BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMSSION, Complainant, v. AVISTA CORPORATION d/b/a AVISTA UTILITIES, Respondent.	DOCKET NO. UE-080416 and DOCKET NO. UG-080417 (consolidated)

BRIEF OF PUBLIC COUNSEL

NOVEMBER 24, 2008

NON-CONFIDENTIAL VERSION

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I. INTRODUCTION

1. Public Counsel files this brief in support of its recommendation that the Commission reject the Multiparty Settlement Stipulation (Stipulation) presented in this case. The Stipulation is fatally flawed in several key respects:

- It improperly imposes on ratepayers responsibility for expenses for advertising, charitable donations, dues and membership fees, sponsorships, executive base salaries, director's compensation, and directors' and officers' liability insurance. These adjustments are not addressed by the settlement.
- The provision for recovery of charges from the Confidential Litigation is unlawful under the rule against retroactive ratemaking and for other reasons.
- The inclusion of large additional sums for new power costs filed in supplemental testimony, but not in tariff, circumvents the sharing of power costs required by the Energy Recovery Mechanism and evades the statutory framework for ratemaking.
- The Stipulation permits Avista to charge ratepayers for expenses that it does not incur --- for taxes and for cost of removal of plant included in depreciation.
- The Stipulation harms ratepayers by seeking an early effective date for implementation of new rates without justification.

For these reasons, the Stipulation is not in the public interest. The revenue level established will not yield fair, just, and reasonable rates for Avista's customers. Public Counsel and Industrial Customers of Northwest Utilities (ICNU) recommend that their alternative recommendations be

adopted in order to establish rates at a reasonable level, or in the alternative, that the Stipulation be rejected in its entirety.[1]

II. APPLICABLE LEGAL STANDARDS

A. The Commission Has Established A Clear Framework For Setting Rates That Is Applicable In This Case.

2. As the Commission stated in an earlier contested gas and electric rate case involving Avista, the "ultimate determination" which must be made by the Commission in a rate proceeding is "whether the rates and charges proposed in the revised tariffs are fair, just, reasonable and sufficient, pursuant to RCW 80.28.020."[2] The Commission elaborated:

> These questions are resolved by determining the Washington intrastate adjusted results of operations during the test year, establishing the fair value of the Company's property-in-service for intrastate service in the state of Washington (rate base), determining the proper rate of return permitted the Company on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return.[3]

The Commission went on to explain in more detail the analysis required in the setting of fair rates:

> In order to accomplish these tasks, the parties in a rate proceeding develop evidence from which the Commission may determine the following:
>
> 1) The appropriate *test period* ....The test period is used for investigation of the Company's operations for purposes of the proceeding;
>
> 2) The Company's *results of operations* for the appropriate period, adjusting for unusual events during the test period, and for known and measurable events;
>
> 3) The appropriate *rate base*, which is derived from the balance sheets of the test period. The rate base represents the net book value of assets provided by investor's funds which are used and useful in providing utility service to the public;

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[1] Public Counsel and ICNU are filing separate briefs in order to divide up the issues for briefing.
[2] *WUTC v. Avista Corporation*, Docket Nos. UE-991606, UG-991607, Third Supplemental Order (September 2000), ,¶ 14.
[3] *Id.*, ¶ 14.

4) The appropriate *rate of return* the Company is authorized to earn on the rate base established by the Commission;

5) Any existing *revenue excess or deficiency*; and

6) The *allocation* of the rate increase or decrease, if any, fairly and equitably among the Company's rate payers. [4]

Any rates approved in this case, whether as a result of the Stipulation, or based on other recommendations, must meet this standard. In addition, the Commission must regulate in the public interest.[5] Both contested rate determinations and settlement approvals are based upon a determination that the result is in the public interest. [6]

B. These Ratemaking Rules are Applicable in The Context of a Settlement Review.

3. The Commission settlement rules define a "multiparty settlement" as "[a]n agreement of some, but not all, parties on one or more issues [that is] offered as their position in the proceeding, along with the evidence that supports it."[7] A "full settlement" is separately defined as "an agreement of all parties that would resolve all issues in the proceeding."[8] Opponents of a settlement have specified procedural rights, including "the right to present evidence or, in the commission's discretion, an offer of proof, in support of the opposing party's preferred result."[9]

4. WAC 480-07-750 provides that the Commission has discretion to accept the settlement, reject it, or impose conditions. Under WAC 480-07-750(1), in order to approve the settlement in this case the Commission must conclude that doing so is lawful, that the settlement terms are supported by an appropriate record, and that the result is consistent with the public interest in

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[4] *Id.*, ¶¶ 15-21 (Emphasis added).
[5] RCW 80.01.040(3).
[6] *Id.*, ¶ 449 (contested rates); *WUTC v. Avista Corporation,* Docket No. UE-011595, Fifth Supplemental Order (June 18, 2002)(2001 electric rate case all-party settlement approval).
[7] WAC 480-07-730(3). Public Counsel interprets the rule as allowing the Commission broad discretion to consider and adopt all alternative recommendations presented, not only the non-unanimous settlement.
[8] WAC 480-07-730(1).
[9] WAC 480-07-740(2)(c).

light of all the information available to the Commission. In addition, in order to set rates, either by approving the settlement, or approving it with conditions, the Commission must make the findings described in the previous section on the basis of evidence in the record.

5. The burden of proof is on Avista to establish that the proposed rates which would result from the settlement are fair, just, reasonable, and sufficient.[10] By virtue of the settlement, that burden also falls upon the joint settling parties who "must present sufficient evidence to support its adoption under the standards that apply to its acceptance."[11]

6. Within the parameters of WAC 480-07-750, the evidence presented by ICNU and Public Counsel, along with other record evidence, is more than adequate to (a) provide a basis for adopting additional conditions to the settlement; or (b) alternatively, establish a *prima facie* case that the Stipulation should be rejected and that the case should be set for further proceedings.

III. PUBLIC COMMENT

A. The Pullman Public Hearing – September 18, 2008.

7. A public hearing was held in Pullman on September 18, 2008. Three people attended the hearing and one witness addressed the Commission. John Raymond Yates from Pullman testified on his own behalf:

> I want speak out against this proposed rate increase. We just had a 9 percent [increase] last year, is that not true? And I look at the justification is for improvements to the infrastructure, that's what's been published. And I'm concerned with the way we, the State of Washington, we do our business.[12]

[10] RCW 80.04.230(2).
[11] WAC 480-07-740(2)(b).
[12] TR. 47:1-7.

B. The Spokane Public Hearing – September 18, 2008.

8. A public hearing was held in Spokane on September 18, 2008. Twenty-four people attended the hearing and ten witnesses addressed the Commission. The majority of those who testified opposed to the rate increase.

9. Margaret Herzog from Spokane testified:

> Accountability is a factor that needs to be demanded of Avista. Avista got an increase in January, and it's asking for another increase now. I think they need to have someone who looks in to see that these requested increases are actually used as requested. And when those requests are met, can the billing be reduced. I don't ever remember a bill going down. Therefore I ask the company to treat its budget as every hard-working family in a stress economy has to do. I ask Avista to be accountable for the wise use of its customers' money. And, obviously, I'm asking that the increase in gas and electric rates be denied[.][13]

10. Maria Hernandez-Peck from Spokane testified on the behalf of the Planning and Management Council of Aging and Long-term Care of Eastern Washington:

> Council members are very concerned about the adverse impact that electrical and natural gas rate increases will have on home heating, cooling and lighting costs for low income residents of Spokane County. It is reported that we are the poorest of the five most populated counties in Washington State. We know that increase stipulated in the proposed settlement average, an average of 9.2 percent for electricity, and 2.4% for natural gas, will have an adverse effect on frail, vulnerable seniors, and others who live on fixed incomes. [14]

11. Karen Cosgrove of Spokane testified on her own behalf and on the behalf of her neighbors:

> I find this situation of you, Avista Company, asking several times a year for large price hikes is unforgivable. Especially when so many Americans

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[13] TR. 72:14-73:1.

[14] TR. 80:25-81:10.

are strapped and in terrible financial situations, whether it be from poverty, low incomes, fixed incomes, or the stock market and bank failures that are occurring today. Or just Mother Nature's destructiveness. These huge price hikes are putting all of us in a tremendous jeopardy situation...[T]hese hikes in general everyday basic necessities and living expenses are literally, dramatically lowering the quality of life, at least in my area they are. [15]

C. Written Public Comments.

12. Exhibit No. 6 consists of letters, e-mails, and other written materials submitted by the public to the Commission and Public Counsel to provide comment on this case. The exhibit includes a total of 1,849 public comments, with 1,811 opposing the requested rate increase, 21 supporting and 17 not taking a position.

