the three-block approach.

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[47] U-78-05, *supra* note 43.

[48] *Id.*, Decision and Order, p. 21.

[49] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-80-13 (1981).

Over succeeding rate proceedings, including U-81-15[50], U-82-10[51], U-83-26[52], U-84-28[53], U-85-36[54], and U-86-99[55], the three block rate design was retained.

During this same era, the Commission rendered many decisions on what costs should be included in the "customer cost" category used to establish a monthly customer charge, the rate that applies to residential customers even with zero usage. Perhaps the clearest expression of this policy was in a 1989 Puget proceeding:

> Costs such as meter reading, billing, the cost of meters and service drops, are properly attributable to the marginal cost of serving a single customer. The cost of a minimum sized system is not. The parties should not use the minimum system approach in future studies.[56]

The most recent landmark proceeding on this issue was Puget's 1992 rate design proceeding, UE-920499.[57] Washington Water Power and Pacific Power were both parties to that case, as it was recognized from the outset that it would have an influence on future decisions. In that proceeding, the Commission reaffirmed what costs should be incorporated in the customer cost category, and explicitly linked the initial block rate to the availability of low-cost hydroelectric power:

> The break between the two blocks should occur at 600 kwh per month, as proposed by Public Counsel. The level of 600 kwh will best reflect the actual cost of new resources in the end block, so customers can make economically efficient decisions at the margin. It will also equitably allocate the limited amount of low-cost power on Puget's system."[58]

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[50] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-81-15 (1985).
[51] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-82-10 (1982).
[52] U-83-26, *supra* note 5.
[53] *Washington Utilities and Transportation Commission v. Washington Water Power Co.*, Docket No. U-84-28 (1985).
[54] U-85-36, *supra* note 9.
[55] U-86-99, *supra* note 10.
[56] U-89-2688-T, *supra* note 39, Third Supplemental Order, p. 71.
[57] UE-920499, *supra* note 42.
[58] UE-920499, *supra* note 42, Eleventh Supplemental Order, p. 97.

Public Counsel supports each of the precedents the Commission has established, as discussed above. There are certain issues which are unique to this company, and those must be discussed in the context of this historical framework, relevant precedents, and the current energy situation.

2. Issues in this proceeding

There are two key rate design decisions before the Commission. The first is the level of the monthly customer charge. The second is the retention of the 3-block rate design, or the modification requested by the Company to a two-block rate design. In the context of the rate decrease which the record justifies, Public Counsel feels there should be no change in the customer charge, and the three rate blocks should all be reduced uniformly.

3. Customer charge

Avista is proposing a 66% increase in the monthly customer charge, from $3.00 per month to $5.00 per month.

The Company alleges that its customer costs total some $12.92 per month per residential consumer. (Exhibit 493, p. 4) However, when Mr. Lazar used the actual methodology approved by the Commission, to include meters, services, meter reading, and billing, he got less than $5.00 per customer per month. (Exhibit 698) What explains the differences?

First and foremost, the Company has greatly overstated Administrative and General Costs (see Section VI.). Second, the Company has greatly overallocated those costs to the residential class (see the rate spread section above). Finally, Avista has classified a very large and unsupported proportion (60%) of those costs as customer-related in Ms. Knox's cost of service study. (Exhibit T-460, p. 11)

Mr. Lazar's approach prorates the Administrative and General costs between all functions of the Company, in proportion to plant and expenses. Only those A&G expenses associated with services, meters, meter reading, and billing are included in the customer cost category in Mr. Lazar's analysis.

In Exhibit 40, the Company introduced some minor corrections to Mr. Lazar's original exhibits. With these corrections, it is clear that the Company's proposed increase to $5.00 per month is unjustified. We should note that the A&G cost figures used in Exhibit 40 do not reflect the proposed restating and proforma adjustments to A&G expenses proposed by Staff and Public Counsel. With lower overall A&G expenses, the figures shown in Exhibit 40 would be commensurately reduced. Mr. Lazar's study does show, however, that the Company's customer costs are above the $3.00 per month currently in effect. The question is how they should be changed in this proceeding.

We believe that an overall decrease in rates should be ordered, and every customer should see a decrease in their bill. For that reason, we oppose any increase in the customer charge, for if this rate element is increased, small use customers will not share in the overall rate decrease. We would hold the customer charge at current levels, and apply the decrease to the energy blocks.

