Exhibit T-____ (TES-T)
Docket Nos. UE-991606, UG-991607
Witness: Thomas E. Schooley

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
Complainant,	)	**DOCKET NOS. UE-991606, UG-991607**
v.	)	
AVISTA CORPORATION,	)	
Respondent.	)	

DIRECT TESTIMONY

OF

THOMAS E. SCHOOLEY

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

May 5, 2000

Q: Please state your name and address.

A: My name is Thomas E. Schooley. My business address is 1300 S Evergreen Park Drive SW, PO Box 47250, Olympia, Washington, 98504-7250.

Q: By whom are you employed and in what capacity?

A: I am employed by the Washington Utilities and Transportation Commission as a Policy Research Specialist.

Q: How long have you been employed by the Commission?

A: Since September, 1991.

Q: Please briefly describe your educational background and experience at the Commission.

A: I received a Bachelor of Science degree from Central Washington University in 1986. I met the requirements for a double major in Accounting and Business Administration-Finance. Additionally, I have a Bachelor of Science degree from the University of Michigan majoring in geology. I passed the Certified Public Accountant exam in May, 1989. Since joining the Commission I have attended several regulatory accounting courses, including the summer session of the Institute of Public Utilities.

Since joining the Staff of this Commission I have jointly investigated a large waste disposal company (Docket TG-911369); analyzed data and developed text which was incorporated into the testimony of senior Staff in PRAM 2 (Docket UE-920630); presented the Staff recommendation on environmental remediation (Docket UE-911476); prepared detailed statistical studies for use by Commissioners and others; and interpreted utility company reports to determine compliance with Commission regulations. I analyzed PacifiCorp's proposed accounting treatment of Clean Air Act allowances (Docket UE-940947) and participated in meetings of PacifiCorp's inter-jurisdictional task force on allocations. I also prepared and presented testimony in the merger between Washington Natural Gas and Puget Sound Power and Light Co.

Q: What issues do you cover in your testimony?

A: My testimony addresses the following:

1. Electric Adjustment P (Gas Adj. L) - Injuries and Damages.
2. Electric Adjustment Q (Gas Adj. M) - Federal Income Tax.
3. Electric Adjustment T (Gas Adj. P) - Office Space Charges to Subs.
4. Electric Adjustment (ee) - Hydro Relicensing.
5. Electric Adjustment (ff) - Commercial Trade.
6. Electric Adjustment (gg) - Nez Perce settlement.
7. Electric Adjustment (jj), (Gas Adj. (z)) - Misc. Adjustments.
8. Staff proposed Miscellaneous Adjustment (t).
9. Allocation factors applied to results of operations.

Q: Do you contest all of the above adjustments?

A: No. Staff does not contest the adjustments for federal income taxes (electric Q and gas M) and the office space charges to subsidiaries (electric T and gas P). Also, we accept the allocation factors as applied to costs common to gas and electric service, and between states.

Q: Do you sponsor any exhibits in support of your testimony?

A: Yes, see Exhibit _____ (TES-1) through Exhibit ____ (TES-5).

INJURIES AND DAMAGES

Q: Please describe the adjustment for Injuries and Damages.

A: Adjustment P, as presented by Avista, consists of three parts. First is the six-year average of damages to third-party properties or persons. Second is damages to homes incurred during a period of lightning storms and fires in 1991. And third is recovery of damages to company properties during a winter storm in 1996.

Q: What is the history of the first item?

A: In Docket U-88-2380-T (WUTC v. Washington Water Power Company, Third Supplemental Order), Washington Water Power Company (WWP) proposed and the Commission accepted a six-year average of third-party damages to determine a representative level of expense. This method smooths the volatile nature of the expenses in the injuries and damages account since in some years there are more accidents than in other years. Exhibit 232 (page P4) shows that the directly assigned expenses in electric operations for the years 1993 through 1998 range from $109,500 in 1995 up to $260,900 in 1998, with an average of $185,000. The variation in the gas operations is more lop sided with a range from $11,000 in 1996, up to $195,000 in 1998, and an average of $53,400. The use of an average actually reduces the test year expenses. Staff accepts this method and these numbers for this part of the Injuries and Damages adjustment.

Q: Please describe the situation called "Firestorm."

A: In 1991, a period of drought followed by lightning and high winds caused many fires in the Spokane area. Some homeowners sued WWP for damages, claiming the Company did not adequately keep trees away from power lines. The wind blew the wires into the dry trees, igniting the trees and causing widespread damage. Many years of litigation followed. Finally, a settlement was reached in 1997 with a payment of over $10 million to the plaintiffs. Insurance covered much of the Company's liability.