13. Ann Jorgensen wrote:

> Why are the top executives at Avista getting such outrageous salaries? Seems they could trim costs a bit there. Those executives must hold a good deal of stock and the higher rate of return would be an increase for them as well. I am retired and try to spend my time and resources giving back to the community. Higher utility rates mean fewer resources for me to share with the community. Please look carefully at their request. For lower income families another rate increase is a real hardship. [16]

14. Anna Schluneger of Colfax wrote:

> In yesterday's Spokesman Review, Avista announced that they had DOUBLED their profits from last year and were happy to report that to stockholders! I am thrilled that my mom is a stockholder due to the fact my dad retired from the company before he passed away and left her some stock. However, she is on a fixed income and the continuing increases in rates when the company is doubling their profits are a disgrace! The economy is terrible right now and it is going to be a strain on fixed income/lower income families to even turn on the heat! Even the working class hates to open that utility bill! I am appalled that our regulatory commission continues to approve these rate hikes! Our country's economy

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[15] TR. 93:9-17, 94:8:11.

[16] Exhibit No. 6, p.19, Avista Comments database (e-mail received at WUTC September 17, 2008).

> and finance sector collapsed due to faulty regulatory oversights. . . please don't let the utility sections go that way too![17]

15. The comments from witnesses at the hearings, and the large number of written comments in this case, reflect the real and serious impact of the continual rate increases which Avista customers have been facing, and which they face again here. Customers are right to question the justification for Avista's request, when, as Ms. Schluneger noted, the Company reported in September dramatic increases in net income, double the level for the same period just one year ago.[18] Avista's request for added revenue in this case deserves the closest scrutiny. Avista must be held to its burden of proof to establish that it is entitled on the facts and the law to every dollar of increase it seeks in this case.

IV. REVENUE REQUIREMENT ISSUES – GENERAL

A. The Stipulation Fails To Adjust The Revenue Requirement For Administrative and General Expenses That Are Improperly Charged To Ratepayers.

16. Public Counsel and ICNU recommended numerous adjustments for administrative and general (A&G) expenses in the direct testimony of Michael J. Majoros, Jr.[19] The Stipulating Parties included a few, but not all, of these adjustments in the Stipulation.[20] The Stipulating Parties also made other adjustments, which, while not among those in his original recommendation, were accepted by Mr. Majoros in his response testimony.[21] Specifically, the Stipulating Parties removed the pro-formed 2009 wage increase for union and non-executive employees ($1.508 million).[22] Thus, there remain seven adjustments, not included or accounted

[17] Exh. No. 6, p. 19, Avista Comments database (e-mail November 12, 2008).
[18] TR. 195:11-24 (Norwood).
[19] Exh. No. MJM-1CT, pp. 18-40 (Majoros)(Revised 11/7/08).
[20] *See* Multiparty Settlement Stipulation, pp. 8-9 (items (e), (f), and (i)).
[21] Exh. No. MJM-8T, pp. 1:19-2:17 (Majoros Response).
[22] *See* Stipulation, p. 8 (item (g)).

for in the Stipulation, which Public Counsel and ICNU recommend should be made to Avista's requested revenue requirement.

17. As the evidence demonstrates, the administrative and general expenses covered by these adjustments are not necessary to the provision of safe and reliable electric and natural gas service and inclusion of such expenses would result in rates that are not just, fair, reasonable, and sufficient as required by RCW 80.28.020. Contrary to the position taken by Avista witness, Ms. Elizabeth M. Andrews, the Company's adjustment for union and non-executive wages does not make inclusion of such expenses proper and the Pubic Counsel/ICNU adjustments should be made in addition to the pro-formed 2009 wage adjustment.[23]

1. Advertising.

18. Public Counsel and ICNU recommend that certain advertising expenses ($29,173 for electric and $31,432 for gas) be disallowed.[24] These expenses relate to marketing and advertising campaigns designed to enhance Avista's corporate image and promote the use of Avista's natural gas service and are thus unrecoverable under WAC 480-90-223 and 480-100-223.[25] The Stipulation does not include any adjustments for advertising or marketing expenses.[26]

19. Ms. Andrews testified regarding two specific examples of the types of advertisements for which Public Counsel and ICNU recommend disallowance—a natural gas advertisement and a

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[23] TR. 222:22-223:14 (Andrews). Ms. Andrews also stated that Commission Staff did not recommend any adjustments in any of the areas recommended by Public Counsel and ICNU although they had reviewed the company's case over a period of months. TR. 234:8-25.

[24] Exh. No. MJM-1CT, pp. 34:1-35:13 (Majoros)(Revised 11/7/08).

[25] WAC 480-90-223 provides in part: "The commission will not allow expenses for . . . advertising to encourage any person or business to select or use the service or additional services of a gas utility, to select or install any appliance or equipment designed to use the gas utility's service, or to influence consumers' opinions of the gas utility." WAC 480-100-223 establishes a similar prohibition for electric utilities. Both rules list specific, allowed types of customer communications relating to rates and service, safety, and conservation. *See also*, *WUTC v. Washington Natural Gas Company*, Docket No. UG-920840, Fourth Suppl. Order, pp.12-13 (disallowing the cost of advertising that encourages customers to switch to natural gas and/or to install gas appliances).

[26] TR 225:25-226:2 (Andrews).

legacy website.[27] As to the natural gas advertisement, Ms. Andrews admitted that "those particular ads were for promoting natural gas" and intended to encourage people to install natural gas appliances and select Avista's natural gas service.[28] Accordingly, the natural gas advertisement falls within the category of advertisements for which recovery is prohibited under WAC 480-90-223.[29] As to the legacy website, Ms. Andrews confirmed that the purpose of the website is to "hopefully continue the reputation that [Avista] ha[s]."[30] Thus, the website, too, falls under the Commission's prohibition on recovery for costs of advertisements designed to "influence consumers' opinions of the . . . utility."[31]

2. Charitable donations.

20. Public Counsel and ICNU recommend that Avista's revenue requirement be reduced by $23,953 ($15,670 electric and $8,283 gas) for charitable donations.[32] The donations that Avista recorded as a utility expense include contributions to organizations and activities such as: The Spokane Youth Sports Association, 4-H animal sales, benefit golf tournaments, and a high school year book fund.[33] The Stipulation does not include a disallowance for charitable contributions.[34]

21. In Washington, charitable contributions cannot be recovered through rates. In *Jewell v. Washington Utilities and Transportation Commission*,[35] the Washington Supreme Court held that the Commission lacks statutory authority to allow a regulated utility to recover its charitable

[27] *See* Exh. No. EMA-9, pp. 2 and 12-14.
[28] TR. 230:2-15 (Andrews).
[29] TR. 230:10-15 (Andrews).
[30] TR. 228:18-21 (Andrews).
[31] WAC 480-90-223(1) and 480-100-223(1).
[32] Exh. No. MJM-1CT, pp. 36:19-37:11 (Majoros). *See also* Exh. No. EMA-25 and Exh. No. EMA-26 (showing charitable contribution expense amounts allocated to Washington).
[33] TR. 232:25-233:6 (Andrews). *See also* Exh. No. EMA-25, pp. 2-3 (Attachment A).
[34] TR. 233:9-12 (Andrews).
[35] 90 Wn.2d 775, 777-779 (1978).

contributions as an expense for purposes of ratemaking. Ms. Andrews confirmed that such contributions are not necessary to Avista's provision of safe and reliable electric and natural gas service.[36] Moreover, Ms. Andrews stated that, had she been aware of these costs during the test period, she may have removed them, and that she did not later exclude them because she did not "go down every line item or transaction that [Public Counsel] excluded to see whether it was appropriate or not."[37] Thus, regardless of what other adjustments the Stipulating Parties have agreed to, charitable contributions should be removed from Avista's Washington revenue requirement.

3. Dues and membership fees.

22. Public Counsel and ICNU recommend removing certain dues and membership fees from Avista's revenue requirement ($159,214 electric and $39,217 gas).[38] These amounts include dues related to charitable and civic organizations including: rotary clubs, athletic clubs, and various chambers of commerce.[39] The Commission has previously determined that such dues and membership fees should not be recovered through rates, stating: "[t]he costs of memberships in social, fraternal, and civic-spirited organizations are properly to be assigned to the company's shareholders."[40] Additionally, Ms. Andrews indicated that such costs are not necessary to Avista's provision of safe and reliable electric or natural gas service, and that she had not confirmed that they should have been charged to the utility in the first place.[41]

[36] TR. 233:18-24 (Andrews).
[37] TR. 233:21-234:7 (Andrews).
[38] Exh. No. MJM-1CT, p. 36:6-18 (Majoros) (Revised 11/7/08).
[39] Exh. No. EMA-20, pp. 2-6 (Attachment A). *See also* TR. 237:6-8 (Andrews).
[40] *WUTC v. Cascade Natural Gas Corporation,* Cause No. U-78-76, Second Suppl. Order, p. 10.
[41] TR. 237:9-238:4 (Andrews) (also stating that the purpose of such expense were "to promote economic growth" and "provide dollars for healthy communities").