If the Commission orders a rate increase, we would support a portion of that increase being collected through the customer charge. However, as Mr. Lazar points out in his testimony, an increase of more than 25% in this rate element would be inconsistent with previous Commission policy, would constitute an unfair increase to small use customers, and should be avoided. In Cause U-86-02, Pacific Power also proposed an increase in its customer charge from $3.00 to $5.00, and the Commission approved only a 25% increase, based on Staff testimony that a larger increase would constitute rate shock.[59]

If rates are increased by less than 2%, the customer charge should remain unchanged. If rates are increased by more than 5%, it should be increased to $3.75. A rate increase between these figures should bring an intermediate increase in the customer charge.

4. Rate blocks

The Company's justification for its proposed elimination of the third residential

[59] *Washington Utilities and Transportation Commission v. Pacific Power and Light Co.*, Docket No. U-86-02, Second Supplemental Order, p. 43 (1986) (hereinafter cited as U-86-02).

block is utterly inadequate to support a major policy change of this type. Mr. Hirschkorn defends this by saying there are relatively few electric heat customers left, and other utilities have two-block rates. (Exhibit T-490, p. 15)

Conversely, Mr. Lazar shows convincingly that there are two entirely separate approaches which justify the three-block rate design. His first approach is the Baseline Rate method first adopted by the Commission in Cause U-78-05[60] and reaffirmed as recently as Docket UE-920499.[61] The second is the load factor method, which he describes in detail.

The first method divides Avista's resources between low-cost hydro, mid-cost thermal, and high-cost new resources. He finds that the Company has available low-cost hydro resources sufficient to provide each customer with 800 kwh/month at a price lower than the current rate of $.039/kwh, sufficient mid-cost resources to provide each customer with an additional 600 kwh at about the current second-block rate of $.047/kwh, and additional usage causes the Company to incur costs of $.065/kwh, well above the current third-block rate. From this analysis, it is clear that the Company's rates need to be more inverted, not less, and that the largest-use customers are being subsidized by those whose usage falls within the low and mid-cost resources. (Exhibit T-686, p. 9 and Exhibit 688)

The second method averages all resources together, but then sets rate blocks based on the Company's own calculated "demand" costs and "energy" costs. This analysis looks at the actual day-to-day, hour-to-hour usage of various residential end uses. That analysis shows in a detailed and researched fashion something that is rather intuitive: electric heat usage is relatively sporadic and peaky, and it costs more to provide service to that type of load. Conversely, lights and appliance usage is more stable through the day and the year, and costs less to serve. The data for this analysis came from Avista's own calculation of unit costs, plus analysis prepared by Mr. Richard Byers for the 1989 Puget rate proceeding.

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[60] U-78-05, *supra* note 43.
[61] UE-920499, *supra* note 42.

Using the load factor approach at the Company's current rate level, Mr. Byers calculated that the cost of serving lights and appliance loads is less than $.035/kwh, or less than the current initial block rate. The cost of serving water heating load is about $.042/kwh, similar to the current second block rate. The cost of serving electric heating loads is $.057, slightly above the current end-block rate. At the Company's proposed rate level, the cost of serving electric space heat rises to $.074/kwh, which is far above the current or the Company's proposed rate. (Exhibit 688)

No party seriously challenged Mr. Lazar's analysis. In rebuttal, Mr. Hirschkorn shows how the Company dispatches its hydro resources to meet peak period loads. (Exhibit 507). He seems to imply that because the low-cost hydro is used to meet on-peak increases in demand, it is actually cheaper to serve on-peak demands than off-peak demands. He admitted during cross examination that this type of dispatch is actually a way to minimize total system costs, but that incremental power values are much higher during on-peak periods. (Tr. 2227) Exhibit 563 shows some of those on-peak and off-peak prices, and they can be as much as two or three times higher during on-peak periods.

The Company's rate design completely ignores any sort of cost-based principles. First, the Company is actually proposing to reduce the rate for electric heat usage over 1300 kwh/month, in spite of its request for an overall 10% rate increase. (Exhibit 493, p. 3) While electric heat customers will see their bills increase by 15% under the Company's proposal, gas heat customers will see their electric bills increase by 20%. (Exhibit 493, p. 6)

Frankly, gas heat customers have rate increases of their own to contend with, including not only the sharp increase the Company has proposed in this case, but also rising gas costs recovered through the tracker. Last winter, the Company imposed a tracking increase of about 17% (Tr. 995), and additional increases are inevitable as gas prices rise.