Q: What does the Company propose for this part of the adjustment?

A: Avista proposes adding one-sixth of the past six year's total "Firestorm" expenses (about $346,000) to the injuries and damages average of $185,000.

Q: What types of costs are included in the "Firestorm" expenses?

A: Exhibit 233 lists the expenses included for recovery. Mr. Falkner states that, other than the final settlement payment, the costs are primarily legal fees. (Tr. 450)

Q: Should certain legal fees be singled out for specific recovery in rates?

A: No. Legal fees are an ongoing expense of a utility company. The subject of the litigation changes from year to year, but total legal expenses remain fairly consistent. The expense level used to determine a utility's revenue requirement includes the legal expenses of the test year. Recovery of specific legal fees is unnecessary and duplicative.

Q: Should any of the expenses from the "Firestorm" event be recovered at this time?

A: Arguably, the settlement payment less insurance recoveries may be included in the six-year average of injuries and damages. This payment is similar in nature to the types of expenses in this account. It is a payment for damages to third party property. While the "Firestorm" event occurred prior to the six-year period in question, as is often the case in these situations, the payment occurred later.

Q: What level of expense do you propose for inclusion in rates?

A: I propose to include the settlement payment of $10,300,000 less the insurance recoveries of $9.1 million and $518,000. This adds the balance of $682,000 into the total for averaging. In other words, to the initial six-year average of $185,000 for injuries and damages, I add $114,000 for the Firestorm.

Q: Please describe the third part of this adjustment.

A: In November, 1996 freezing rain coated eastern Washington with a glaze of ice. The weight of the ice toppled trees into utility lines, causing massive power outages. WWP's costs of repairing the damage tallied over $15 million. Avista requests recovery of this "Ice Storm" using a six-year average of the expenses.

Q: Have any similar events occurred in Washington's recorded history?

A: No. According to a report on this event published by the Company, the National Weather Service categorized this ice storm as the only event of its kind in 115 years of record.

Q: How does this event differ from the "Firestorm" or from the injuries and damages portions of the adjustment?

A: The damages caused by the "Ice Storm" were damages to Company-owned property, not damages caused by the Company to third parties. This is an important distinction. The injuries and damages adjustment accepted by the Commission in Docket U-88-2380-T addresses only damages to third parties. Damages to Company property due to weather events are unrelated.

Q: Does Avista propose a multi-year averaging mechanism for storm damages?

A: No. Avista wishes to build one-sixth of the Ice Storm costs (over $2 million) into rates. The Company does not address the level of storm damages during the test year, nor whether or not that level represents ongoing expenses. (Tr. 453)

Q: How do test year storm damages compare to recent years?

A: Test year storm damages are approximately $1,231,000. This is below the average of the past six years, but Avista makes no adjustment for that item.

Q: What did Washington Water Power say about the ice storm costs in late 1996?

A: A press release by WWP quotes Mr. Paul Redmond, CEO, stating that WWP will "write off the costs of this storm against our 1996 fourth quarter earnings" and that "our customers will see no change in electric prices as a result of the storm damage costs." (Ex. 234, Tr. 454)

Q: What did WWP say to the financial community about this event?

A: The 1996 Form 10-K filed with the Securities and Exchange Commission states that "No increase in rates will occur as a result of these costs." (Ex. 235)

Q: What did Staff take these comments to mean?

A: Staff read these comments to the public at the time of the event and assumed the Company meant it would not seek recovery of the costs in rates. The Company's representations are clear. Any inclusion of ice storm costs in this rate case is an "increase in rates," all else being equal.

Q: Did WWP or Avista attempt to establish an accounting basis for later recovery of this cost?

A: No. No accounting petitions were filed to capitalize this expense for later recovery. It is only now, three years after the fact, that the Company presents a means to increase rates because of this expense.

Q: What are your reasons for excluding this portion of the Injuries and Damages adjustment?

A: The Ice Storm occurred two years prior to the test year and the event causing the costs is not likely to happen again. This non-recurring, extraordinary expense should be excluded from the calculation of today's revenue requirements.

Q: What is the effect of your proposals compared to the Company's adjustment?