23. The Stipulation does not include a disallowance for dues and membership fees. Regardless of what other adjustments the Stipulating Parties have agreed to and included in the settlement proposal, dues and membership fees should not be included as an expense for ratemaking purposes.

4. Sporting events and sponsorship attributable to natural gas service.

24. Public Counsel and ICNU recommend a disallowance ($68,131) from Avista's natural gas revenue requirement for amounts related to sporting and other entertainment events. Such expenses were removed from Avista's electric revenue requirement in the Stipulation.[42] The Stipulation confirmed that removing these expenses was proper because they were "non-utility expenses that should have been excluded from utility results . . . in [Avista's] original filing."[43] Removing these costs is also in line with Commission precedent; the Commission has previously specifically disallowed the cost of sporting tickets from rates.[44]

25. Despite this, the Stipulation does *not* include a corresponding reduction for gas revenues. The Company has indicated that not removing these expenses from the gas side was an error. In Avista Response to Public Counsel Data Request No.114, the Company stated that such expenses still need to be removed from the natural gas revenue requirement.[45] Additionally, at hearing Ms. Andrews stated, "I'll admit that they were inadvertently missed on the gas side when we did the settlement."[46] Accordingly, amounts attributable to sporting and other entertainment events should be removed from gas revenues because they are non-utility expenses that should be paid by shareholders, not ratepayers.

[42] TR 231:9-232:6 (Andrews).
[43] *Id.*
[44] *See WUTC v. Washington Natural Gas Company,* Docket No. UG-920840, Fourth Suppl. Order, p. 12.
[45] Exh. No. EMA-24.
[46] TR. 232:4-6 (Andrews).

5. Executive base salaries.

26. Public Counsel and ICNU make two recommendations regarding executive base salaries: (1) recalculate (i.e. reduce) the 2009 pro forma executive pay using actual amounts for 2008 and increasing the 2008 amounts by 3.75 percent to arrive at 2009 amounts;[47] and, (2) allocate 25 percent of executive pay for eight out of twelve executives to non-utility operations.[48] In her Rebuttal Testimony, Ms. Andrews appears to almost entirely accept the first of these recommendations by replacing estimates of 2008 base pay for the actual amounts, and by calculating 2009 pay increases at 4 percent rather than Avista's originally requested 5 percent.[49] The Stipulation includes a smaller amount for 2009 pro forma executive pay.[50] However, the Stipulation does *not* reallocate any portion of executive pay to non-utility expenses. This leaves a difference between the Stipulation and the Public Counsel/ ICNU recommendation of $248,826 for the electric revenue requirement and $64,642 for the gas revenue requirement.

27. Avista's executives spend a portion of their time performing subsidiary- and shareholder-related functions.[51] Thus, the Company allocates executive base salaries between utility and non-utility operations.[52] In its 2007 rate case filing, Avista allocated 25 percent of many executive base salaries to non-utility operations.[53] In the current case, Avista reduced the amount allocated for these executives to 10 percent.[54]

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[47] Exh. No. MJM-1CT, p. 31:1-4 (Majoros) (Revised 11/7/08).
[48] *Id.*, p. 29:4-8.
[49] *See* Rebuttal Testimony of Elizabeth M. Andrews, Exh. No. EMA-7T, pp. 16:1-17:11.
[50] *See* Stipulation, p. 8 (item (f)) (including a smaller amount for 2009 pro forma executive pay, but not tying the reduction recalculations proposed by Mr. Majoros and discussed by Ms. Andrews).
[51] TR. 238:7-13 (Andrews).
[52] *See* Exh. No. EMA-17.
[53] *See* Exh. No. MJM-1CT, p. 27:4-5 (Table 2) (Majoros) (Revised 11/7/08).
[54] *Id.*

28. Avista relies on estimated "individual allocations proposed by each officer" to divide executive salaries between utility and non-utility operations.[55] Executives do not use any set of factors or consistent method for allocating time spent.[56] The Company relies entirely on such estimates and does not track how executive time is actually spent. [57] Moreover, the Company does not check or review each executive's estimates.[58]

29. In its filing, the Company does not provide any greater explanation of how the assignment is determined.[59] Moreover, the Company provides scant explanation for the change in allocation between 2007 and the current case, stating only that it is attributable to the mid-2007 sale of Avista Energy.[60] Furthermore, neither in its initial filing nor through discovery did Avista provide any studies or workpapers accounting for executive time spent on utility versus non-utility activities.

30. In the Company's 1999 general rate case, the Commission rejected Avista's proposal to allocate executive salaries based on the "informed judgment of each officer."[61] In its Order, the Commission noted that there was "no documentation or actual data to support the officers' allocation decisions, and no work papers or study to account for time spent on specific activities or subsidiaries."[62] It went on to say:

> [a]llocators are most appropriately used for ratemaking purposes when a reliable direct assignment of costs cannot be made. Avista has provided a direct assignment, albeit without much evidence of how that assignment was done. Our decision rests on how much weight to give to the Company's allocation judgment.

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[55] Rebuttal Testimony of Elizabeth M. Andrews, Exh. No. EMA-4T, p. 17:17. *See also* Exh. No. EMA-17.
[56] TR. 239:9-16.
[57] TR. 238:18-239:16 (Andrews). *See also*, TR 262:2-15 (Andrews).
[58] TR. 262:9-263:1 (Andrews).
[59] Rebuttal Testimony of Elizabeth M. Andrews, Exh. No. EMA-4T, pp. 17:21-18:2. Ms Andrews confirmed this at hearing, stating "the officers are asked on, at least annually, on an individual basis based on their judgment what they believe the amount of allocation should be to non-utility operations." TR. 238:22-239:2 (Andrews).
[60] Exh. No. EMA-4T, p. 18:7-8 (Andrews).
[61] *WUTC v. Avista Corporation,* Docket Nos. UE-991606 and UG-991607, Third Suppl. Order, ¶¶ 244-250.
[62] *Id.*, ¶ 246.

> Recalling that the Company bears the burden of proof, we find that Commission Staff is correct: the Company provided virtually no support in the record to validate the reliability or accuracy of the officers' "informed judgment." Given that some assignments are clearly at odds with other evidence of officer responsibilities, Avista has failed to carry its burden of proof for its direct assignment of officers' salaries.[63]

31. In the absence of any accurate method of allocation or demonstration that the change in allocation is proper, executive base salaries should be allocated in a manner similar to that previously proposed and approved by the Commission in 2007, i.e. 25 percent to non-utility operations, with lower allocations only being applied to the four positions that clearly justify that allocation (positions that focus entirely on the provision of safe, reliable and efficient electric and natural gas service). This method is likely to provide a more accurate assignment of executive pay expenses between ratepayers and shareholders and is consistent with Commission precedent.

6. Directors' compensation and other shareholder related expenses.

32. Public Counsel and ICNU recommend removing one half of Avista's claim for directors' compensation as well as certain expenses related to shareholder services.[64] These adjustments result in approximately $.5 million reduction for the Company's revenue requirement ($395,607 for electric and $103,089 for gas).[65] The Stipulation does not include any reduction to directors' compensation or shareholder expenses.[66]

33. In its original filing, Avista assigned 100 percent of director compensation for recovery from the regulated utility ratepayers.[67] The Company did so despite the fact that directors serve

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[63] *Id.*, ¶ 249.
[64] Public Counsel and ICNU are cognizant of the fact that Avista must compensate its directors and that directors do play an important role in utility functioning. Ms. Andrews pointed this out in her rebuttal testimony. *See* Exh. No. EMA-7T, p. 21:19-22 (Andrews). Thus, Public Counsel and ICNU are *not* recommending a complete disallowance of directors' compensation but instead recommending that the expense be shared.
[65] Exh. No. MJM-1CT, pp. 37:16-38:15 (Majoros) (Revised 11/7/08); Exh. No. MJM-9C, p. 20 (Revised 11/21/08).
[66] TR. 240:22-25.
[67] Exh. No. EMA-16) p. 1. *See also,* TR. 240:18-21 (Andrews).

shareholders as much, or more, than ratepayers. Directors are selected by shareholders, not ratepayers.[68] Directors then determine for themselves how much they should be compensated.[69] Moreover, a large amount of this compensation *must* be provided and held in company stock—a requirement put in place specifically to "align the interests of the Board with the Company's shareholders."[70] Indeed, the share ownership requirement was recently increased nearly 50 percent, from 6,500 to 9,500 shares. [71] Avista stated in its most recent Proxy Statement that "[t]he ownership expectation illustrates the Board's philosophy of the importance of stock ownership for directors in order to further strengthen the commonality of interests between the Board [of directors] and shareholders."[72] Because directors' interests align most closely with shareholders and their work includes service to shareholders as well as ratepayers, sharing responsibility for director compensation is appropriate. Dividing recovery equally between ratepayers and shareholders is a reasonable apportionment.

