

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
A. Avista’s Requested Rate Increase is Excessive and Ill-founded. It Should Be Firmly Rejected by the Commission	1
B. Public Counsel Recommends that Avista’s Rates Be Reduced Substantially	2
C. General Legal and Ratemaking Principles	3
II. THE PGE/RATHDRUM TRANSACTION	3
A. Avista Improperly Failed to Incorporate the PGE Contract Monetization in its Rate Filing	3
B. The Link Between the PGE Contract and Rathdrum	4
III. RATE OF RETURN	8
A. Legal Principles	8
B. Overview of Rate of Return	9
1. Capital Structure	9
2. Cost of Equity	11
C. Capital Structure Should Be Based on Avista’s Actual Utility Capital Structure	13
D. Cost of Equity and Corroborative Analyses	19
1. The Macroeconomic Environment	19
2. Market-based Estimation Methodologies for Comparison	20
3. Discounted Cash Flow	20
4. Capital Asset Pricing Model	21
5. Modified Earning Price Ratio	22
6. Summary of Cost of Equity Estimation Results	22
E. Flotation Costs	23
F. Utility-Only Structure and the Sample Group	23
G. Management Efficiency “Adder”	24
H. Kettle Falls Bonus	27
1. The statutory standard	27
2. Kettle Falls was not cost-effective when it was placed into rate base	27
3. Kettle Falls is still not cost-effective; the statutory standard is not met and the equity bonus should be denied	30
I. Public Counsel Critique of Dr. Avera’s Testimony	30
1. Avista cost of capital	30
2. Risk Premium	30

J.	3.	Avera Rebuttal	33
		Public Counsel Recommends An Overall Cost of Capital of 8.82%	36

IV.	POWER COST ADJUSTMENT	36
A.	Avista's Power Cost Adjustment (PCA) Proposal Ignores The Commission's PCA Parameters	36
B.	Avista's PCA Proposal Contains No Cost of Capital Adjustment	37
C.	The Mid-Columbia Price Index Should Not Be The Only Indicator of "Fair Market Value"	39
D.	Avista Has Ignored PCA's Extreme Sensitivity to Hydro	40
E.	The PCA Has A Potential for Gaming	40
F.	The Commission Should Not Order Implementation of the Proposed PCA	41
V.	MAJOR POWER SUPPLY ISSUES	41
A.	Introduction	41
B.	Centralia Replacement Power	42
C.	Potlatch	46
D.	Hydro Flexibility	46
VI.	PUBLIC COUNSEL ADJUSTMENTS	48
A.	Administrative and General Salaries	49
B.	Corporate Name / Franchise Fees and Royalties	51
C.	Hydroelectric Production Depreciation Expense	52
D.	Meter Reading, Billing, and Bill Insert Expenses	54
VII.	STAFF HAS BEEN CONSERVATIVE IN ITS RECOMMENDATIONS	57
A.	Hydro Flexibility	57
B.	PGE Contract Interest	57
C.	Executive Compensation	58
D.	Franchise Fees for Name Use	58
E.	Billing Envelopes	58
F.	Centralia Gain – State Income Tax	59
G.	Executive Lobbying	59
H.	Gain on Real Estate	60
VIII.	OVERVIEW OF ADJUSTMENTS TO ELECTRIC RESULTS OF OPERATIONS	60
A.	Restating Adjustments – Uncontested	61
B.	Restating Adjustments – Contested	62
C.	Additional Restating Adjustments Proposed by Public Counsel	63
D.	Pro Forma Adjustments – Uncontested	65
E.	Pro Forma Adjustments – Contested	66

F.	Conclusions	72
IX.	ELECTRIC RATE SPREAD AND RATE DESIGN.....	
	72	
A.	The Commission Should Adopt The Joint Position of Public Counsel, Staff and ICNU On Rate Spread	72
B.	Rate Spread Discussion	73
1.	Ms. Knox's study is not a reasonable definition of "unity"	73
2.	Ms. Knox did not update her study	74
3.	The Commission has consistently rejected mechanical application of cost study results	74
4.	Several adjustments would not affect classes uniformly	75
5.	In the absence of a valid cost study, a uniform percentage increase is the accepted practice	76
6.	Conclusions on rate spread	77
C.	Residential Rate Design	78
1.	Historical Background	78
2.	Issues in this Proceeding	79
3.	Customer charge	80
4.	Rate blocks	81
5.	Summary	83
X.	OVERVIEW OF GAS RESULTS OF OPERATIONS	84
A.	Restating Adjustments – Uncontested	84
B.	Restating Adjustments – Contested	85
C.	Pro Forma Adjustments – Uncontested	87
D.	Pro Forma Adjustments – Contested	87
E.	Conclusion	89
XI.	GAS RATE SPREAD AND RATE DESIGN	89
A.	The Commission Should Adopt Joint Proposal of Staff, Public Counsel and ICNU Regarding Gas Rate Spread	89
B.	Service Drops Are Usage-Related	90
C.	Bimonthly Meter Reading and Billing	93
D.	Non-Residential Rate Design	94
XII.	LOW INCOME CUSTOMERS	95
XIII.	PUBLIC PARTICIPATION	95
XIV.	CONCLUSION	

APPENDICES

- Appendix A Summary Electric Pro Forma – per Company and Public Counsel
- Appendix B Summary Gas Pro Forma – per Company and Public Counsel
- Appendix C Public Counsel Recalculation of Power Supply Adjustment
- Appendix D Proposed Treatment of Interest on PGE Contract