A: Overall, Staff proposes an increase of $49,000 to test year electric expenses for an after tax decrease in net operating income of $32,000. Exhibit ____ (TES-1) presents this calculation. The Company's adjustment shows an increase of $2,329,000 in electric expenses for a decrease in NOI of $1,514,000. Gas operations are unaffected by my modifications, so I concur with the Company's adjustment for gas operations.

HYDRO RELICENSING

Q: Please give a brief background for the Hydro Relicensing adjustment.

A: In February, 2000 Avista received a new license for two hydroelectric dams on the Clark

Fork River in Idaho and Montana. The license was issued by the Federal Energy Regulatory Commission a full year prior to the expiration of the old license, a feat never before accomplished for projects of this size. Mr. Anderson's testimony (Ex. T-345) reviews the relicensing process. The term of the new license is 45 years.

Q: **What is the Company's financial request in this adjustment?**

A: Avista requests recovery of the ongoing annual expenses relating to meeting the conditions of the license plus amortization of over $14 million in process costs incurred to reach the Settlement Agreement. The impact on Washington operations is an increase of $1,467,000 in expenses (reducing net operating income by $954,000) and an increase in regulatory assets of $9,387,000 less accumulated amortization of $110,000.

Q: **What else does Avista propose?**

A: Avista also proposes a "balancing account" to capture the variations in the annual expenditures.

Q: **Please explain.**

A: The Company proposes to use the Commission accepted expense level as the financial expense in its income statement. The opposite side of this entry will go to a balance sheet account. Thereafter, the actual expenditures are posted to the balance sheet account. Therefore, the credits to the balance sheet will equal the Commission approved expense level, and the debits to the balance sheet will be the amounts spent to implement the license agreement. The Company expects to recover the outstanding balance in the account in future general rate cases.

Q: Why does Avista propose this method for handling these costs?

A: Avista posits the potential for a "mismatch between recovery and expenses associated with the O&M level of Settlement cost authorized in this case." (Ex. T-226, p. 20)

Q: What is wrong with this idea?

A: The Commission neither authorizes nor approves a particular expense level for any one item. The basic premise for calculating revenue requirements is the determination of representative relationships between all incomes, all expenses, and total rate base at a given point in time. Applying a cost of money factor to the rate base and adding to that the total expenses derives a desired level of revenue. Comparing that calculated revenue to the normalized revenues of the test year shows the need for an increase or decrease in total revenues. Nowhere in this process is there a need to "authorize" any particular expense. Rates that are fair, just, reasonable, and sufficient do require the determination of costs that represent the ongoing operations of the utility. In subsequent years, expenses, incomes, and the rate base investments deviate from the test year levels, but generally the relationship between the three remains similar to the test year relationships. If the Company finds these relationships out of synch, thus providing investors with an insufficient return, it may file a case to revise rates.

Q: Are the costs to implement the new license particularly volatile?

A: No. Exhibit ____ (TES-2) shows the pattern of expenses for the first 20 years of the license. This is my best interpretation of the expected payments in the settlement agreement and data from Exhibit 346. The expenditures for Protection, Mitigation, and

Enhancement Measures (PME measures) only are shown on line 34 of Exhibit ____ (TES-2). These costs are only for promised and expected annual expenses and some identifiable one-time expenses. It appears the expense level of the first year is about $1,221,000. Some subsequent years exceed this amount by up to about $80,000, but eventually the expenses level out at $37,000 <u>below</u> the first year's amount. (Line 37) This is the pattern in nominal dollars.

Q: Will these future payments be adjusted for inflation?

A: Yes. Per the settlement agreement annual payments are increase by a defined inflation factor over the years.

Q: What do you propose for this adjustment?

A: I propose an expense level for the PME measures of $1,268,000 system-wide, or $650,000 for Washington. I accept the company's proposal to capitalize the costs to reach the agreement and to amortize those over the life of the license, 45 years. The result is an increase in Washington electric operating expenses of $1,070,000 for an NOI reduction of $695,000. Washington rate base is increased by $9,387,000 and accumulated amortization by $110,000, as proposed by Avista. I reject the idea of a balancing account for accruing future expenses.

Q: How does this differ from the Company's proposal?

A: For the PME measures only, the company presents a total of $1,208,000, or $60,000 less than my proposed $1,268,000. However, Avista adds over $650,000 in additional administration costs to its request for a total of $1,862,000.

Q: Why do you exclude the incremental administration costs?