34. Avista also included in its original filing certain other shareholder-related expenses, including: trustee, registrar, and transfer agent fees; stockholder meetings; dividend and other financial notices; the printing and mailing of dividend checks; the publishing and distributing of annual reports to shareholders; and, public notices of financial, operating, and other data required by regulatory statutes.[73] These expenses are directly related to shareholder, not ratepayer services, and should not be included as a utility expense for ratemaking purposes.

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[68] Exh. No. EMA-28), p. 1.
[69] *Id.*, p. 2.
[70] *Id.*
[71] Exh. No. EMA-27, p. 41. *See also* TR. 243-13-25 (Andrews).
[72] Exh. No. EMA-27, p. 41.
[73] Exh. No. MJM-1CT, 37:20-38:15 (Majoros) (Revised 11/7/08).

7. Directors' and Officers' (D&O) Insurance.

35. Public Counsel and ICNU recommend sharing Avista's expense for D&O insurance between ratepayers and shareholders.[74] This adjustment would reduce the Company's electric revenue requirement by $406,187 and its gas revenue requirement by $105,845.[75] The Stipulation does not include any adjustment to the Company's D&O insurance expense.[76]

36. D&O insurance is an appropriate cost of doing business that provides substantial benefits to directors and shareholders. Thus, while it may be proper for ratepayers to bear a portion of the cost, shareholders should be responsible for a portion as well. Sharing the cost is proper because D&O insurance provides a direct financial benefit to shareholders if and when they successfully bring suit against directors.[77] It also provides a direct benefit to directors by protecting them from personal liability for poor directorial decisions.[78] Ms. Andrews confirmed this point at hearing, stating that "the purpose of director insurance is a means to remove significant financial risk to directors and officers" and that it is a "benefit to directors and officers."[79] These benefits are illustrated by the recent settlement between Avista and its shareholders, which resulted in its D&O insurance company paying shareholders $8.5 million.[80]

37. The Commission has disallowed portions of D&O insurance in the past, even while acknowledging that some insurance coverage is a legitimate and recoverable utility expense.[81]

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[74] Exh. No. MJM-1CT, 38:17-40:9 (Majoros)(Revised 11/7/08).
[75] Exh. No. MJM-9C, p. 21 (Revised 11/21/08).
[76] TR. 245:4-7 (Andrews).
[77] TR. 247:4-7 (Ms. Andrews stated that "it's the outcome typically of any claims [that] those dollars would go to . . . shareholders").
[78] Exh. No. MJM-1CT, pp. 39:15-40:3 (Majoros).
[79] TR. 245:23-246:19 (Andrews).
[80] Exh. No. EMA-27, p. 42.
[81] *WUTC v. Puget Sound Power & Light Company*, Docket No. UE-921262, Eleventh Suppl. Order, pp. 59-60 (disallowing half of the D&O insurance coverage sought by the Company despite the Company's argument that increased coverage was "necessary . . . in order to retain qualified directors." The Commission concluded that the

Moreover, other jurisdictions have held that sharing the cost of D&O insurance is proper. The California Public Utilities Commission has required an equal sharing of this cost since 1996.[82] The Arkansas Public Service Commission has also assigned 50 percent of D&O insurance to shareholders.[83]

B. Inclusion of Avista's Supplemental Revenue Request in the Revenue Requirement is Improper.

38. Through its supplemental testimony filing in this case, Avista has improperly "reframed" and increased the revenue request which is currently before the Commission in a manner which has a significant financial impact on consumers. On March 4, 2008, Avista filed proposed tariffs to increase its electric revenues by $36.6 million and its natural gas revenues by $6.6 million. On July 28, 2008, nearly five months after its initial tariff filing, Avista filed supplemental testimony purporting to justify an additional $10.8 million in electric revenues, for a total of $47.4 million, an increase of almost 30 percent over the initial request. The Company did not revise its tariff filing to reflect the new rates and stated that it was "not requesting additional rate relief beyond the requested $36.6 million."[84]

Company had not shown that the level of coverage was reasonable and in line with its revenues and the amounts of coverage obtained by comparable companies.)

[82] *See e.g., Re Pacific Gas and Electric Company*, 199 P.U.R.4th 177, 2000 WL 289723 (Cal.P.U.C.), pp. 331-32 (stating, "[w]e adopt a 50% allocation to shareholders as an appropriate reflection of the benefits received by shareholders from this insurance"). These utilities have adjusted their filings to remove one-half of D&O insurance in later rate cases. *See also, Re Southern California Edison Company,* 64 CPUC 2d 241, 1996 WL 33178 (Cal.P.U.C.), pp. 74-75 (holding that, "to the extent that shareholders also benefit from this insurance coverage, they should . . . share in the expense").

[83] *See e.g., Re Entergy Arkansas, Inc.,* 259 P.U.R.4th 434, 2007 WL 2458085 (Ark.P.S.C.), p. 456 (stating, "D&O [insurance] provides unique, direct benefits to shareholders which are not enjoyed by ratepayers and that D&O [insurance] should, therefore, be shared"). *See also, Re Arkansas Western Gas Company*, 2005 WL 3617553 (Ark.P.S.C.), p. 21 (declaring, "the Commission finds that D&O insurance benefits both stockholders and ratepayers [and therefore] this expense should be split 50/50 between stockholders and ratepayers").

[84] Exh. No. EMA-4T, p. 2, 15-18 (Andrews Supplemental).

39. Avista's motion to supplement was granted.[85] The supplemental testimony was offered at the evidentiary hearing and admitted over Public Counsel's objection. Public Counsel here argues for the record that the evidence is not properly relied upon as a justification for the revenue level established by the Stipulation. The policy and legal arguments contained in the Public Counsel Answer to Avista Motion For Leave To File Supplemental Testimony are hereby incorporated by reference in this brief.

40. The concerns raised in Public Counsel's opposition to the supplemental filing have become reality. The electric revenue requirement in the case has become a moving target. The increased electric revenue amounts set out in the supplemental testimony, while not "expressly" incorporated in the Company's tariff, are very "expressly" incorporated in the revenue amounts used to calculate the revenue requirement.[86]

41. Ms. Andrews testified that the amount in the Stipulation attributable to the supplemental evidence is approximately \$8.8 million.[87] When added to the tariffed request of \$36.6 million, therefore, the actual electric revenue requested by Avista in this case has increased to \$45.8 million and it is that number against which Avista and the settling parties measure any adjustments. Avista's supplemental filing has thus translated into direct rate impact, contrary to the explicit representations of Avista in its pleadings and testimony.

42. There is no actual difference between this outcome and the result that would have occurred if Avista had filed new tariffs including the higher amount. Moreover, by choosing to not file revised tariffs Avista avoided triggering the additional ten months for review that would

[85] Order 04.
[86] TR. 254:3-255:3 (Andrews).
[87] TR. 255:3-17 (Andrews).

have been permitted for new tariffed request under RCW 80.04.130.

43. Avista may argue that this issue is now moot because the amount of the Stipulation is lower than the initially tariffed request. However, if the relicensing and Confidential Litigation amounts are added back in to the revenue requirement, the amount of new revenue approved in this Stipulation effectively exceeds the original tariffed amount.[88] The subtraction of these amounts is misleading because the Stipulation actually agrees that the full amount is ultimately recoverable from ratepayers. Viewed in this light, the Stipulation approves $40.59 million in new electric revenue.

44. Public Counsel acknowledges that RCW 80.04.130 provides that the Commission "may prescribe a different rate to be effective…in its final order after its investigation, it if concludes based on the record that the originally filed and effective rate is unjust, unfair, or unreasonable." The statutory provision must be read together with the other statutory provisions of Title 80, however. It cannot be read in such a way as to nullify all the remaining tariff filing and notice requirements.

C. There are Additional Reasons Why Increased Revenue for Power Costs Should Not Be Included in This Case.

1. Avista's inclusion of increased power costs improperly circumvents the Energy Recovery Mechanism (ERM).

45. The bulk of the supplemental revenue which Avista is including in this case is derived from increased power costs ($8.48 million).[89] Rejecting inclusion of the supplemental power costs, however, does not deprive Avista of any avenue for recovery. Mr. Norwood admitted at the hearing that if the new additional power costs were not included for recovery in this rate

[88] Adding the relicensing/litigation figure of $8.053 million to the settlement amount of $32.53 million brings the total revenue amount to $40.59 million.

[89] Multiparty Settlement Stipulation, p. 4 (Summary Table).