The Public Counsel proposal and preservation of the three block rate design would effectively allocate the limited low-cost hydroelectric power on the Avista system so that each

customer gets an equal share. In this manner, only those who cause higher cost resources to be needed would pay for those resources, in direct proportion to their usage of the higher cost power.

5. Summary

The Commission should accept the recommendation of the Joint Testimony on rate spread sponsored by Staff, Public Counsel and ICNU. Any allowed rate increase or decrease should be spread in accordance with the examples in Exhibit 676.

The Commission should reject Avista's proposal to increase the monthly electric customer charge from $3.00 to $5.00, a 66% increase. If this proceeding results in a decrease, as we believe it should, we concur with Staff that the entire decrease should be applied to the three rate blocks. If the Commission orders an increase, the customer charge should not be increased above $3.75 per month, consistent with past Commission decisions.

Finally, the Commission should order the rate adjustment – increase or decrease – spread between the residential rate blocks on an equal percentage basis.

X. OVERVIEW OF GAS RESULTS OF OPERATIONS

Appendix B is a summary of all adjustments to gas operations advocated by Avista, the WUTC Staff and Public Counsel. Columns (B) and (C) summarize Avista's position at rebuttal, filed 6/2/00. Columns (D) and (E) are Public Counsel's position on brief.

A. Restating Adjustments- Uncontested

RA-01 Deferred FIT Rate Base

RA-02 Deferred Gain on Office Building

RA-03 Gas Inventory

RA-04 Weatherization and Investment

RA-05 Customer Advances

RA-06 Eliminate B&O Taxes

RA-07 Pro Forma Property Taxes

RA-08 Uncollectible Expense

RA-09 Regulatory Expense Adjustment

RA-10 Injuries and Damages

RA-11 FIT (Federal Income Taxes)

RA-13 Eliminate A/R Expenses

RA-14 Office Space Charged to Subsidiaries

RA-16 Lease Expense Adjustment

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B. Restating Adjustments - Contested

RA-12 Pro Forma Restated Debt Interest: This adjustment is discussed in the electric section of this brief as adjustment RA-16, only the numbers are different for gas operations. The Company's original adjustment decreased NOI by $289,000. In rebuttal the Company's adjustment was revised to a decrease in NOI of $297,000. The adjustment is contested by the WUTC Staff.

Public Counsel proposes that the weighted cost of debt of 4.37% proposed by Mr. Hill be used in the calculation. Mr. Hill's weighted cost of debt includes Long-Term Debt, Short-Term Debt and Preferred Securities. (See Public Counsel's discussion regarding the Electric adjustment R-16).

RA-15 Restate Excise/Franchise Taxes: This adjustment is discussed in the electric section of this brief as adjustment P-14, only the numbers are different for gas operations. Public Counsel adopts the adjustment made by the WUTC Staff. The Commission should adopt its standard policy regarding Franchise Fees in this case.

RA-PC-01 Administrative & General Expense Adjustment: This adjustment is discussed in the electric section of this brief under the same adjustment number, only the numbers are different for gas operations. Public Counsel, through Mr. Lazar, proposes to increase NOI by $924,000. The Company opposes the adjustment.

The WUTC Staff, through Ms. Huang, proposes three pro forma adjustments, P-02 Pro Forma Labor/Benefit Adjustment, P-05 Staff Bonuses Adjustment and P-07 Staff Relocation Expense adjustment. Collectively, these three labor related adjustments increase NOI by $277,000. To avoid disallowing the same expenses twice, if the Commission adopts these WUTC Staff adjustments, then Mr. Lazar's adjustment RA-PC-01 should be reduced by the same amount. In brief, Public Counsel is therefore showing the impact of Mr. Lazar's adjustment PA-PC-01 as an increase to NOI of $647,000 ($924,000 minus $277,000 = $647,000).

The Company has not justified the level of A&G Salaries for the test period. Public

Counsel adjustment RA-PC-01 should be adopted by the Commission.

<u>RA-PC-02 Franchise Fees for Use of Corporate Name</u>: This adjustment is discussed in the electric section of this brief under the same adjustment number, only the numbers are different for gas operations. Public Counsel, through Mr. Lazar, proposes to increase NOI by $364,000. The adjustment is reasonable and appropriate and is supported by prior Commission decisions.

