BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Washington Utilities and Transportation Commission, Complainant v. Avista Corporation, Respondent	)	**DOCKET NO. UE-991606** **DOCKET NO. UG-991607** **POST-HEARING BRIEF OF INTERVENOR INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES**

INTRODUCTION

On October 22, 1999, Avista Corporation ("Avista" or the "Company") filed a general rate case with the Washington Utilities and Transportation Commission ("Commission" or "WUTC"). The Commission suspended the proposed tariff revisions on November 30, 1999, pending an investigation and hearings on the Company's proposal. The filing proposed an increase in the Company's annual revenue requirement of approximately $26.3 million, which the Company later reduced to approximately $22 million as a result of a settlement on depreciation expenses and a proposal related to the gain from the sale of the Centralia Generating Plant.

The Industrial Customers of Northwest Utilities ("ICNU") sponsored the Direct Testimony of Donald W. Schoenbeck (Ex. T-718), and the Joint Testimony of Kilpatrick, Lazar, and Schoenbeck (Ex. T-675), which were submitted on May 5, 2000. ICNU has chosen to focus

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its participation in this case on the key issues that were outlined in Mr. Schoenbeck's testimony. ICNU submits this Post-Hearing Brief on those issues. On the issues not addressed in this Post-Hearing brief, ICNU generally supports the testimony of Staff and Public Counsel.

SUMMARY

This brief addresses six significant issues that are raised by the Company's filing. First, should the Commission approve a Power Cost Adjustment mechanism ("PCA") that does not meet the established criteria for PCAs in Washington? Second, should the Company be required to flow through to customers the $145 million that it received as proceeds from the assignment of its long-term capacity sale agreement with Portland General Electric Company ("PGE")? Third, in what manner should the customers' share of the Centralia gain be provided to customers? Fourth, should the Commission impute commercial trading profits to the Company's revenue requirement? Fifth, should the extraordinary, non-recurring costs associated with the 1991 Fire Storm , the 1996 Ice Storm and Y2K be excluded from the Company's revenue requirement? Sixth, is the Company entitled to an equity kicker?

ICNU proposes that the Commission reject the PCA in its entirety as it did when the Company proposed a similar PCA in 1989. In addition, the Commission should: (1) require the Company to pass on the entire gain from the Centralia sale to customers in the form of a rate credit amortized over eight

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YEARS; (2) REQUIRE THAT THE COMPANY AMORTIZE THE PROCEEDS FROM THE ASSIGNMENT OF THE PGE CONTRACT AS A RATE CREDIT OVER AN EIGHT YEAR PERIOD; (3) IMPUTE POWER SALE PROFITS TO CUSTOMERS FROM THE COMPANY'S COMMERCIAL TRADING ACTIVITY DURING THE TEST YEAR; AND (4) DISALLOW ALL NON-RECURRING COSTS FROM THE *PRO FORMA* REVENUE REQUIREMENT. FINALLY, THE COMMISSION SHOULD REJECT THE COMPANY'S REQUEST FOR A 25-BASIS POINT ADDER TO ITS RETURN ON EQUITY BECAUSE A REWARD FOR THE COMPANY'S PERFORMANCE IS NOT WARRANTED. THIS IS PARTICULARLY TRUE SINCE THE COMPANY CONSCIOUSLY CHOSE TO DISREGARD RULES AND STATUTES APPLICABLE TO THE ASSIGNMENT OF THE PGE CONTRACT.

ICNU'S PROPOSED ADJUSTMENTS TO THE COMPANY'S *PRO FORMA* REVENUE REQUIREMENT ARE SUMMARIZED IN THE FOLLOWING TABLE:

ICNU Proposed Adjustments	**($ millions)**
PGE Contract Assignment	-$9.5
Equity Performance Bonus	-$1.2
Washington Regulatory Fees	-$0.5
Commercial Trading Margins	-$4.2
Centralia Adjustment[1]/	-$8.2
1991 Fire Storm	-$0.6
Name Change	-$0.2
Y2K	-$0.2
ICNU Recommendation Total:	-$24.6

1/ The Centralia adjustment assumes that the $2.1 million for the 1996 Ice Storm costs, which were included in the original filing, have been excluded from the proposed revenue requirement. This adjustment was derived as follows: $6.9 million Centralia gain amortization plus $1.2 million for replacing the TransAlta purchase with market purchases.

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Company Rate Increase/(Decrease)	-$(2.6)

These adjustments are described in further detail in Mr. Schoenbeck's testimony (Ex. T-718), and the work papers supporting these adjustments are contained in Ex. 741. As Mr. Schoenbeck testifies, ICNU's adjustments to the Company's revenue requirement are conservative, "because they assume the use of the Company's proposed capital structure and its proposed 12% return on equity." Ex. T-718, 3:9-11 (Schoenbeck Direct). ICNU believes that the Company's proposed revenue requirement should be decreased even further to reflect a more

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reasonable return on equity and capital structure; however, ICNU intends to rely on the testimony of Staff and Public Counsel to address this issue.

ARGUMENT

THE COMPANY'S PROPOSED PCA FAILS TO MEET THE COMMISSION'S ESTABLISHED REQUIREMENTS FOR A PCA, AND IS NOT IN THE PUBLIC INTEREST

The Power Cost Adjustment ("PCA") proposed by Avista should be rejected because it contains adjustments to rates that are not weather-related, and the Company has not proposed an adjustment to its cost-of-capital to reflect the reduced risk to the Company resulting from a PCA. In addition, adoption of the PCA is not in the public interest because: 1) it would create a disincentive for the Company to plan to serve customers on a least cost basis; 2) it would discourage the Company from filing periodic general rate cases to ensure that its rates reflect its costs; and 3) it is not consistent with changes underway in the electric utility industry.

The Proposed PCA Fails To Meet Two Of The Three Requirements For A PCA

The Commission will not adopt a PCA unless it meets each of these three criteria: 1) the PCA must be based solely on weather-related factors; 2) the PCA must exclude the cost of long-term resources to meet new load; and 3) the PCA must include an explicit cost-of-capital reduction to reflect the decrease in the utility's risk. Re Washington Water Power Co., WUTC Docket No. U-882363-P, First Supplemental Order at 8 (Sept. 18, 1989). In addition to these criteria, a PCA must be easy to administer and must make the nexus between weather and changes in power costs easy for ratepayers to understand. Id.

These principles were first developed in a series of orders during the 1980s related

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to Puget Sound Power & Light's ("Puget") Energy Cost Adjustment Clause ("ECAC").[2]/ The Commission terminated Puget's ECAC in 1990 because it failed to satisfy the three criteria. WUTC v. Puget Sound Power & Light, WUTC Docket Nos. U-892688-T and U-892955-T, Third Supplemental Order at 15 (Jan. 17, 1990).