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case, they would be recovered through the ERM.[90] As Mr. Norwood observed candidly, this would mean that not all of the power costs would be recovered from customers, since the ERM contains sharing bands which would preclude recovery of some portion of the costs.[91] Far from being an objection to removing the supplemental power costs from this case, this illustrates precisely why that should occur. The ERM is designed to fairly apportion power cost recovery between Avista and its customers. By including these new power costs in the rate case after the initial filing, Avista is undermining this important purpose of the ERM.

46. Another avenue is open to Avista as well. It can reflect increased power costs in rates in its next rate case, which it indicates it will file within only 90 days after the rates take effect from the proposed settlement.[92] This will be Avista's third general rate filing since 2005. Given the frequency of its rate filings and the availability of the ERM for power cost recovery, Avista's attempt to enhance its power cost recovery by this mid-case filing is a misuse of the regulatory process.

2. The power costs in the Stipulation appear to be no longer accurate.

47. Avista argues that increasing the revenue requirement during the case to incorporate higher power costs is justifiable because "[t]he Commission should not ignore...known changes in, eg. [sic], fuel costs. The bigger point is that the context for decision-making is important."[93] If that is to be the guiding principle, then it is questionable whether fixing power costs at a level established in September settlement discussions is any longer appropriate given recent trends. Mr. Norwood conceded at the hearing that natural gas costs have been falling since the

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[90] TR. 191:7-192:9 (Norwood).
[91] *Id.*
[92] TR. 195:24-196:11 (Norwood).
[93] Avista Request for Leave to File Supplemental Testimony, ¶ 6 (emphasis in original).

settlement was filed/finalized.[94] He stated that if power costs were set today they would be different, though he could not say whether they would be higher or lower.[95] The record is not sufficient to determine what the current power cost should be, but Mr. Norwood's testimony does establish that a major component of the costs is lower and casts doubt on the current reliability of the settlement figure for approving new rates.

V. CONFIDENTIAL LITIGATION

A. Overview of Relicensing/Litigation Issues.

48. The Stipulation addresses costs related to Spokane River Relicensing, Montana Riverbed Litigation, and the Confidential Litigation.[96] A total amount of $8.053 million is removed from the current revenue requirement to reflect these costs.[97] The Stipulation agrees that all the costs for these matters will be deferred for later recovery in a future rate proceeding.[98] Public Counsel and ICNU do not object to this proposed treatment for Spokane River Relicensing and the Montana Riverbed Litigation. Public Counsel also does not oppose allowing recovery for the portion of the Confidential Litigation settlement described below as **[Begin Confidential]** XXXXXXXXXXXXXX **[End Confidential]**

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[94] TR. 190:21-24 (Norwood).
[95] TR. 190:18-20 (Norwood).
[96] Stipulation, pp. 10-12.
[97] Stipulation, p. 4 (Summary Table).
[98] Stipulation, pp. 10-12.

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[99] Exh. No. TEP-3, p.10 (Pessemier).
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B. Recovery For [Begin Confidential XXXXXXXXXXXXXXXXXXXXXXXXXXXX XXX [End Confidential] The Confidential Litigation Is Barred By The Rule Against Retroactive Ratemaking.

52. The recovery for the Confidential Litigation proposed in the Stipulation constitutes unlawful retroactive ratemaking. "Retroactive ratemaking" refers to the improper recovery of costs that were properly recoverable only in a past period or periods." [101] Three basic functions are served by the rule against retroactive ratemaking:

1. Protecting consumers by ensuring that current customers pay for their own service and not for past deficits;

2. Preventing utilities from using future rates to protect the financial investment of their stockholders, providing a guarantee, rather than an opportunity for a fair rate of return;

3. Requiring the utility to bear losses and enjoy gains based on their own managerial efficiency.[102]

53. The Washington Commission applied the rule against retroactive ratemaking in a case involving Puget Sound Energy in 2001. PSE requested authority to change the past effect of a tariffed rate, contrary to the terms of the tariff in effect at the time, and the accounting order in effect at that time. The Commission determined it was legally barred from granting the requested relief, stating that "the retroactive ratemaking doctrine prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up for past errors in projections."[103] The Commission noted that "with few exceptions (not applicable here), under

[101] Leonard S. Goodman, *The Process of Ratemaking*, Public Utility Reports, Inc., 1998, p. 165. Exh. No. MJM-7, p. 2.

[102] *Id.*, p. 166, Exh. No. MJM-7, p. 3.

[103] In the Matter of the Application of Puget Sound Energy For Authorization Regarding the Deferral of the Net Impact of the Conservation Incentive Credit Program, Schedule 125, and Subsequent Recovery Thereof Through

RCW 80.28.020, the Commission is charged with setting rates on a *prospective* basis.....Here PSE proposes to reach back in time to alter the tariffed rate."[104]

54. Quoting an earlier order, the Commission went on to further describe the nature of retroactive ratemaking:

> [Retroactive rate making involves] surcharges or ordered refunds applied to rates which had previously been paid, constituting an additional charge applied after the service was provided or consumed. The evil in retroactive rate making as thus understood is that the consumer has no opportunity prior to receiving or consuming the service to learn what the rate is or to participate in a proceeding by which the rate is set. The Commission agrees that retroactive rate making, as thus understood, is extremely poor public policy and is illegal under the statutes of Washington State as a rate applied to a service without prior notice and review.[105]

55. In this case, Avista is asking the Commission to authorize charging current and future ratepayers for costs **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**[End Confidential]** As Ms. Andrews acknowledged at the hearing:

> Yes, if we had been paying these types of expenses currently or in the test period or it would have been—yes, they would have been—they would have been incurred.[106]

Ms. Andrews agreed that if Avista had been paying these expenses in 1950 or 1980 they would have been included in rates.[107]

56. On rebuttal on this issue, the Company argues **[Begin Confidential]** XXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

Schedule 120, Conservation Rider, Docket No. UE-010410, Order Denying Petition to Amend Accounting Order (PSE CIC Deferral Order)¶ 7, citing *Town of Norwood, Mass. V. FERC*, 53 F. 3d. 377, 381 (D.C. Cir. 1995).

[104] *Id.*

[105] *Id.*

[106] TR. 250:6-17.

[107] TR. 250:18-23 (Andrews).

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[108] Exh. No. TEP 4-T, p. 6:13-19 (Pessemier Rebuttal).
[109] 533 U.S. 262 (2001).
[110] Exh. No. TEP-7C, pp. 3-11, Appendix A.

59. In the PSE case, the Commission addressed a similar argument in which PSE argued that "no one could have anticipated" a drop in wholesale market prices that affected its recoveries. The Commission stated:

> Once prices fell, and the anticipated benefits dwindled, the Company requested that its general body of ratepayers bear all of the losses associated with the program. Significantly, those ratepayers were not put on notice that, under any circumstances, they would be saddled with those risks. It is not in the public interest for the Commission now, after the fact, to burden PSE's customers with risks that the Company assumed at the outset.[111]

In this case, Avista argues that it could not have anticipated being liable **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

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C. Payments For [Begin Confidential] XXXXXXXXXXX [End Confidential] Are Not Recoverable From Ratepayers.

60. Public Counsel and ICNU object to recovery of amounts for the Confidential Litigation on further and separate grounds. **[Begin Confidential]** XXXXXXXXXXXXXXXXXX

[111] *PSE CIC Deferral Order*, ¶ 9.

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[112] Exh. No. TEP-3C, p. 10.
[113] Exh. No. TEP-4T, p. 18:14-19 (Pessemier).

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63. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.[116] **[End Confidential]** As a general proposition, utilities must demonstrate the prudence of their actions before being allowed to recover costs in rates. A course of conduct that is a legal wrong is *prima facie* imprudent. The concept of prudence is similar to the concept of legal reasonableness. As defined in Black's Law Dictionary, prudence is "carefulness, precaution, attentiveness, and good judgment…commonly associated with care and diligence[.]"[117] Conduct which constitutes a legal wrong (a tort) is hardly synonymous with care and good judgment.

D. In the Alternative, the Confidential Litigation Expense Can Be Offset by Avista's Regulatory Liability.

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[114] Exh. No. TEP-6C, p. 28.
[115] *Id.* p. 29-30.
[116] Restatement Second, Torts ¶ 6; *See* 74 Am. Jur. 2d Torts ¶ 1. *Christensen v. Swedish Hospital*, 59 Wn.2d 545, 548, 368 P. 2d 897 (1962).
[117] Blacks Law Dictionary, Sixth Edition, p. 1226. *See* Leonard S. Goodman, *The Process of Ratemaking*, p. 856 (prudent management is related to reasonable management).