<u>RA-PC-05 Meter Reading & Billing</u>: This adjustment is discussed in the electric section of this brief under the same adjustment number, only the numbers are different for gas operations. Public Counsel, through Mr. Lazar, proposes to increase NOI by $643,000 and increase rate base by $2,114,000. The Company has not demonstrated that the level of test period meter reading and billing expenses are reasonable. In addition, nonregulated operations should pay its fair share of the expenses of billing that allow them to advertise through customer billings. The adjustment proposed by Mr. Lazar is reasonable and appropriate and is allowed by the Commission's regulations in WAC 480-100-101.

<u>RA-PC-06 Remove Name Change Amortization</u>: This adjustment is discussed in the electric section of this brief under the same adjustment number, only the numbers are different for gas operations. Public Counsel, through Mr. Lazar, proposes to increase NOI by $17,000. WUTC Staff witness, Mr. Schooley also recommends the disallowance of these same costs in adjustment P-04 Pro Forma Miscellaneous Adjustments.

The position taken in Adjustment RA-PC-06 should be adopted by the Commission. However, to avoid a double disallowance, Public Counsel, in brief, shows Adjustment RA-PC-06 as zero, and in the alternative concurs with the WUTC Staffs' proposed Adjustment <u>P-04 Pro Forma Miscellaneous Adjustment</u>, which is the same adjustment with the same proposed treatment as that proposed by Mr. Lazar regarding the recent corporate name change.

C. Pro Forma Adjustments – Uncontested

<u>P-PC-01 Pro Forma Depreciation Adjustment</u>: This adjustment is discussed in the electric section of this brief under the adjustment number P-PC-03, only the numbers are different for gas operations. Public Counsel, through Mr. Damron, proposes to decrease NOI by $51,000 and decrease rate base by $11,000 related to the Company's proposed change in depreciation rates. A settlement agreement was reached between the Company and Staff, which was also adopted by Public Counsel, through Mr. Damron's testimony. The adjustments, as detailed in Mr. Damron's Exhibits 709 and 710, should be adopted by the Commission.

P-03 Pro Forma Revenue Adjustment

P-08 Staff Hamilton Street Bridge Remediation

D. Pro Forma Adjustments - Contested

<u>P-02 Pro Forma Labor/Benefit Adjustment</u>: This adjustment is discussed in the electric section of this brief under adjustment number P-07, only the numbers are different for gas operations. The Company proposes to decrease NOI by $108,000 to reflect changes in salary levels as well as normalize test period benefit costs. This adjustment is sponsored by Company witness Mitchell. The WUTC Staff, through Ms. Huang, challenges the adjustment and proposes instead a decrease in NOI of $32,000.

Public Counsel supports Ms. Huang's analysis and adopts this adjustment. As discussed in regards to Public Counsel's proposed adjustment RA-PC-01, we have reduced the impact of our adjustment by the collective impact of the WUTC Staffs' adjustments P-02, P-05 and P-07, which are all adjustments related to labor and employee benefits. This is done to avoid a double disallowance of the same expenses. (See discussion, Section VI.A. Public Counsel Adjustments)

<u>P-04 Pro Forma Miscellaneous Adjustments</u>: This adjustment is discussed in the electric section of this brief under adjustment number P-09, only the numbers are different for gas operations. The Company proposed to increase NOI by $172,000 The WUTC Staff

proposes to increase NOI by $214,000 Public Counsel, through Mr. Lazar, also challenged the inclusion of the name change amortization and proposed the same adjustment. (See Public Counsels' discussion of the Corporate Name Change costs under proposed Public Counsel adjustment RA-PC-06). Public Counsel adopts the proposed adjustment of the WUTC Staff and in this brief shows the impact of Public Counsel's adjustment RA-PC-06 as zero to avoid a double disallowance of operating expenses.

P-05 Staff Bonuses Adjustment: This adjustment is discussed in the electric section of this brief under adjustment number P-15, only the numbers are different for gas operations. The WUTC Staff, through Ms. Huang, proposes to increase NOI by $282,000. The Company rejects the adjustment. Public Counsel adopts the WUTC Staffs' proposed adjustment. As discussed in regards to Public Counsel's proposed adjustment RA-PC-01, we have reduced the impact of our adjustment by the collective impact of the WUTC Staffs' adjustments P-02, P-05 and P-07, which are all adjustments related to labor and employee benefits. This is done to avoid any double disallowance of the same expenses.

P-06 Staff Miscellaneous Restating Adjustments: This adjustment is discussed in the electric section of this brief under adjustment number P-16, only the numbers are different for gas operations. The WUTC Staff proposes to increase NOI by $186,000 in this adjustment. The Company accepts a portion of the adjustment and proposes to increase NOI by $140,000. Public Counsel adopts the WUTC Staffs' proposed adjustment.