The Commission has declined to implement PCA proposals when they fail to satisfy these requirements. For example, in 1988, Washington Water Power ("WWP") requested that the Commission approve a PCA. Re Washington Water Power, WUTC Docket No. U-882363-P, First Supplemental Order at 10-11. The Commission reaffirmed the criteria set forth above, and rejected the proposed PCA because it failed to provide a cost-of-capital adjustment. Id. at 11. The Commission also has modified PCA proposals to meet these criteria. WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-901183-T and UE-901184-P, Third Supplemental Order at 17 (Apr. 1, 1991). In Docket Nos. UE-901183-T and UE-901184-P, the Commission found that the hydropower adjustment clause attached to Puget's Periodic Rate Adjustment Mechanism ("PRAM") did not adequately reduce Puget's cost-of-capital to compensate ratepayers. Id. at 15. The Commission then reduced Puget's proposed rate of return by adopting Staff's proposed cost-of-capital and capital structure to correct the defect. Id. at 17.

In its rebuttal testimony, the Company proposed a modified PCA that provides for price changes based on two variables. The first variable compares actual hydro conditions on a

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2/ Puget's ECAC differed from the PCA Avista proposes in this case because the ECAC required a prudency hearing prior to price changes taking effect. WUTC v. Puget Sound Power & Light, WUTC Docket No. U-8141, Sixth Supplemental Order at 21 (Dec. 19, 1988).

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monthly basis with the hydro conditions assumed in the *pro forma* test year. Hearing Transcript ("Tr.") 2102:8-25 (Johnson Cross). The second variable compares the average monthly price of the Dow Jones Mid Columbia Firm Index with the price for purchased power assumed in the *pro forma* test year. Id. Avista proposes to track these expenses in a deferred account, and if the balance reaches $6 million, Avista will adjust rates in the form of either a rate surcharge or rebate. Ex. T-445, 5:24-6:6 (McKenzie Direct). Although price increases would be limited to 5.0 % per year under the Company's proposal, the remaining balance in the PCA account would continue to grow and would be recovered through future price increases. Ex. T-420, 6:13-20 (Johnson Direct). The purpose of the PCA, according to Avista, is to "enhance earnings stability by flowing through to customers variations in the company's power supply revenues and expenses due to changes in uncontrollable factors…." Id. at 2:16-18.

The Company's PCA proposal should be rejected because it fails to meet two of the three requirements for a PCA in Washington. First, the PCA includes a market-index adjustment that is not weather-related. Second, the proposed PCA fails to incorporate any benefit for ratepayers through a cost-of-capital reduction.

1. The Proposed PCA Includes Inappropriate Non-Weather-Related Factors

This Commission has been absolutely clear that a PCA must be based exclusively on weather-related factors. In the Puget ECAC proceeding, the Commission stated: "The Commission wants every proposed cost change in an ECAC proceeding to be traceable to changing weather patterns. Other cost changes will be the subject of general or other rate

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proceedings." WUTC v. Puget Sound Power & Light, WUTC Docket No. U-8141, Sixth Supplemental Order at 21. The rationale behind the weather-related requirement is two-fold. "First, weather patterns are beyond the control of the company, and, second, and most significantly, the vast majority of customers can intuitively understand the weather/cost link." Id. Any adjustments that are not based on weather-related factors must be removed from the PCA. Id. at 27.

The proposed PCA does not satisfy the weather-related criteria established by the Commission, because the PCA variable that is based on the Dow Jones Mid Columbia Firm Index price is not based on changes in weather. The Company admits that the PCA is not solely weather-related. Tr. 2126:17-23 (Johnson Cross). The Commission should explicitly reaffirm its policy that PCA rate changes must be based only on weather-related factors. This policy makes sense for the reasons the Commission has previously noted. First, price changes based on weather will be understandable to customers. In the current market, prices do not appear to be driven by water conditions. Tr. 1333:23-1334:1 (Buckley Cross). Furthermore, given current market prices, the proposed PCA will likely cause immediate price increases that are unrelated to weather. Tr. 1642:8-17 (Norwood Cross). In addition, the structure of the PCA could result in substantial lag between market conditions and the implementation of a price change. These factors indicate that indexed-based price changes under the PCA will cause confusion among customers.

One justification for basing PCA's on weather-related factors is that the weather,

and thus hydro conditions, are not subject to the reasonable control of the Company. Power costs, unlike hydro conditions, are not uncontrollable. While the Dow Jones Mid Columbia Firm Index price is not within the Company's control, the Company does have the ability to affect its power costs. As Staff noted, the Company can control "the type of power purchased or sold, the time of day of the transaction, delivery points, or other similar characteristics. In addition, the Company controls other resource decisions, such as when to acquire long-term resources to meet its requirements." Ex. T-540, 47:1-4 (Buckley Direct).

The proposed PCA does not reflect the Company's actual power costs because the index variable in the proposed PCA is merely a proxy for power prices. As noted above, the Company can significantly affect its power costs by entering into power purchases and hedging instruments that are different from the transactions tracked by the Dow Jones Mid Columbia Firm Index. Thus, including a market-indexed price variable in a PCA is inappropriate.

Another problem with the use of a market index in the PCA, instead of limiting the PCA to weather-related factors, is that the market index ignores the impact of market prices on the Company's power sales during times of the year when it has energy surpluses. As Mr. Buckley noted, a PCA that adjusts for power costs is one sided because it ignores the benefits of favorable sales opportunities that Avista has when market prices are high. Tr. 1326:4-15 (Buckley Cross). Likewise, Mr. Lazar noted that the proposed PCA was "asymmetrical" and would result in "more surcharges than credits...." Ex. T-691, 26:26 (Lazar Direct).

The Company's short-term power purchases should not be included in the PCA

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because the costs are not directly influenced by weather-related factors. The only link between the price the Company pays for its short-term power and the weather is the increased demand in the market when hydro generation is down. Ex. T-426, 7:17-23 (Johnson Rebuttal). The Company argues that changes in purchases and sales are weather-related "because the volume of short-term purchases and sales varies [with] changes in hydro generation." Id. at 7:18-20. The Company then argues that the change in short-term energy prices is weather driven since increased hydro generation tends to lower short-term prices. Id. at 7:20-23. While weather may affect the amount and availability of power, there are many non-weather-related market factors that can be the driving force behind drastic price increases. Tr. 1642:8-12 (Norwood Cross). Once the weather/cost nexus is severed, and market factors are included in the PCA, customers will find it increasingly difficult to understand the reason for sudden increases in their bills.

The Company has ignored the requirements for a PCA in Washington by asking the Commission to make ratepayers responsible for changes in spot market power prices. The policy behind a PCA in Washington is well established: cost changes in a PCA must be traceable to changing weather patterns. WUTC v. Puget Sound Power & Light, WUTC Docket No. U-8141, Sixth Supplemental Order at 21. This requirement does not include market volatility. As the Commission noted, concerns about a changing market are better addressed through other regulatory avenues. Id. Therefore, the proposed PCA fails to meet the first of the Commission's requirements for a PCA and must be rejected.