64. In the event that the Commission finds it is lawful for Avista to recover **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX **[End Confidential]** Public Counsel recommends that Avista should be required to use a part of its $209.4 million regulatory liability associated with the future cost of removal to offset these charges, as recommended in Mr. Majoros testimony. [118]

VI. DEPRECIATION-RELATED ISSUES

A. The Commission Should Recognize Avista's Regulatory Liability For Future Cost of Removal.

65. This case identifies, for the first time, an important issue related to Avista's collections for future cost of removal. In the past, Avista has increased its depreciation rates by including a charge to consumers for estimated future cost of removal.[119] Due to the inflation inherent in Avista's estimation process, such depreciation rates have accumulated $209.4 million over and above what Avista has actually spent for cost of removal as of December 31, 2007.[120] Avista reports the $209.4 million as a regulatory liability for Generally Accepted Accounting Principles (GAAP) reporting purposes,[121] but includes it in accumulated depreciation for ratemaking purposes.[122] FERC defines such over-collections as non-legal asset retirement obligations (AROs).[123]

66. Public Counsel raises two primary issues relating to this over collection: (1) the need to recognize it as a regulatory liability for ratemaking purposes and, (2) the need to change the

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[118] Exh. No. MJM-1CT (Revised 11/07/08), p. 18:3-14.
[119] Exh. No. CWK-1T, p. 3:6-10 (King).
[120] Exh. No. JJS-2, p. 2 (2007 Avista 10-Q); TR. 287:4-19 and 291:19-25 (Felsenthal); TR. 325:13-15 (Parvinen)
[121] Exh. No. MJM-1CT(Revised 11/7/08), p. 6:1-4
[122] *Id.*, p. 7:13-14.
[123] *Id.*, p. 7:5

mechanism used to accumulate the large over-collection to something that yields a more reasonable result. ¶

1. Non-legal asset retirement obligations.

67. The Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standard No. 143 (SFAS No. 143) and FERC Order No. 631 address AROs associated with long-lived plant. When a company has a legal ARO, SFAS No. 143 requires capitalization and depreciation of the discounted fair value of legal AROs.[124]

68. However, if it is determined upon implementation that a regulated utility has already collected too much depreciation relating to the asset retirement obligation, SFAS No. 143 and the SEC require the utility to report the excess as a regulatory liability. Furthermore, if the utility has collected cost of removal relating to assets bearing no legal retirement obligation, it must also report those prior collections as regulatory liabilities.[125]

69. Both SFAS No. 143 and FERC Order No. 631 identify and highlight these excess collections for future cost of removal. FERC Order No. 631 identified such amounts as non-legal asset retirement obligations, meaning that utilities do not have an actual legal obligation to incur these costs in the future.[126] FERC, however, does not require utilities to report these amounts as regulatory liabilities. FERC Order No. 631 merely requires separate identification and reporting within account No. 108-Accumulated Depreciation.

70. Consequently, even though Avista reports the non-legal AROs as regulatory liabilities for GAAP and SEC purposes, it continues to include these amounts in accumulated depreciation for

[124] *Id.*, p. 6:13-15. Exh. No. JJS-4.
[125] *Id.*, p 6:13-20.
[126] Avista witness Mr. Felsenthal agrees that Avista has a "non-legal asset retirement obligation." TR. 287:20-288:2.

regulatory accounting and ratemaking purposes.

2. Public Counsel recommends recognition of a regulatory liability to protect ratepayers.

71. The ratemaking implication arising from Avista's identification of the $209.4 million regulatory liability is that Avista charged prior ratepayers for cost of removal it has not incurred, and has no legal obligation to incur. The $209.4 million is the manifestation and quantification of a past intergenerational inequity. This amount will continue to grow as Avista grows.[127]

72. Public Counsel recommends that the Commission specifically recognize that Avista has a $209.4 million regulatory liability. Avista should reclassify this from accumulated depreciation to Account 254-Other Regulatory Liabilities for ratemaking purposes. This will result in equivalent GAAP and regulatory treatment for non-legal cost of removal. Revised Exhibit No. MJM-9C, Adjustments No. 1(E) and 1(G) on Schedule 5, p. 9, show the reclassification of the SFAS No. 143 Regulatory Liability. This is a revenue neutral reclassification of a rate base reduction from one account to another.[128] Public Counsel's proposed reclassification does not increase or decrease Avista's revenue requirement, it simply protects this money until Avista spends it for its intended purposes.

73. Notwithstanding the fact that these amounts are included in accumulated depreciation, they are dollars *already* collected from ratepayers for future cost of removal. There is no reason that Avista should be entitled to keep these dollars if it never spends the money for cost of removal. The funds represent a refundable liability to ratepayers until spent on their intended purpose. The Commission implicitly recognized this when it approved the higher depreciation

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[127] Exh. No. JJS-2, p. 2; TR. 332:15-333:11(Parvinen); TR: 306:14-307:3 (Felsenthal).
[128] Exh. No. MJM-1CT(Revised 11/7/08 , p. 11:17-19.

rates in the past.[129] Now that SFAS No. 143 has identified them, the Commission should officially recognize and protect them as the regulatory liability they are. Without that protection, current and future ratepayers face the possibility of losing substantial prepaid funds they have submitted to the Company for future cost of removal.[130]

74. Utilities consider amounts in accumulated depreciation, even excessive amounts, to be *their* money, i.e. capital recovery with no refund obligation. It is certainly fair and reasonable for any Commission to recognize excessive cost of removal collections as a refundable regulatory liability until the utility spends them on their intended purpose.

75. As cross-examination at the hearings confirmed, Avista actually spends this money on general corporate purposes like "any other cash that they receive."[131] Avista does not segregate and hold it for future use when removal costs come due.[132] Mr. Parvinen acknowledged it is not clear where Avista will get the money when it incurs the cost of removal, if that ever actually occurs.[133] The concern is that if and when Avista does incur the cost of removal, it will seek to recover the money from ratepayers at that time, because it will already have spent the money it previously collected for that purpose.

3. The FERC rule to which Avista adheres provides insufficient protection.

76. Although FERC has recognized and identified the amounts involved, it has deferred ratemaking recognition of the regulatory liability to state Commissions. Consequently, until this Commission provides it, there is no official *regulatory* recognition of the liability. Accordingly, there is no provision for a refund to ratepayers if Avista does not spend the cost of removal

[129] TR. 284:24-286:18 (Felsenthal).
[130] Exh. Nos. MMP-2, MMP-3.
[131] TR. 292:1-293:2 (Felsenthal).
[132] *Id.*
[133] TR.325:23-327:7.

amounts they have collected for the intended purpose. In other words, nothing holds Avista directly accountable for these excess collections from a regulatory standpoint. Regardless of the transparency supposedly provided by the FERC rule, Avista failed to mention the regulatory liability in this rate case. This is unfair to ratepayers who have paid these excess costs in rates.

77. An article entitled "Fixed Deprecation Accounting" in Public Utilities Fortnightly,[134] illustrates the risk to these ratepayer funds. Author John Ferguson provides a rationalization for transferring the regulatory liability into income rather than repaying it to ratepayers. Ferguson essentially argues that utilities should transfer accumulated depreciation to the right side of the balance sheet which contains liabilities and equity. He concedes that accumulated depreciation is not a liability, which means that accumulated depreciation becomes equity. As equity, depreciation becomes a source of income for the company. Transparency and accountability are lost, and ratepayers stand to lose the incurred cost of removal included in accumulated depreciation.

78. The California Public Utility Commission has recognized non-legal AROs for several of its major energy utilities, including Southern California Edison [135] and Pacific Gas & Electric Company.[136] In the 2008 San Diego Gas & Electric Company general rate case, the Commission adopted a settlement requiring the company to record a regulatory liability for ratemaking purposes for prefunded asset removal costs.[137]

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[134] Exh. No. ADF-3.

[135] *Application of Southern California Edison Company For Authority, Among Other Things, To Increase Its Authorized Revenues for Electric Service in 2006*, Application No. 04-12-014, Decision 06-05-016 (May 11, 2006), ¶:16.7.1, pp. 166-167.

[136] *Application of Pacific Gas and Electric Company For Authorization, Among Other Things, To Increase Rates and Charges For Electric and Gas Service Effective on January 1, 2007*, Application 05-12-002, Decision 07-03-044 (March 15, 2007), p. 214.

[137] *Application of San Diego Gas & Electric Company For Authority to Update Its Gas and Electric Revenue Requirement Effective 2008*, Application 06-12-009, Decision 08-07-046 (July 31, 2008), p. 96 (ordering para. 1), Appendix 1 (Settlement Agreement, p. 11).