P-07 Staff Relocation Expense Adjustment: This adjustment is discussed in the electric section of this brief under adjustment number P-18, only the numbers are different for gas operations. The WUTC Staff, through Ms. Huang, proposes to increase NOI by $27,000. The Company opposes the adjustment.

Public Counsel adopts the WUTC Staffs' proposed adjustment. As discussed in regards to Public Counsel's proposed adjustment RA-PC-01, we have reduced the impact of our adjustment by the collective impact of the WUTC Staffs' adjustments P-02, P-05 and P-07,

which are all adjustments related to labor and employee benefits. This is done to avoid any double disallowance of the same expenses.

E. Conclusion

1. Revenue (Excess) or Deficiency: Appendix B, l. 37, column (D), reflects excess revenues of $1,919,000.

2. Conversion Factor: Public Counsel adopts the Staff's proposed conversion factor.

XI. GAS RATE SPREAD AND RATE DESIGN

A. The Commission Should Adopt Joint Proposal of Staff, Public Counsel and ICNU Regarding Gas Rate Spread

The Joint Testimony of Staff, Public Counsel, and NWIGU proposed that any allowed change in natural gas margin approved in this proceeding be spread on a uniform percentage of margin basis to all schedules except 131 and 148. (Exhibit T-680). In its rebuttal testimony, the Company accepted this approach. (Exhibit T-506, p. 5) We consider this an uncontested issue, and urge the Commission to adopt this.

On rate design within the residential class, there is a disagreement between the Company, on the one hand, and Public Counsel and Staff, on the other, with respect to the level of the monthly customer charge. The Company is seeking an increase from $4.00 to $5.00 per month (Exhibit T-490, p. 32). Staff has advocated that the customer charge be increased (or decreased) by the same percentage as the overall increase. (Exhibit T-668, p. 3) Public Counsel witness Lazar recommends no increase in the customer charge. (Exhibit T-686, p. 18)

Mr. Lazar has presented a detailed analysis of the costs which should be included in the gas customer charge, and these total only $2.82/month. (Exhibit T-686, p. 18, and Exhibit 481) Because the current monthly charge is $4.00 per month, no increase in the customer charge is justified.

The Commission has been very clear in the past that customer-related costs to be reflected in the customer charge should include only those costs which actually vary with the number of customers served, and that customer charges should be kept low in order to encourage conservation. Staff and Public Counsel's testimony is consistent with that tradition, while the Company is proposing a 25% increase in this rate element.

There are three key differences between the Company's analysis and Mr. Lazar's analysis. First, Mr. Hirschkorn includes the cost of service drops, while Mr. Lazar demonstrates that these are usage-related under the Company's line extension policy, Schedule 151.

Second, Mr. Hirshkorn relies on the Company's excessive cost of capital request, while Mr. Lazar uses the Public Counsel cost of capital.

Finally, Mr. Hirschkorn includes monthly meter reading and billing costs as customer-related costs, while Mr. Lazar calculates these costs using only the bimonthly meter reading and billing costs.

B. Service Drops Are Usage-Related.

The first of these is by far the largest impact. Mr. Hirschkorn's own exhibit shows that with this removed, his own analysis shows only a $4.13/month customer cost. (Exhibit 496, p.5)

The Company's gas line extension policy, Schedule 151, clearly requires that the cost of service drops be included in the formula for determining whether the Company or the Customer will pay for installation of gas service. In the Applicability section it explicitly states:

> "To service piping or main extensions installed, owned, operated and maintained by the Company." (Original Sheet 151)

This line extension policy provides that the Company will pay up to three times the expected annual revenue for installation of service piping. The worksheet included in this Schedule specifically provides that the line extension allowance is larger for larger homes, and for homes with more gas appliances. For example, a customer with only a gas range would receive only a

$60 allowance for that usage, while one with a 2000 square foot home with gas heat and water heat would receive an allowance of $1,321.

The Commission's rules require that the Company provide a meter at no cost to the customer, stating:

> **Installation of meter set assembly (MSA).**
> No utility shall make any charge for furnishing and installing any meter or other appliance for measuring the amount of gas furnished, excepting that if a customer desires for his convenience the installation of more than one meter at one premise for one class of service, then the utility may install such meters upon the payment by the customer of installation cost and a reasonable rental therefor. No meter shall be required on flat rate services.