2. The Proposed PCA Does Not Offer A Cost-of-Capital Reduction To Reflect The Reduced Risk For Shareholders

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The Commission has stated that "ratepayers should receive the benefit of a cost-of-capital reduction if the Commission approves a PCA for a company." Re Washington Water Power Co., WUTC Docket No. U-882363-P, First Supplemental Order at 8. The reason for this requirement is that "[a] PCA introduces rate instability for ratepayers and produces earnings stability for stockholders." Id. The Company has explicitly recognized that its proposed PCA would reduce shareholder risk; however, it has not proposed a quantifiable reduction in its cost-of-capital.

Mr. Eliassen testified that a PCA definitely would reduce the Company's risk. Tr. 1898:1-2 (Eliassen Cross). Dr. Avera agreed: "I want to be very clear with you – that all else being equal, there is more risk without a PCA than with. I think the investment community has told us that clearly and concisely." Tr. 1842:18-21 (Avera Cross). Despite this reduction in risk, Mr. Eliassen admitted that the Company has not prepared any analysis "that quantifies the risk in terms of the amount of reduction in the cost-of-capital." Tr. 1891:17-22 (Eliassen Cross).

Given the Commission's explicit requirement that a PCA proposal must contain a cost-of-capital reduction, the Company's failure to address this requirement is inexplicable. Nowhere in the Company's testimony is there an analysis of the impact of a PCA on capital costs, or a proposal to provide a cost-of-capital reduction to compensate for the reduced risk. The Company makes a half-hearted attempt to address this requirement through Dr. Avera's claim that some of the utilities in his peer group have similar mechanisms. Tr. 1842:13-14 (Avera Cross). According to this logic, the cost of equity proposed by Dr. Avera already has a

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PCA adjustment built in to it. Id. at 16-17.

Dr. Avera's claim that the PCA adjustment is built into the cost of equity is invalid for two reasons. First, the fact that some peer group utilities may have a PCA does not satisfy the Company's requirement to propose an explicit cost-of-capital adjustment. Second, and most importantly, Mr. Schoenbeck's unrebutted testimony demonstrates that most of Dr. Avera's peer group utilities do not have similar PCA mechanisms. Ex. T-718, 33:14-34:17 (Schoenbeck Direct); Ex. 720.

THE COMPANY BASED ITS EQUITY ANALYSIS ON A SELECTION OF TWELVE "COMPARABLE" COMPANIES. THESE COMPANIES WERE CHOSEN, IN PART, BECAUSE THEY ALLEGEDLY HAVE A PCA OR SIMILAR MECHANISM. TR. 1842:9-21 (AVERA CROSS). DURING THE FIRST PHASE OF HEARINGS, JUDGE SCHAER ASKED MR. DUKICH WHY THE COMPANY DID NOT SPONSOR ANY KIND OF EXPLICIT EQUITY ADJUSTMENT TO ACCOMPANY THE PROPOSED PCA. MR. DUKICH RESPONDED THAT:

> [A]ny reduction in risk or equity is already reflected in Mr. Avera's numbers. It would be double counting to decrease our ROE because we have a PCA because the comparables already have a PCA. So you would double deduct us if you did that.

Tr. 400:12-17 (Dukich Cross). Mr. Dukich's statement makes the assumption that Dr. Avera's comparable companies have PCAs similar to the one Avista proposes. This assumption is incorrect. Four of the twelve utilities have no PCA at all. Ex. T-718, 33:18-34:3 (Schoenbeck Direct). Furthermore, only three of the eight utilities that have a PCA have one that is similar to the PCA proposed by the Company. Id. Of these three, two are limited to certain jurisdictions

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within their multi-state service area, and the third is using the PCA as an interim step before performance-based procurement is approved. Id. In reality, the majority of Dr. Avera's peer group utilities do not have PCA's that are comparable to the PCA proposed by the Company. Ex. 720. Therefore, an equity analysis using the twelve companies that Dr. Avera selected does not contain an implicit cost-of-capital reduction to account for the reduced risk resulting from a PCA.

The Company bears the burden of proving that it is providing a cost-of-capital reduction to justify its PCA. It has failed to do so. Neither the Commission, Staff, Public Counsel, nor Interveners are required to disprove the Company's proposal in a rate case. WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order at 19 (Sept. 21, 1993).

The Commission should not abandon its long-standing policy that a PCA must include a cost-of-capital reduction. As the Commission has previously recognized, "[a] PCA introduces rate instability for ratepayers." Re Washington Water Power, WUTC Docket No. U-882363-P, First Supplemental Order at 8. Therefore, a PCA must recognize some value to ratepayers. WUTC v. Puget Sound Power & Light, WUTC Docket U-8141 Sixth Supplemental Order at 20. That value comes in the form of a lower rate of return. If the Commission abandons this requirement and approves the Company's proposed PCA, the result will be a one-sided shifting of the risk from shareholders to customers.

B. The Proposed PCA Is Not In The Public Interest

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Even if Avista had satisfied the Commission's three requirements for a PCA, adoption of the PCA proposed in this case is not in the public interest because it creates inappropriate incentives for the Company. Throughout the hearings in this case, the Commissioners questioned whether some other form of performance-based ratemaking would create better incentives for a utility than a PCA. Tr. 2023:13-2025:6 (Matthews Cross); Tr. 2086:13-16 (Dukich Cross); and Tr. 2121:23-2122:17 (Johnson Cross). ICNU suggests that alternative forms of regulation may be more appropriate, and that the proposed PCA is not in the public interest because it creates inappropriate incentives for the Company.

1. THE PROPOSED PCA CREATES A DISINCENTIVE FOR THE COMPANY TO SERVE CUSTOMERS ON A LEAST COST BASIS

In essence, the Company's PCA proposal is designed to transfer the risk of power market prices and price volatility to customers. Tr. 2004:14-2005:3, 2008:7-25 (Matthews Cross). Unlike previous Washington power adjustment mechanisms, such as PSE's ECAC, the proposed PCA does not provide for prudence hearings before power cost adjustments take effect. *See* WUTC v. Puget Sound Power & Light, Docket No. U-8141, Sixth Supplemental Order at 21. The problem with this approach is that the Company will be encouraged to rely on daily spot power markets to cover its power purchase needs even if other power purchase options, such as longer-term purchases, resource construction, or hedging mechanisms, would be more prudent. In other words, the Company can purchase daily spot power virtually risk-free because customers will pay for the power through the PCA. Likewise, the proposed PCA will discourage the Company from purchasing longer-term products because of the risk that the cost would be

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different from the index price reflected in the PCA. Furthermore, the PCA allows Avista to pass on to customers the increases in the index price without any demonstration that purchasing spot power at the index price is prudent. In the long run, this mechanism will not result in a least cost power supply for Avista's customers.

The Commission's test for the prudence of costs is what "a reasonable board of directors and company management [would] have decided given what they knew or reasonably should have known to be true at the time they made a decision." WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order at 20. This test applies both to the need for and to the appropriateness of an expenditure. Id. Approval of the Company's PCA proposal would avoid this assessment and free the Company of its obligation to serve loads based on prudently incurred costs. Using the Dow Jones Mid Columbia Firm Index Price simply passes the market price through to customers, without any incentive to purchase power in the least cost manner. Ex. T-540, 47:4-6 (Buckley Direct). Therefore, the Commission should reject the PCA because it is not prudent.