B. Calculating Net Cost of Removal and Depreciation Rates and Expenses.

79. Public Counsel/ICNU witness Charles W. King addresses Avista's depreciation expense. He recommends alternative depreciation rates and expenses to Avista's proposals, based on a corrected treatment of future cost of removal. His adjustments to Avista's depreciation rates and expenses apply only to those for electric transmission and distribution plant and for gas distribution plant.[138] A comparison of Mr. King's rates and test year expenses with those of the Company is set forth in Schedule 1 of Exh. No. CWK-4. A summary of that information is as follows:

Table 1: Year 2007 Depreciation Expense[139]

	Avista	Public Counsel	Adjustment
Electric			
Transmission	$ 8,233,982	$ 6,881,601	$ (1,352,381)
Distribution	14,781,408	12,913,082	(1,868,326)
Gas			
Distribution	7,976,709	6,363,402	(1,613,307)

80. The differences between the Avista and Public Counsel depreciation expense relate solely to the way Mr. King allowed for future net removal costs relative to Avista's procedure.[140]

81. Regulated public utilities include an allowance for future salvage and cost of removal in their depreciation rates. Salvage is the estimated value of plant as scrap or reuse/resale. Removal costs are the estimated amounts to dismantle and remove plant from its current location. Most electric and gas utility plant has far more removal cost than salvage value, so the net of the two is negative, in other words a net cost.[141]

[138] Exh. No. CWK-1T, p. 2:1-7 (King).
[139] The table reflects corrections reported in Public Counsel/ICNU Response to Bench Request No. 4.
[140] TR. 266:13-267:14 (Spanos) (agreeing only difference is treatment of removal costs).
[141] Exh. No. CWK-1T, p. 2:17-3:5 (King).

82. The conventional procedure for accruing for future removal costs is to increase the depreciation rate to allow for the accrual of future removal costs. The rationale for this treatment is that the ratepayers who benefit from the use of the plant should pay for the cost of its removal while it is in service. That payment should be spread over the life of the plant in a fair and equitable manner.[142]

1. Avista's proposal to accrue net removal costs.

83. Avista accrues net removal costs by computing a "net salvage ratio," which is a ratio of anticipated net removal costs to total plant in service. As noted above, because the ratio is typically negative, these ratios are more appropriately termed "net removal cost ratios." Avista applies these removal cost ratios to the plant in service to create an adder to the total amount of money recovered through depreciation.[143]

84. Avista's removal cost ratios for electric transmission and distribution plant and gas distribution plant are set forth in column B of Schedule 2 of Exh. No. CWK-4. They range from 5 to 30 percent. A 30 percent removal cost ratio means that for every dollar of investment recovered, Avista accrues another 30 cents for future removal costs.[144]

85. Avista's net cost of removal ratios were calculated as part of a depreciation study of Avista's plant by the consulting firm of Gannett Fleming in the course of Avista's last general rate case, Docket Nos. UE-070804 and UG-070805. That study was adopted as part of a stipulated settlement in those cases.[145]

86. Mr. King did not challenge Avista's removal cost allowance ratios for its electric

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[142] *Id.*, p. 3:6-10.
[143] *Id.*, p. 3:11-19.
[144] *Id.*, p. 5:17-23.
[145] *Id.*, p. 5:24-6:3.

production plant or for its gas storage and processing plant. These are "life span" accounts for which a specific estimate is made of the cost to dismantle and remove the plant. Because those estimates are based on studies of the current cost to dismantle and remove the plant, that is the cost to remove the plant today, Mr. King had no objection to the removal cost allowances for those categories of plant.

87. Mr. King focused on transmission and distribution net removal cost allowances because these are "mass property" plant accounts. The procedure that Avista uses to generate removal cost allowances for these accounts grossly overstates removal costs as demonstrated by the accumulation of the $209.4 million regulatory liability discussed above.[146]

2. Comparison of accrued cost of removal to actual cost of removal.

88. Schedule 2 to Mr. King's Exh. No. CWK-4 develops an approximation of the annual accruals for future removal costs as of the time of the Gannet Fleming study. It compares those accruals with the average annual costs incurred by Avista to remove plant during the previous five years. As the schedule shows, Avista accrued $1,222,406 in 2004 (the year of the Gannett Fleming study) against removal costs for electric transmission plant. It actually spent only $52,276 on average during each of the previous five years to remove that plant. For electric distribution plant, Avista accrued $2,500,234 but spent only $113,842 annually during the previous five years. For gas distribution plant, Avista accrued $1,296,135 but spent only $177,587. Overall, Avista accrued more than 12 times its actual removal costs for electric plant and more than seven times its actual removal costs for gas plant.[147] These differentials increased Avista's regulatory liability for non-legal AROs each year.

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[146] *Id.*, p. 6:4-18.
[147] *Id.*, p. 7:1-14.

89. As Mr. King explains, this imbalance is the result of the procedure by which Gannett Fleming developed the mass property removal cost ratios. Gannett Fleming compared the original cost of retirements during recent years with the experienced costs of removal during those same years. This comparison involves dollars of very different values. The numerator of the removal cost ratio is recently incurred removal costs covering the years between 2000 and 2004. The denominator is the original cost of the plant retired. Those costs can be quite old. The average service life of a section of gas main is 65 years. If a 65 year-old gas main is retired in 2004, its original cost is expressed in 1939 dollars. With many low-valued dollars in the numerator and a few high-valued dollars in the denominator, the removal cost ratio is very high. As noted, these high ratios result in removal cost accruals well over 12 times the actual removal cost expenditures for electric plant and seven times for gas plant. This is why Mr. King refers to Gannett Fleming's procedure as the Traditional Inflated Future Cost Approach, or TIFCA.[148]

90. The TIFCA procedure effectively projects into the future all of the inflation that occurred between the time that recently retired plant was installed and the time it was removed. [149] TIFCA therefore has the effect of charging ratepayers now for the nominal dollar cost of removing plant at the time of its retirement.

91. Under Gannett Fleming's TIFCA methodology, when Avista installs a gas main in 2008, it would add a removal cost allowance of $0.25 to each dollar of construction cost recovered. Yet that $0.25 will not be spent, on average, for another 65 years, or until the year 2073. A dollar spent in 2073 is worth far less than a dollar collected in 2008. The TIFCA procedure simply ignores this relationship between present and future dollars. It assumes that a dollar

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[148] *Id.*, p. 8:1-14.
[149] *Id.*, p. 9:13-19.

collected now has exactly the same value as a dollar spent 65 years from now. Gannett Fleming would have Avista collect these 2073 dollars from ratepayers starting next year.[150]

92. Schedule 3 of Mr. King's Exh. No. CWK-4 illustrates that effect. As can be seen, when inflation is factored in, the TIFCA removal cost accrual is severely front-loaded. Ratepayers in the early years of the asset's life pay much more than those in later years.[151]

93. Mr. King proposes a methodology that eliminates this front-loading of future inflation into current depreciation accruals. Columns D through H of Schedule 3 illustrate a procedure that fairly allocates the effect of inflation to the years when that inflation occurs. There are two elements to this accrual mechanism. The first is the straight-line depreciation of the final removal cost, not in its future nominal dollars, but in dollars discounted back to the year of the asset's placement. The second component is the cost of inflation. This is measured by the annual change in the discounted value of the removal costs. This value increases each year. The sum of the annual depreciation of the discounted value of the final removal cost and the annual inflation amount is the annual accrual that can fairly be charged to ratepayers each year.[152]

94. Mr. King did not invent this procedure. It is the methodology embodied in SFAS 143, adopted by the Financial Accounting Standards Board in 2002.[153] The timing of the recognition of removal costs embodied in SFAS 143 is the appropriate and fair approach to accrual of removal cost allowances. That is true regardless of the legal status of those removal cost obligations or the condition of regulation.[154] Mr. Spanos agreed on cross-examination that Mr.

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[150] *Id.,* p. 10:1-7.
[151] *Id.,* p. 10:8-11:2.
[152] *Id.*, p 11:3-11. Mr. Parvinen indicated he would "possibly" accept this methodology if the funds were set aside in escrow. TR. 334:11-335:16.
[153] Exh. No. JJS-4.
[154] Exh. No. CWK-1T., p. 12:1-13:3 (King).

King's method ultimately accrues all of the costs of removal over the service life of the asset, assuming the plant does not go out of service early.[155]

3. Other states have adopted the SFAS 143 based approach to accruing removal costs.

95. The Maryland Public Service Commission (PSC) adopted the SFAS 143 methodology to calculate removal costs in a decision involving the Delmarva Light & Power Company.[156] In July of last year in a Potomac Electric Power Company case, the Maryland PSC adopted the present value methodology advocated by Public Counsel and ICNU in this case. The Maryland PSC specifically stated:

> The Commission has carefully reviewed the record and finds that the Present Value Method should be adopted for the recovery of removal costs. The Straight Line Method recovers the same annual cost in nominal dollars from ratepayers today as it does at the time plant is removed from service. However, a dollar is worth substantially more today than it will be 20 to 40 years from now. Consequently, today's ratepayers would pay more in "real" dollars under the Straight Line Method for the recovery costs of the plant they consume than would future ratepayers when net salvage is negative, as everyone projects.[157]

Mr. Spanos acknowledged at the hearing that it is the Straight Line method he is advocating here.[158]

96. In June 2007, the Michigan Public Service Commission imposed a requirement that each utility compute both discounted and undiscounted removal costs when developing its depreciation rates.[159] Similar approaches, focusing on current rather than future removal costs,

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[155] TR. 268:3-269:11 (Spanos).