WAC 480-90-131. Because the Commission's rules require that meters be provided at no installation charge to customers, regardless of usage, the rate design should logically follow to include the cost of the meter in the monthly customer charge. The same logic does not extend to the service drop, because the customer will pay through a contribution in aid of construction for the service drop if their usage will not provide the Company with sufficient revenue.

The Company's proposal would appear to double-charge small use customers for the cost of a service connection. First, the Company would include a portion of this cost in the monthly customer charge regardless of usage, as proposed by Mr. Hirschkorn. However, if they were expected to use very little gas, the line extension policy would also require that the customer pay up front for this cost.

The Company's rebuttal to Mr. Lazar's analysis on how the line extension policy interacts with the cost of service and rate design analysis is weak. Mr. Hirschkorn stated that nearly all customers are large-use customers, and do not pay any contribution in aid of construction. He stated that there are "very few customers who may only use gas for cooking or some other low use appliance." (Exhibit T-506, p. 15)

The record of evidence does not support Mr. Hirschkorn's statement. Exhibit 509 shows that there were 2,451 customers whose use did not exceed 20 therms in any month of the test

period. Exhibit 510 shows that there were 3,792 customers whose use in January did not exceed 20 therms, and in the month of July, this rose to 74,870, or about 70% of the total customer base. All of these are "small-use" customers who would be adversely affected by the Company's proposed rate design.

The facts are quite clear: The Company's line extension policy requires small-use customers to pay for their service connections at the time service is extended. Large use customers have their service connections paid by the Company, with the amount allowed based on expected sales revenues. The cost of the service pipe is a usage-related cost, not a customer-related cost.

Why is this issue treated differently for gas and electric customers? The reason is quite simple: the line extension policies are different. While the gas extension policy, Schedule 151, has no "minimum" line extension allowance, the electric line extension policy allows small-use customers up to $1,000 in company-paid line extension costs. This is available to any customer expected to use more than 4800 kwh/year (400 kwh/month).

At Tr. 984, Mr. Hirschkorn stated: "I believe it's approximately 700 kilowatt hours a month. And that would include lighting, appliance use, a base load amount that pretty much every customer uses each month on average." Mr. Hirschkorn agreed with the characterization that 600 kwh/month was "basically a minimum usage level". (Tr. 2226) Thus, even "minimum usage" levels by residential electric customers quality for up to $1,000 in electric line extension costs, but minimum use gas consumers qualify for only small ($60) company-paid line extensions.

Because the line extension policies are different, Mr. Lazar included the cost of services in his electric customer cost calculation, and excluded the costs of service connections in his gas customer cost calculation. Both are consistent with previous decisions of the Commission. Both are consistent with this Company's line extension policies. Both calculations should be accepted by the Commission.

The Commission has previously adopted Mr. Lazar's methodology for computing customer-related costs. In Docket UE-920840, the Commission explicitly adopted the methodology applied by Mr. Lazar in his testimony:

> The reduction to residential rates should be equal to the system average, with the reduction first applied to reduce the customer charge from $4.51 to $4.00, on the basis of Public Counsel's cost analysis. Any further reduction should be applied to the commodity rate.[62]

Mr. Lazar has applied the same methodology in this proceeding, taking the investment in meters, plus the cost of meter reading and billing into account, and adding overhead to each of those costs for administrative and general costs, taxes, and so forth. (Exhibit 691) With all of those costs included, Mr. Lazar concluded that the monthly customer costs were $2.82/month with bimonthly meter reading and billing, and $3.59/month with monthly meter reading and billing. (Exhibit T-696, p. 18)

Once the service connection cost is removed from the calculation, even at the Company's requested rate of return, only a $4.13/month customer charge can be justified. At any reasonable rate of return, this would drop to $4.00 or less, the current charge. Mr. Lazar computed this cost, using the Commission-approved methodology, at $3.59/month at the Public Counsel proposed rate of return. No increase in the customer charge above the current level of $4.00/month is justified, even if removing the service connection cost is the only correction made to the Company's proposed methodology.

C. Bimonthly Meter Reading and Billing

Mr. Lazar computed the customer-related costs for the gas system under two sets of assumptions. Assuming bimonthly meter reading and billing, these costs were $2.82/month. Assuming monthly meter reading and billing, these rose to $3.87/month, an additional cost of

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[62] UE-920840, *supra* note 36, Fourth Supplemental Order, p. 42.

$1.05/month.