2. THE PROPOSED PCA DISCOURAGES THE COMPANY FROM FILING PERIODIC GENERAL RATE CASES TO ENSURE THAT ITS RATES REFLECT ITS COSTS

The Company appears to want a PCA in this case because it believes that the *pro forma* power costs numbers in its current case are wrong. The appropriate way for Avista to deal with this issue is to file a new rate case that includes more accurate costs. *See* Tr. 1900:13-18 (Eliassen Cross). A PCA is not an appropriate mechanism to correct a deficient rate filing.

According to Staff, Avista has not had a fully litigated rate case since 1986. Ex. T-540, 6:3-4 (Buckley Direct). In addition, concern was expressed throughout the hearing that the 13-year lag since Avista's last rate case was too long. *See*, *e.g.*, Tr. 2031:18-22 (Matthews Cross). Significantly, Avista waited 13 years to file a rate case without a PCA. If the Commission implements a PCA that insulates Avista from the risk of changes in power market prices, Avista will have even less of an incentive to file a rate case, and the Commission will be deprived of the periodic opportunity to evaluate whether Avista's rates are just and reasonable.

3. A PCA IS NOT CONSISTENT WITH CHANGES UNDERWAY IN THE ELECTRIC INDUSTRY

In Washington, as well as other states, regulators have implemented and then rejected PCA's because they are inefficient, difficult for customers to understand, and ultimately not in the public interest. *See*, *e.g.* WUTC v. Puget Sound Power & Light, WUTC Docket No. UE-950618, Third Supplemental Order at 7 (Sept. 21, 1995). In Docket No. UE-950618, the Commission reasoned that rate adjustment mechanisms are not well suited to an electric industry moving towards increased market competition. Id. In addition, most of the commissions regulating the twelve utilities chosen by Dr. Avera have moved away from a PCA type mechanism in favor of deregulation, marketplace incentives, or other forms of alternative regulation. Ex. T-718, 34:8-17 (Schoenbeck Direct).

The Commission also has determined that rate adjustment mechanisms are not well-suited to competitive power markets. WUTC v. Puget Sound Power & Light, WUTC Docket No. UE-950618, Third Supplemental Order at 7. In Docket No. UE-950168, the

Commission terminated a periodic rate adjustment mechanism in favor of development of a new approach in light of the changing electric industry. Id. The proposed PCA should be rejected for the same reason.

In summary, Avista's proposed PCA should be rejected because it fails the standards for PCA's established by this Commission. Furthermore, the proposed PCA will create inappropriate incentives for the Company, which is not in the public interest. While Avista and this Commission may need to take action in the future to address rising power costs, the proposed PCA is not the right solution.[3/]

II. THE PROCEEDS FROM THE ASSIGNMENT OF THE PGE CONTRACT SHOULD BE PAID TO CUSTOMERS OVER AN EIGHT-YEAR PERIOD

The Company entered into a complex set of agreements in 1998, pursuant to which it assigned its rights under a 1992 long-term capacity sale agreement with PGE ("PGE Contract") to a related entity called Spokane Energy, LLC ("Spokane Energy"), and received a lump sum payment of $145 million. Ex. T-203, 7:4-5 (Norwood Rebuttal). The Company's testimony proposes to ignore the assignment of the PGE Contract and include in its revenue

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3/ In Docket No. UE-000972, the Commission recently approved a request by the Company to create deferred accounts for the Company's power costs. A proceeding related to placing deferred power costs in rates may be a better mechanism than a PCA to address rising power costs.

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requirement the $18 million per year that it would have received under the PGE Contract if it had not been assigned. Id. at 7:1-3. Furthermore, the Company failed to notify the Commission of this transaction and did not acknowledge its existence until the initial hearing in this matter. Regardless of the Company's conduct, the most appropriate treatment of the lump sum payment is to amortize the payment as a credit to customers over eight years and to reflect the unamortized balance as a credit to rate base.

The Company's Revenue Requirement Should Accurately Reflect The Assignment Of The PGE Contract

The PGE Contract called for WWP to sell 50 megawatts (MW) of capacity to PGE from November 1992, through October 1994, and to sell 150 MW of capacity from November 1994, until the contract terminated on December 31, 2016. Ex. T-203, 8:5-19 (Norwood Rebuttal). The Agreement contained a stream of capacity rates for each year. Id. The Company received $18.72 million in 1998 under the PGE Contract, and expected *pro forma* revenues of approximately $18 million under the agreement, between June 30, 2000, and June 30, 2001. Ex. 152, columns (b) and (d).

On September 4, 1998, the Company sold all of its rights and obligations under the PGE Contract to Spokane Energy, a wholly owned affiliate of Avista, for a cash payment of $145 million. Ex. 225; Ex. T-203, 7:4-5 (Norwood Rebuttal); Re Spokane Energy, LLC, 85 FERC ¶ 61,059 at 1 (Oct. 16, 1998). Avista no longer has any relationship with PGE with respect to the PGE Contract. Tr. 1692:11-14 (Norwood Cross). In a related transaction, the Company entered into a contract to sell capacity to Enron Power Marketing, Inc. ("EPMI"), an

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affiliate of Enron Corporation. Re Washington Water Power, 85 FERC ¶ 62,131 at 2 (Nov. 25, 1998). Spokane Energy also signed a power purchase agreement with EPMI that will permit it to perform its obligations to PGE. Ex. T-718, 10:7-8 (Schoenbeck Direct).

The Company has proposed to ignore the assignment of the PGE Contract by including $18 million in its *pro forma* revenues. Ex. 152, column (d). This amount should be reduced to zero because the Company no longer has any obligation nor does it receive any revenues under the PGE Contract. Therefore, the assignment of the PGE Contract is a known and measurable change to the test year that should be reflected in the *pro forma* revenue requirement. The *pro forma* revenue calculation should also be increased to reflect income from the sale of capacity to EPMI, in an amount equal to $1.8 million for the *pro forma* period. ICNU proposes to treat the $145 million lump sum payment as follows: (1) reduce or credit the test period rate base with the lump sum payment of $145 million that the Company received from Spokane Energy plus accrued interest, adjusted for one-half years amortization amount; and (2) include an amortization credit of one-eighth of the lump sum. Ex. 741. The net revenue requirement impact of these adjustments is approximately $9.5 Million. Id.

The Commission Should Reject The Company's Proposal To Amortize The Lump Sum Payment Over 16 Years

The Company does not dispute that the lump sum payment should be paid to customers. Ex. T-203, 11:21-27 (Norwood Rebuttal). However, it proposes to amortize the $145 million over 16 years, which will result in a $16.2 million credit to the *pro forma* revenue requirement. Id. According to the Company, "the present value of $16.2 million per year for 16

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years at a discount rate of 7.83% is equal to $145 million." Ex. T-203, 11:23-24 (Norwood Rebuttal). This assertion is not true if a higher discount rate is used. Tr. 1605:17-25.