[156] *Re Delmarva Power and Light Company* Maryland P.S.C Case No. 9093, Order No. 81518 (July 19, 2007), p. 14, 16. Westlaw Citation: 2007 WL 2159659.

[157] Exh. No. JJS-3, p. 30, *In the Matter of the Application of Potomac Electric Power Company*, Maryland P.S.C. Order No. 81517, Case No. 9092, 258 PUR4th 463 (July 19, 2007).

[158] TR. 280:13-281:4.

[159] *Re Statement of Financial Accounting Standards No. 143*, Michigan PSC, Case No. U-14292, Opinion and Order, p. 19 (June 26, 2007). Westlaw Citation: 2007 WL 2042567.

are used in New Jersey for Rockland Electric Company,[160] Atlantic City Electric Company,[161] Jersey Central Power & Light Company[162] and Public Service Electric & Gas Company,[163] and in Delaware for the Delmarva Power & Light Company.[164]

97. Schedule 4 of Mr. King's Exh. No. CWK-4,[165] applies a discounting approach to Avista's mass property electric transmission and distribution accounts and to its gas distribution accounts. As noted, Mr. King's depreciation rates are lower than Mr. Spanos' depreciation rates solely due to the difference in their respective procedures for accruing net removal costs. Both use the same end-of-life removal cost estimates, but Mr. King properly discounts the estimates back to their present value, consistent with SFAS No. 143 and sound economic ratemaking practices. Unless Mr. King's recommendations are adopted, Avista's $209.4 million regulatory liability (amount owed to ratepayers) will continue to grow indefinitely as evidenced by its most recent Form 10Q.[166]

VII. CONSOLIDATED TAX ISSUE

98. Public Counsel and ICNU recommend adjustments (Adjustments 2(E) and 2(G)) which reduce Avista's federal income tax expense to reflect Avista's effective corporate tax rate.[167]

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[160] *In the Matter Of Rockland Electric Company*, New Jersey BPU Docket Nos. ER02080614 and ER02100724, Initial Decision, June 10, 2003, pp. 47-49 and Summary Order, July 31, 2003, p. 2. 2005 WL 1377887 (N.J.B.P.U.)

[161] *In the Matter of Atlantic City Electric Company*, New Jersey BPU Docket Nos. ER03020110, ER04060423, EO03020091 and EM02090633, Decision and Order Adopting Initial Decision and Stipulation of Settlement, pp. 5-6, May 26, 2005. 2005 WL 1377887.

[162] *In the Matter of Jersey Central Power & Light Company*, New Jersey BPU Docket Nos. ER0208056, ER0208057, EO02070417 and ER02030173, Summary Order, August 1, 2003, p. 3. 2003 WL 21961993

[163] *In the Matter of Public Service Electric and Gas Company*, New Jersey BPU Docket No. GR05100845, Decision and Order Adopting Initial Decision and Stipulation of Settlement, November 11, 2006, p. 4.

[164] *In the Matter of the Application of Delmarva,* Delaware P.S.C. Order No. 6930, Case No. 05-304, signed June 6, 2006, ¶ 174.

[165] *See*, Public Counsel/ICNU Response to Bench Request No. 4.

[166] Exh. No. JJS-2, p. 2; TR. 332:15-333:11(Parvinen); TR: 306:14-307:3 (Felsenthal).

[167] Exh. No. MJM-1CT (Revised 11/07/08), p. 11:20-14:5.

This issue is addressed by ICNU in its separately filed brief. Public Counsel hereby adopts the brief of ICNU on this issue.

VIII. PROCEDURAL ISSUES

99. Two procedural issues have a bearing on the consideration of this Stipulation. First is the timing of the settlement. Settlement discussions began in this case on August 20, nearly a full month before the due date for testimony. [168] Public Counsel had not completed its discovery nor had its expert witnesses completed their analysis. The settlement process did not have the benefit of fully developed analysis and published positions by Staff or other intervenor witnesses. Ms. Andrews acknowledged at the hearing that the timing of the hearing precluded her review of some matters and that Staff did not raise the A&G issues identified by Public Counsel and ICNU. As a result, the settlement entirely fails to address a number of important issues and the record in support of many of the settlement components is weak at best.

100. An additional procedural problem presented in this case is the recommendation for an early effective date for rates. The stipulating parties agreed to an effective date of January 1, 2009, over a month in advance of the statutory end of the suspension period, February 4, 2009. This was termed "an integral part of this settlement" and the parties agreed to "support a modification of the procedural schedule to accommodate such a date."[169] Aside from the significant procedural challenges this forced upon the Commission and the non-settling parties in terms of the hearing schedule, the advanced effective date adds a month of higher bills for

[168]The case schedule adopted in Order 02, as is common, provided for both an initial issue discussion/settlement conference set for August 20-21 and a post-testimony settlement conference set for October 22.

[169] Multiparty Settlement Stipulation, III.F., p. 14.

customers, at a time of year when utility bills are most difficult to pay. The Stipulating parties have offered no evidence to justify this component of the settlement and it should be rejected.[170]

IX. SUMMARY

101. The following table summarizes the revenue impact of the Public Counsel and ICNU recommendations in this case.

Table 2: Electric and Natural Gas Revenue Requirement Joint Settlement Adjusted For Remaining PC Adjustments 000s of Dollars			
		Electric Revenue Requirement	Natural Gas Revenue Requirement
1	**Avista Amount As Filed**	**$ 36,617**	**$ 6,587**
2	Total Settlement Adjustments	(4,079)	(1,819)
3	**Settlement Amount**	**$ 32,538**	**$ 4,768**
Additional Non-Duplicative PC Adjustments:			
4	Reclassify COR Regulatory Liability	-	-
5	Consolidated Income Tax Savings	(758)	(685)
6	King Depreciation	(2,687)	(1,064)
7	Executive Compensation	(249)	(65)
8	Advertising	(29)	(31)
9	Sporting Events	-	(68)
10	Dues & Membership Fees	(159)	(39)
11	Charitable Contributions	(16)	(8)
12	Directors' Comp and Shareholders' Services	(396)	(103)
13	D&O Insurance	(406)	(106)
14	**Total Additional PC Adjustments**	**(4,700)**	**(2,170)**
15	**PC Adjusted Settlement Revenue Requirement**	**$ 27,838**	**$ 2,598**

Sources:

- Lines 1 through 3 from Joint Testimony in Support of Settlement, p.19 and 24.

[170] Avista has chosen to pursue a non-unanimous settlement with an early effective date in this case. Avista has voluntarily accepted the risk that there may be insufficient time to allow further proceedings before the suspension date in this case, should the settlement be rejected, or should Avista reject any conditions imposed. Avista should be prepared to extend the suspension date if that becomes necessary.

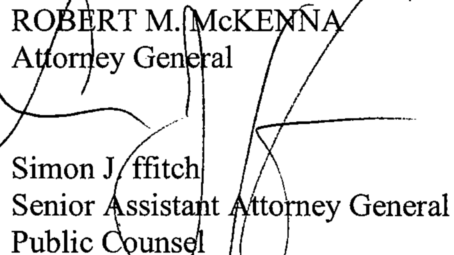
- Lines 4 through 13 from Exhibit No. (MJM-9C)(Revised 11/21/08)
- Line 7, Executive compensation calculated as:
  - PC electric adjustment of $(389) less settlement change of $(140), and
  - PC natural gas adjustment of $(102) less settlement change of $(37). (described at ¶¶ 26-27 of the brief)

102. This table depicts the revenue requirement result assuming none of the supplemental power costs are removed from the case. Removing those additional power costs, as noted above, would significantly reduce the amount of revenue established by the Stipulation itself, and correspondingly reduce the rates after the Public Counsel and ICNU adjustments are applied. Even when that issue is not taken into account, this table shows that the Stipulation establishes electric revenues $4.7 million and gas revenues $2.1 million in excess of a just and reasonable level. This evidence provides a basis for either rejection of the settlement as filed, or adoption of conditions which would require incorporation of these adjustments Stipulation before approval.

X. CONCLUSION

103. For the reasons set forth in this brief, Public Counsel respectfully requests that the Commission adopt the Public Counsel and ICNU recommendations as conditions for approval of the Multiparty Settlement Stipulation, or reject the Stipulation as filed. Public Counsel and ICNU further request adoption of their recommendations which do not have immediate rate effect: adoption of a regulatory liability for cost of removal and disallowance of the specified Confidential Litigation amounts.

104. DATED this 24th day of November, 2008.



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