The Company objected to Mr. Lazar's proposal that only the costs of bimonthly meter reading and billing be allowed. That issue is separate from the rate design issue, and is addressed elsewhere in this brief. The only issue for rate design purposes is whether these costs are <u>customer</u> costs, not whether they are <u>prudent</u> costs. While we believe these costs need to be contained, and have provided an appropriate way to do so, even if the Commission determines that monthly meter reading and billing is justified based on the amount of usage and size of bills, it should not allow the excess costs beyond what are required to comply with WAC 480-100-109 to be reflected in the customer charge.

Mr. Hirschkorn agreed that the justification for monthly meter reading and billing is that customers use significant amounts of energy each month, and that the amount used varies from month to month. (Tr. 985)

Since the only justification for reading meters more frequently than that required by the WAC is that customers use significant amounts of energy, and the amounts they use varies from month to month, it follows that if more frequent meter reading and billing is allowed in the revenue requirement, that cost should be treated as usage-related, and included in the rate per therm, not treated as customer-related and included in the basic charge.

We find it interesting that the difference between monthly and bimonthly meter reading and billing on the Avista system – $1.05/month, is at the low end of the range on which consumers were surveyed by the City of Olympia – and even at that level of incremental cost, 83% of consumers said that they were not willing to pay the extra cost of monthly meter reading and billing. (Exhibit T-691, p. 22)

The Commission should find that only the costs of bimonthly meter reading and billing are properly included in the basic charge, and that any more frequent meter reading and billing, if allowable at all, should be considered usage-related.

D. Non-Residential Rate Design

Both Staff and NWIGU have taken similar positions on the Company's proposed rate design for large industrial consumers. Public Counsel supports the rate design recommendations of NWIGU. These will mitigate schedule shifting.

XII. LOW INCOME CUSTOMERS

Public Counsel supports the process outlined in the testimony of Roger Colton on behalf of SNAP. Ex T-726. We find the notion of a collaborative process designed to yield a program to effectively serve Avista's low-income population, subject to a capped contribution by ratepayers and yielding cost savings for the utility and ratepayers, to be attractive from both a process and policy perspective. Public Counsel believes the success of the Company's energy efficiency programs is enhanced by Avista's meaningful engagement of its stakeholders and we see no reason why such an effort could not be replicated for low-income assistance programs. We note that the recent approval of the settlement of the Pacificorp rate case includes a similar proposal for the parties to work in collaboration to develop a low-income energy assistance program.

Ms. Hirsh describes the general need for low-income assistance programs and notes the Commission has familiarity with that need through its role in developing the Washington State Electricity Systems Study (the "6560 study"). Exhibit T-649, p. 13, 1-20. Through Mr. Colton's testimony, SNAP has demonstrated there is a need for such a program to serve Avista's low-income population. Exhibit T-726, p 4-8. SNAP has further demonstrated that Avista has not targeted a program to meet this need, nor to capture any benefits to the utility and its ratepayers that could accrue from such a program. Exhibit T-726, pp. 11-18; 33-35. Public Counsel therefore recommends the Commission direct Avista to engage in a collaborative planning process with stakeholders to develop a low-income assistance filing in time for the onset of the winter heating season.

XIII. PUBLIC PARTICIPATION

Customer reaction to the requested increase has been strong and it has been unfavorable. In his written testimony, Avista CEO Tom Matthews made the assertion that Avista customers understood why the Company needed the requested rate increase, and went on to opine that the

low turnout at the Spokane hearing was reflective of low public concern. [63]

Public Counsel submits that Mr. Matthews has reached an erroneous conclusion about public sentiment with regard to this rate increase request. The contents of illustrative Exhibit 744 are the comment letters received up through July 21, 2000. Of the 250 letters or other written comment contained in the exhibit, 237 oppose Avista's requested rate increase.

The following are excerpts from some of the letters:[64]

> "This is nothing more than corporate greed and welfare." John O. Wittemberg Jr., Spokane, WA, p.6.
>
> "This is not a rate increase born out of the normal cost of doing business, but lack of planning and error in judgment." JoAnn F. Marvicsin, Spokane WA, p. 14.
>
> "Further, I think the proposed increase is in very bad timing considering that a new CEO was recently hired at a very, very large salary. One of the first things he saw fit to do was change the Company name at a considerable expense." Arthur Wachetndorf, Addy, WA, p. 19.
>
> "The organization seems to have shifted its northwest focus to other interests that do not serve Washington residents." Dr. Mike Ingram, Colbert, WA, p. 20
>
> "The stock holders, administrators, and big bosses are receiving obscene raises and bonuses that are not deserved. Eliminate these fringes and there will be no reason to punish the ratepayers with further increases." Alexander D. Stuart, Spokane, WA, p. 24.
>
> "I wonder if this is not an effort on their management to make up for some poor choices in Avista's other investments." Laurence R. Morgan, Spokane, WA, p. 25.
>
> "I want to add that I was privileged to come across documentation noting that Avista had a party recently & they spent just under $40,000 in food alone. That is a lot of money to be wasting on a party & peoples incomes to have electricity." David K. Kephart, Spokane, WA, p. 26.