The best way to look at the PGE transaction is that an above-market capacity sale with PGE was replaced with a market-priced capacity sale to EPMI. The lump sum payment represents the equivalent of the above-market portion of the PGE Contract. In effect, it is a gain. The documents attached to Mr. Buckley's testimony indicate that the complex structure of the transaction was designed in part to avoid taxes on the gain. Ex. 545, 24 (APB-5).

ICNU's proposal to amortize the lump sum payment over eight years makes sense for two reasons. First, an eight-year payback is consistent with the Company's recommendation regarding the treatment of the Centralia gain. Ex. T-447, 2:11-20 (McKenzie Rebuttal). In addition, since the PGE Contract was not a depreciable asset, all of the gain should be paid to customers under the risk follows reward principle set out in the Centralia case. Re Avista Corp, PacifiCorp and Puget Sound Energy, WUTC Docket Nos. UE-991255, UE-991262 and UE-991409, Second Supplemental Order at 29 (Mar. 6, 2000). Second, an eight-year payback has a higher value to customers than the sixteen-year payback proposed by the Company because customers likely have both a higher cost of capital and a higher discount rate than the 7.83% rate used by Avista.

C. The Company Failed To File The PGE Contract With The Commission As Required By Washington Statutes And The Commission's Rules

Two aspects of the PGE transaction required the Company to file with the Commission. First, Avista assigned the PGE Contract to Spokane Energy, an affiliate of Avista,

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in exchange for a lump sum payment of $145 million. In addition, the Company entered into an Account and Control Agreement with Spokane Energy. Ex. 225. Contracts with affiliates must be filed with the Commission prior to the date they become effective. RCW § 80.16.020; WAC § 480-146-350. Second, Avista states that the lump sum payment is in effect a loan for tax purposes. Ex. T-203, 7:17-18 (Norwood Rebuttal). If this is true, then the Company was required to file with the Commission prior to entering into the transaction. RCW § 80.08.040. The Company did not make any filing, nor did it inform the Commission that the transaction was taking place.[4]/ Ex. 224.

1. **The Agreements Between Avista And Spokane Energy Were Affiliate Transactions That Require Filing With The Commission**

The affiliated interests statute grants the Commission authority over contracts between any public service company and its affiliate. RCW § 80.16.020. A wholly owned subsidiary is an affiliate under RCW § 80.16.020. *See* US West Communications, Inc. v. WUTC, 134 Wash. 2d 74, 88, 949 P.2d 1337, 1344 (1997). Spokane Energy is a wholly owned subsidiary of the Company. Re Spokane Energy, LLC, 85 FERC ¶ 61,059 at 1. As noted above, Avista entered into at least two agreements with Spokane Energy in 1998, pursuant to which it assigned the PGE Contract in exchange for a lump sum payment of $145 million. As a result, the Company was required to file that contract with the Commission prior to its effective date. RCW § 80.16.020 provides:

4/ Both Staff and ICNU first learned of the transaction by reading a footnote to the Company's financial statements in the 1998 10K. *See* Ex. T-540, 14:8-10 (Buckley Direct).

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> Every public service company shall file with the commission a verified copy…of a contract or arrangement providing for the…purchase, sale, lease, or exchange of any property, right, or thing, or for the furnishing of any service, property, right, or thing…hereafter made or entered into between a public service company and any affiliated interest as defined in this chapter….The filing must be made prior to the effective date of the contract or arrangement.

RCW § 80.16.020. *See also* WAC § 480-146-360.

The Company stated in a data response and at the hearing that "the Company was not required to provide documents regarding the PGE transaction to WTUC Staff and none were provided." Ex. 224; Tr. 1609:17-25. The Company also stated that the documents were publicly disclosed through a notice issued by the Federal Energy Regulatory Commission ("FERC"). Ex. 224. This argument ignores the fact that the Company had an explicit statutory obligation to file all agreements between the Company and Spokane Energy with the Commission prior to their effective date. RCW § 80.16.020. A filing with FERC does not meet this requirement. When asked at hearing whether the Company was required to file affiliate transactions with the Commission, Mr. Norwood stated that he didn't know. Tr. 1609:17-20 (Norwood Cross). It is disturbing that the Company continues to maintain that it was not required to file or notify the Commission that it was entering into a $145 million transaction with an affiliate.

The purpose of the affiliated interest statute is to allow the Commission the opportunity to reject an affiliated interest transaction that is not in the public interest. *See* US West Communications, Inc. v. WUTC, 134 Wash. 2d at 94, 949 P.2d at 1348. The Company's failure to file the agreements with Spokane Energy deprived the Commission of this opportunity.

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2. If The PGE Transaction Was A Loan, The Company Was Required To File It As An Evidence Of Indebtedness

The Company also argues that the transaction was a loan for tax purposes. Ex. T-203, 7:17-18 (Norwood Rebuttal). RCW § 80.08.040 states, "[a]ny public service company that undertakes to issue … bonds, notes, or other evidences of indebtedness shall file with the commission before such issuance." Therefore, if the transaction was a loan, RCW § 80.08.040 required the Company to file with the Commission, especially since the "loan" involved a $145 million loan from an affiliate to a utility.[5]/

In addition, WAC § 480-146-360 requires every public service company to file with the Commission by June 1, every year, an annual report of all affiliate interest transactions that occurred during the period January 1, through December 31, of the preceding year. That report must contain a description of any loans between the Company and any of its affiliates. WAC § 480-146-360(3)(c). The Company also failed to satisfy this requirement.

The record in this case demonstrates that the Company knowingly and intentionally decided not to file the transaction with this Commission. Mr. Buckley attaches several internal memoranda from the Company, which were drafted prior to completion of the transaction, that show that the Company considered and rejected the idea of filing with the Commission. Ex. 545. Tellingly, one memorandum states that under a filing scenario, the benefits of the transaction to Avista would be reduced. Id. at 26. In other words, the Company

5/ Loans for less than $1 million or with terms less than one year are exempt from the filing requirement. RCW § 80.08.043.

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chose to disregard the requirements of Washington law by not making a filing in order to enhance the benefits of the transaction to the Company's shareholders.

While Avista's failure to comply with applicable rules and statutes is not necessarily dispositive of the manner in which the PGE transaction should be treated for regulatory purposes, the Commission should certainly take the Company's behavior in to account. At the least, the Commission should discount the Company's proposed treatment of the transaction. Had the Company made a filing with respect to the transaction, Staff and other

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parties would have had an opportunity to discuss and possibly agree upon the appropriate regulatory treatment. Ex. T-540, 15:12-17 (Buckley Direct). The Commission should also take note of the magnitude of the transaction.

As noted below, the Commission should deny the Company's request for an equity kicker to reflect the Company's failure to comply with applicable requirements. In addition, the Commission should consider assessing a penalty. The Company acknowledges that if an equity bonus is allowable, then an equity penalty is also allowable when appropriate. Ex. T-46, 2:15-17 (Dukich Direct). While an equity penalty is one possible approach, the Commission should also consider disallowing recovery of any Washington regulatory fees in the current proceeding. Ex. T-718, 15:1-13 (Schoenbeck Direct). This would reduce the Company's revenue requirement by approximately $0.5 million. Id. at 7-8.

The Commission should assess a penalty for two reasons. First, the Company completely disregarded its statutory obligation to file affiliate transactions. The Company not only ignored this requirement, but also refused to acknowledge it was subject to the statute. Ex. 224. Second, the Company failed to disclose the transaction in its application in this proceeding, and at the same time requested a 25 basis point equity kicker that would increase its revenue requirement by $1.2 million to reward good management. Imposing a penalty would demonstrate to the Company that the Commission demands full and honest disclosure in all rate case proceedings.

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III. THE COMPANY SHOULD FLOW THROUGH TO CUSTOMERS THE ENTIRE GAIN FROM THE SALE OF CENTRALIA AND DISALLOW THE TRANSALTA CONTRACT

In Docket Nos. UE-991255 and UE-000080, the Commission decided that customers are entitled to a portion of the gain from the sale of Centralia. Re Avista Corp., PacifiCorp and Puget Sound Energy, WUTC Docket Nos. UE-991255, UE-991262 and UE-991409, Second Supplemental Order; Re Avista Corp., WUTC Docket No. UE-000080, Order (Mar. 22, 2000). The Washington customers' share of the Centralia gain is approximately $19.9 million. Ex. T-447, 3:6-7 (McKenzie Rebuttal). This amount should be grossed up for revenue requirement purposes, placed in a bill credit account, and amortized to customers over an eight-year period.[6]/ The amount placed in the account would be approximately $32 million. Ex. T-601, 3:18 (Martin Direct). The unamortized balance of the bill credit account should earn interest at the Company's authorized rate of return. Id. at 1:17-19.

A. The Company Should Flow Through To Ratepayers The Entire Gain From The Sale Of Centralia

The Company proposed that a portion of the Customers' share of the Centralia gain should be used to offset the costs of the 1996 Ice Storm. Ex. T-447, 3:5-8 (McKenzie Rebuttal). Staff, on the other hand, proposes that the balance in the bill credit account should be amortized in an annual amount equal to the Company's Demand Side Management ("DSM") tariff rider (Schedule 91). Ex. T-601, 1:19-21 (Martin Direct). The Commission should reject

6/ ICNU would also support a five-year amortization period, which the Commission recently approved with respect to PacifiCorp's share of the gain from the Centralia sale. WUTC v. PacifiCorp, WUTC Docket No. UE-991832, Third Supplemental Order at 13 (Aug. 9, 2000).

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these proposals and require a bill credit equal to an eight-year amortization. The proposals of both the Company and Staff will create needless complication by tying the distribution of the Centralia gain to unrelated issues such as the Ice Storm costs or DSM. Furthermore, as noted below, recovery of the Ice Storm costs is not appropriate. The amortization proposal described above is the simplest and most easily understandable manner to implement the Commission's decisions in Docket Nos. UE-991255 and UE-000080 with respect to allocation of the Centralia gain.

B. The Commission Should Require Market Purchases Of Power Until It Can Complete A Thorough Review Of The Reasonableness Of The Company's Replacement Resource Strategy For Centralia

THE COMPANY PROPOSES TO INCREASE ITS TEST YEAR REVENUE REQUIREMENT BY $4.1 MILLION TO ACCOUNT FOR ITS PURCHASE FROM TRANSALTA TO REPLACE CENTRALIA POWER. TR. 229:9-10 (NORWOOD CROSS). THE COMMISSION SHOULD REJECT THIS ADJUSTMENT UNTIL THE COMPANY SUBMITS A PLAN FOR REPLACING CENTRALIA ON A PERMANENT BASIS. ICNU AGREES WITH STAFF THAT "THE ACQUISITION OF THE TRANSALTA PURCHASE DOES NOT MEET THE COMMISSION'S PRUDENCE STANDARDS FOR RESOURCE ACQUISITIONS." EX. T-540, 37:15-16 (BUCKLEY DIRECT). ACCORDING TO MR. BUCKLEY:

> "The Company conducted no studies analyzing the actual size or shape of replacement power that might be needed to replace Centralia based on the Company's existing resource portfolio." Id. at 36:18-20.
>
> "The Company conducted no analysis of alternatives, other than looking at Mid-C prices." Id. at 36:20-21.

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Even Mr. Norwood admitted that the Company's analysis was cursory:

> Did the Company carry out any analysis to determine what the least cost or most optimal long-term replacement resource would be absent Centralia?
>
> **A. [T]HERE WAS NO FORMAL ASSESSMENT OTHER THAN ANALYSIS DONE BY OUR WHOLESALE MARKETING PEOPLE TO ASSESS THE MARKET.**
>
> **Q. DID THE COMPANY ENGAGE IN ANY KIND OF BID PROCESS TO ACQUIRE THE REPLACEMENT POWER REPRESENTED BY THE CONTRACT?**
>
> **A. NO, WE DID NOT.**

Tr. 222:13-223:6 (Norwood Cross). Mr. Schoenbeck testified that the TransAlta contract is not a good replacement resource for Centralia because it is not displaceable. Ex. T-718, 24:11-20 (Schoenbeck Direct). Mr. Schoenbeck valued this displaceability at $9.9 million. Id. at 27:1.

Mr. Buckley recommended that the Commission adopt the present rate base and power supply *pro forma* expenses for Centralia until the Company provides an acceptable plan to permanently replace the lost power on a least-cost basis. Ex. T-540, 35:14-17 (Buckley Direct). In contrast, Mr. Schoenbeck suggested that interim rates be based on the cost of market purchases using the results of the Company's power supply model filed in this case. Ex. T-718, 27:22-24 (Schoenbeck Direct). Either approach would be acceptable to ICNU. In any event, the cost of the TransAlta contract should be excluded from the Company's *pro forma* revenue requirement.

IV. THE COMPANY SHOULD INCLUDE PROFITS FROM COMMERCIAL TRADING ACTIVITY IN DEVELOPING ITS REVENUE REQUIREMENT FOR THE TEST YEAR

The Company proposes to exclude commercial trading activity from its *pro forma* expenses and revenues. Ex. T-151, 22:1-3 (Norwood Direct). However, the Company has

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traditionally optimized the operation of its resources to take advantage of favorable power sale opportunities, which benefit customers. If the Commission adopts the Company's proposal, it should impute potential profits rather than pay a portion of employee overhead. This method is appropriate because commercial trading (or resource optimization) profits are based on opportunities developed by the utility. Tr. 148:13-149:18 (Matthews Cross).

According to documents the Company provided, it made a profit of $6.9 million on a system basis during the test year from commercial trading activity. Ex. T-718, 20:23-24 (Schoenbeck Direct). ICNU recommends that the Washington share of these profits, or $4.2 million, be deducted from the proposed revenue requirement.[7/] Id. at 21:9-12. While the Company has stated that it has ceased all trading activity, presumably high market prices will create sales opportunities for the Company. Therefore, the Commercial trading adjustment still is appropriate.