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[63] Tr. 1989.

[64] The quotes are referenced by page number to Exhibit 744. Since Exhibit 744 is not numbered, the given number refers to the sheet number in the filed and served exhibit. The page number listed refers to the first page of the customer letter even when the quote came from a subsequent page.

"Every year Avista gives huge bonuses to the executives instead of maintaining their lines or giving raises to the linemen where it is needed and do all the hard work." Jackie Cummings, Chewelah, WA, p. 28.

"We do not believe that we, as customers, should have to make up for mismanagement of the business over the past years of the Avista Utilities corporation in one fell swoop." Andrew J. Brustkern, Spokane, WA, p. 29.

"I am opposed to any emergency relief for Avista utilities due to their poor performance in the resale market. Don't allow them to tell the Wall St. people one thing, and the regulators another. They say the sum of their parts is greater than the whole…Let them balance their books on their backs, rather than the rate payer." Jerry Cahill, Spokane, WA, p. 80.

"I am not against Avista getting a fair return on there investment, but in my community of Clarkston, Washington, there "services" as slim to none." Ronald C. Russell, Clarkston, WA, p. 108.

"The Company is already making good money and if they can afford to compensate the CEO to the tune of $750,000 per year and if they can afford to have 'pricey' folks like General H. Norman Schwartzkopf on their Board of Directors; then they can damned well afford NOT to gouge the ratepayers, who are a captive market anyway!!" Roger Erdman, Spokane, WA, p. 112.

"Government agencies across our state are being forced to conserve, please afford Avista the same opportunity, and do not provide them with the ability to charge more for what is unremarkable service." Bob Crouch, Spokane, WA, p. 131.

"Most of us do not make close to the base salary of Avista's corporate employees, and bonuses on top of that huge salary is a slap in the face to Avista's customers who are told that rates need to go up to cover costs." Susan Boyd, Clarkston, WA, p. 139.

"Avista has increased response time for servicing their customers and increased individual service fees. They care less than WWP about their customer base." Nicholas T. Andrizzi, Spokane, WA, p. 155.

"Since the merger with Washington Water Power their level of customer service has fallen off greatly. The number and length of outages has increased. They need to improve their customer service and customer relations before ANY increase should be considered." Doug A. Crockett,

> Latah, WA, p. 176.
> "The lack of customer service since Washington Water Power sold is reprehensible." A Concerned Voter and Customer of Avista, p. 247.
>
> "If Avista wants a raise in rates maybe they should consider delivering dependable electricity first and not giving the CEOs such big bonuses. We wouldn't mind a small increase in rates if we weren't having to spend so much for repairs and replacement of our appliances and equipment." Marva l. Kisman, Kettle Falls, WA, p. 296.

These characterizations are typical of the customer sentiments expressed in the illustrative exhibit. What is significant about these comments, in addition to the basic opposition which they convey, is the fact that so many of the customers raise the very concerns raised by the parties to this rate case, issues relating to executive salaries, to the quality of management and service of the Company, and to the impact of unregulated activities on Avista.

The Commission held a public hearing in Spokane on April 20, 2000. While the turnout was low, those who did attend and who spoke opposed the rate increase. One of the speakers, representing VOICES, a Spokane low income group, addressed the impact of the rate increase on low-income customers:

> "This will mean more people will be choosing between paying the electric bill, or buying medicine, or eating, or school supplies for their kids."

(Tr. 1074)

XIV. CONCLUSION

For the foregoing reason, Public Counsel respectfully requests that the Commission adopt the adjustments, the cost of capital and the other recommendations set forth in this brief, issue an order denying the Avista Corporation request for a rate increase, and order Avista to file revised tariffs to set a fair, just, reasonable, and sufficient rate. The evidence establishes that a revenue reduction of $32,755,000 in electric rates and $1,919,000 for gas rates is appropriate in this case.

DATED this 10th day of August, 2000.

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