V. THE COMMISSION SHOULD REJECT THE COMPANY'S PROPOSAL TO INCLUDE EXTRAORDINARY COSTS IN THE *PRO FORMA* REVENUE REQUIREMMENT BECAUSE THESE COSTS ARE NOT LIKELY TO OCCUR AGAIN IN THE FORESEEABLE FUTURE

It is a generally accepted principle that test-year costs are expected to be representative of those that will be incurred when the rates take effect. *See* Nat'l Assoc. of Regulatory Util. Comm'rs, Electric Utility Cost Allocation Manual Chapter 3: Developing Total Revenue Requirements (1992). This principle requires normalization of test year costs to

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7/ Mr. Buckley recommends that a higher adjustment of $5.5 million be imputed for commercial trading. Ex. T-540, 37:25-29 (Buckley Direct).

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exclude any extraordinary events and other nonrecurring costs. 1 Leonard Saul Goodman, The Process of Ratemaking 287 (1998). The Commission has previously removed costs it considered non-recurring and one-time expenses that a company is not likely to experience again during the term of the proposed rates. WUTC v. Cascade Natural Gas, WUTC Docket No. U-7420, Fourth Supplemental Order (Mar. 6, 1975); WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order. In Docket No. U-7420, the Commission disallowed the initial cost of a gas company's listing of its stock on the New York Stock Exchange. While the continuing annual fee was allowed, one-time costs were removed from the revenue requirement. WUTC v. Cascade Natural Gas, WUTC Docket No. U-7420, Fourth Supplemental Order at 20. Likewise, in WUTC Docket Nos. UE-920433 *et al.*, the Commission removed the costs associated with litigation over service to a customer during the test year. The Commission determined that this type of litigation was not common, and did not expect similar litigation in the future. WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order at 148. Similarly, the Commission has rejected the inclusion of individual settlement payments. WUTC v. Washington Natural Gas, WUTC Docket Nos. U-8222 and U-8237, Third Supplemental Order (Dec. 29, 1982). In WUTC Docket Nos. U-8222 and U-8237, the Commission removed the expense of a solar home settlement payment from rates because they were non-recurring. Id.

The Company's proposal includes several costs that are either not likely to, or will not, occur again during the time the proposed rates will be in effect. ICNU believes four costs

should be excluded from *pro forma* revenue requirements: (1) costs associated with changing the company name from Washington Water Power to Avista; (2) litigation costs from the 1991 Fire Storm; (3) costs associated with the 1996 Ice Storm; and (4) costs associated with the Company's Y2K preparedness. With the exception of the Y2K costs, these costs fall outside the 1998 Test Year. One time expenses that occur between rate cases and test years should not be included in revenue requirement on a going forward basis.

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<u>Expenses Associated With The Name Change Will Not Reoccur During The Time Rates Will Be In Effect And Thus Must Be Excluded From The *Pro Forma* Revenue Requirement</u>

The expenses associated with the name change from Washington Water Power to Avista will not reoccur during the time the proposed rates will be in effect. Therefore, test costs should be excluded from the *pro forma* revenue requirement. The current situation is similar to the Commission decision noted above where the Commission disallowed the utility's cost of an initial stock listing on the New York Stock Exchange. <u>WUTC v. Cascade Natural Gas Corp.</u>, WUTC Docket No. U-7420, Fourth Supplemental Order. Like the costs associated with listing on the stock exchange, the cost of changing the Company's name is essentially a one-time expense.

The name change costs also should be excluded because the name change provides no benefit to customers. Ex. T-718, 36:7-8 (Schoenbeck Direct). The Company argues that name changes have become relatively common in the utility industry and the benefit of the name change is ongoing, which justifies the inclusion of these costs in rates. Ex. 267. This argument is unpersuasive. The Company also claims the new name benefits customers because it is "not specific as to resource or geography…and favorably received in…new markets." Ex. T-226, 27:13-15 (Falkner Direct). "These arguments lack any relevance to maintaining a…quality utility system in eastern Washington." Ex. T-595 at 15:4-6 (Schooley Direct). Removal of the name change costs would reduce the *pro forma* revenue requirement by $200,000.

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B. **The 1991 Fire Storm Costs Should Be Excluded From The *Pro Forma* Revenue Requirements Because These Costs Were Due To Extraordinary Events That Are Not Likely To Occur Again During The Term Of The Proposed Rates**

Commission policy states that the costs of extraordinary events that take place during a test year must be removed along with any other non-recurring costs. *See* WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order; WUTC v. Washington Natural Gas Co., WUTC Docket Nos. U-8222 and U-8237, Third Supplemental Order. In the current case, the Company proposes to include in its *pro forma* revenue requirement the costs of an event that it openly acknowledges was extraordinary. Tr. 509:8-11 (Falkner Cross); Ex. 266 at 7. Furthermore, the extraordinary event occurred seven years before the test year. The Commission should exclude the costs associated with the 1991 Fire Storm litigation from the Company's revenue requirements because of the extraordinary nature of the expense.

The Company asks this Commission to include the costs of litigation related to the 1991 Fire Storm in base rates because the litigation was unique and highly complex. Ex. T-268, 7:11 (Falkner Rebuttal). The Company admits, however, that the legal costs "do not represent anything close to normal levels of year to year legal expenditures." Id. at 7:14-15. Nevertheless, the Company requests that these costs be included in rates until its next rate case. Tr. 511:18-21 (Falkner Cross). If the Company does not file another rate case prior to the end of the amortization period, then these costs will continue in the base rates and the Company will, in effect, over-recover its costs. Id.

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The Commission has previously denied this type of over-recovery. *See*, *e.g.* WUTC v. Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order; WUTC v. Washington Natural Gas, WUTC Docket Nos. U-8222 and U-8237, Third Supplemental Order. In WUTC Docket Nos. UE-920433 *et al.*, the Commission removed the costs associated with litigation between a customer and Puget over continuing service because the litigation was not common and could not be expected to occur again. Re Puget Sound Power & Light, WUTC Docket Nos. UE-920433, UE-920499 and UE-921262, Eleventh Supplemental Order at 148. Similarly, the Commission has removed settlement payments from rates because of the non-recurring nature of the litigation. *See* WUTC v. Washington Natural Gas, WUTC Docket Nos. U-8222 and U-8237, Third Supplemental Order.

The Fire Storm legal expenses cannot be considered normal and should not become part of the test year revenue requirement. Any other recovery of specific legal fees is unnecessary and duplicative. Ex. T-595, 4:15-18 (Schooley Direct). Removal of the cost of the Fire Storm litigation costs would reduce the *pro forma* revenue requirement by $600,000. However, if the Commission is inclined to allow recovery of these costs, a more appropriate approach is to use a balancing account to avoid over-recovery.

C. The Commission Should Deny Recovery Of The 1996 Ice Storm Expenses Because They Were Due To Extraordinary Events That Occurred Outside The Test Year

The Company sought in its original filing to recover $2.1 million in costs

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associated with the 1996 Ice Storm, an event that the Company acknowledges was the only one of its kind in the last 115 years. Tr. 510:21-511:5 (Falkner Cross). The Company made this request despite the statement of its CEO at the time that their "customers will see no change in electric prices as a result of the storm damage costs." Ex. 234. The Idaho Public Utility Commission rejected this same request because the event caused an extraordinary non-recurring expense that cannot be allowed, categorizing the ice storm as the only event of its kind in 115 years. In re Washington Water Power, IPUC Case No. WWP-E-98-11, Order No. 28097 (July 29, 1999). As in the Idaho case, the Company has shown no evidence that the event is likely to occur in the future. Tr. 511:14-17 (Falkner Cross). While the Company has removed this request as part of its proposal to use the Centralia gain to recoup the Ice Storm costs, any recovery of these costs should be denied because they are non-recurring. Customers should not lose a portion of their Centralia gain to pay for an expense that was incurred by the Company four years ago.

D. Y2K Costs Should Be Removed From The *Pro Forma* Revenue Requirement Because They Are Not Likely To Reoccur In The Future

The Company's Y2K costs are also non-recurring costs that must be excluded from the test-year. These expenses should be removed from operating expenses according to the Commission policy discussed above. Removal of this expense would reduce the Company's revenue requirement by $200,000. Ex. T-718, 3:6 (Schoenbeck Direct).

The Company proposes to amortize Y2K costs in an amount equal to $1.6 million system-wide over five years. Ex. T-226, 25:12-16 (Falkner Direct). According to Mr. Falkner,

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the Y2K expenses create value by assuring the system will continue to perform properly. Id. at 26:12-13. However, as Mr. Schooley points out, it is the Company's responsibility to maintain the system. Ex. T-595, 15:14-15 (Schooley Direct). The Company has the option to ask the Commission for recovery of the expenses over a certain period, but these costs will obviously not occur again in the anticipated life of the proposed rates. Therefore, $200,000 in Y2K expenses should be removed form the *pro forma* revenue requirement.

VI. THE COMMISSION SHOULD REJECT THE PROPOSED EQUITY KICKER

THE COMPANY HAS ASKED FOR A 25-BASIS POINTS INCREASE IN ITS AUTHORIZED RETURN ON COMMON EQUITY TO RECOGNIZE THAT IT IS A "WELL MANAGED" RATHER THAN "AN ADEQUATELY MANAGED UTILITY." EX. T-46, 2:16-17 (DUKICH DIRECT). THE COMPANY'S REQUEST IS BAFFLING FOR TWO REASONS. FIRST, THE COMPANY IS PROPOSING TO IMPLEMENT A PCA THAT WILL SIGNIFICANTLY REDUCE SHAREHOLDER RISK AT THE SAME TIME IT IS REQUESTING THAT THE COMMISSION AWARD A RATE OF RETURN ON EQUITY THAT IS IN EXCESS OF A REASONABLE RATE. INVESTORS WILL BE FULLY COMPENSATED FOR GOOD MANAGEMENT AT THE AUTHORIZED RATE OF RETURN. SECOND, THE RECORD DEMONSTRATES THAT THE COMPANY KNOWINGLY AND INTENTIONALLY DECIDED NOT TO MAKE ANY REGULATORY FILING WITH THE COMMISSION RELATED TO ASSIGNMENT OF THE PGE CONTRACT, EX. 544, 24, EVEN THOUGH SUCH FILINGS WERE REQUIRED BY LAW. RCW § 80.08.020.

THE COMMISSION SHOULD REJECT THE REQUEST FOR AN EQUITY KICKER AND

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CONSIDER IMPOSING A PENALTY ON THE COMPANY FOR ITS CONDUCT, SUCH AS DENYING THE RECOVERY OF WASHINGTON REGULATORY FEES. EX. T-718, 14:7-15:13 (SCHOENBECK DIRECT). THE COMPANY CLAIMS THAT IT HAD NO OBLIGATION TO FILE THE PGE TRANSACTION WITH THE COMMISSION (EX. 224), AND THAT THE COMMISSION WAS ON NOTICE OF THE TRANSACTION AS A RESULT OF A ONE-PAGE FERC NOTICE (EX. 204) ARE BOTH INSULTS TO THE REGULATORY AUTHORITY OF THIS COMMISSION. THE COMPANY'S FAILURE TO FOLLOW REGULATORY REQUIREMENTS IS NOT NEW. IN IDAHO, THE COMPANY ALSO SOUGHT A 25 BASIS-POINT EQUITY KICKER, WHICH THE IDAHO PUBLIC UTILITY COMMISSION ("IPUC") DENIED BECAUSE THE COMPANY FAILED TO FOLLOW EXPRESS COMMISSION DIRECTIVES AND RULES. <u>IN RE WASHINGTON WATER POWER</u>, IPUC CASE NO. WWP-E-98-11, ORDER NO. 28097. THE IPUC'S COMMENTS ARE INSTRUCTIVE:

> **[A]S REGULATORS WE CANNOT IGNORE THE INSTANCES CITED IN THIS ORDER WHERE THE COMPANY HAS…IGNORED EXPRESS COMMISSION DIRECTIVES AND/OR RULES.…IT IS SUGGESTED THAT A MINIMUM STANDARD OF MANAGEMENT COMPETENCY IS COMPLIANCE WITH COMPANY TARIFFS AND COMMISSION ORDERS AND RULES. WE ENCOURAGE THE COMPANY TO PAY GREATER ATTENTION TO THE DETAILS OF REGULATORY COMPLIANCE. THE COMPANY SHOULD CONSIDER SUCH COMPLIANCE AS A THRESHOLD QUALIFICATION FOR ANY [EQUITY BONUS]. IN THIS CASE WE DECLINE TO INCLUDE AN EQUITY [BONUS].**

<u>Id.</u> at 23-24. Likewise, this Commission should encourage greater regulatory compliance in Washington by denying the equity kicker and the recovery of Washington regulatory fees.

<u>CONCLUSION</u>

For the reasons provided above, ICNU respectfully requests that the Commission

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take the following action:

1. Deny the Company's proposed PCA;

2. Flow through the gain from the assignment of the PGE Contract to ratepayers in the form of a rate credit over eight years;

3. Flow through the entire gain from the sale of the Centralia power plant to ratepayers in the form of a rate credit over eight years;

4. Include profits from commercial trading activity in the *pro forma* revenue requirement; and

5. Remove extraordinary, non-recurring expenses from the Company's normalized costs for the test-year.

ICNU also requests that the Commission deny the Company's proposed equity kicker, and instead consider a penalty, such as the removal of Washington regulatory fees from the Company's revenue requirement, as penalty for the Company's blatant failure to comply with its statutory obligations. Incorporating all of these adjustments would decrease the Company's total revenue requirement by approximately $2.6 million.

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Respectfully submitted,

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