A: The test year level of administration costs is about $740,000. Avista claims to need $650,000 more to administer this license. While there may be some additional costs for this item, the Company provides inadequate details to quantify any known and measurable incremental costs. Administrative costs are in the control of the Company. (Tr. 496) As such, the Commission should not build into rates mere guesses as to legal fees or company labor. Certainly the ability to control administrative costs leaves the idea of a balancing account unnecessary for this portion of the hydro-relicensing adjustment. Future test years will contain the specific costs to implement these license programs and those costs may be reflected in future rate cases.

Q: Does Staff's calculation of Clark Fork license costs include estimated program expenses?

A: Yes. Staff recognizes the efforts of Avista to achieve a fair settlement of the issues surrounding the relicensing of one of its major generation facilities. Our calculation of the protection, mitigation, and enhancement measures attempts to cover expected costs over the near-term future. We leave it up to the Company to manage those costs and to accept the annual variations in the expenses.

COMMERCIAL TRADING ACTIVITIES

Q: Please explain Adjustment FF, Commercial Trading Activities.

A: Avista removes from the test year expenses some of the costs of its resource optimization department. It claims 4.1 people are used to buy and sell power in open market transactions that are not part of the regulated operations. I remove this adjustment, as Staff adds back the revenues and expenses generated by this department to the regulated results of operations. See Mr. Buckley's testimony for a complete explanation.

NEZ PERCE SETTLEMENT

Q: Please explain Adjustment GG, the Nez Perce Settlement.

A: In 1991 the Nez Perce tribe sued WWP for damages to fish runs on the Clearwater River in Idaho. WWP owned two dams on the river from 1937 until the dams were demolished in 1963 and 1973. After extensive litigation, the court sided with WWP, ruling against the tribe's claim. Upon appeal, the Federal Appeals Court sent the case to mediation. The mediated settlement is the source for this adjustment. Exhibit 239 presents this settlement.

Q: What does the Company request?

A: The Settlement Agreement provides a payment of $2,500,000 to the tribe in 1999, and annual payments of $835,498 for the next 44 years. Avista requests recovery of the levelized payments, or $872,487 system-wide. They also request regulatory asset treatment for the initial payment of $2.5 million.

Q: Does the Settlement Agreement cover only fishing related issues?

A: No. The Settlement Agreement also settles tribal tax issues and power line rights-of-way issues. (Tr. 468-470)

Q: What do you propose?

A: I propose a reduction in the company's request to reflect payments relating to Idaho distribution plant and tribal taxes. Both of these items are solely the responsibility of Idaho customers. The issue is one of assigning some of the settlement payments to Idaho operations. Staff is not generally contesting the inclusion of this settlement in current Washington rates.

Q: How did you calculate an amount to assign to Idaho?

A: Attachment J of the settlement agreement calculates rights-of-way payments for power lines crossing the Nez Perce Tribal property. (Ex. ____ (TES-3)) I recreated this document and calculated an amount representing the payment for distribution lines. This payment represents about three percent of the annual payments. Therefore, I assign this percentage to Idaho operations for distribution line rights-of-way.

Q: How do you treat the tribal tax issue?

A: I assume a reasonable level of tribal taxes to equal the distribution right-of-way cost.

Q: What is your proposed adjustment?

A: My adjustment increases Washington operating expenses by $525,000 which reduces net operating income by $341,000 after taxes.

MISCELLANEOUS ADJUSTMENTS

Q: Avista proposes two items in electric miscellaneous Adjustment JJ (Gas Adj. Z). Please describe these.

A: During 1998 Avista incurred expenses to change the corporate name from Washington Water Power to Avista, and it incurred expenses to "fix" so-called Y2K problems.

Q: What is Avista's proposed adjustment for the name change?

A: Avista proposes to amortize $1,123,000 of system-wide 1998 name change expenditures over five years. Washington electric operations include $529,000 of name change expenses in the test year. Amortizing this amount over five years reduces test year expense by $423,000. Washington gas operations include $133,000 in name change costs. Amortizing this amount over five years reduces test year expense by $106,000.

Q: What is Avista's proposal for the Y2K expenses?

A: For the Y2K, Avista proposes amortizing $1,651,000 (system-wide) over five years. Washington electric operations contain $777,000 in test year Y2K expenses. Amortizing this over five years reduces electric operating expenses by $622,000. Washington gas operations contain $197,000 in test year Y2K expenses. Amortizing this over five years reduces gas operating expenses by $158,000.

Q: What is your proposal for the name change expenses?

A: I eliminate all name change expenses from the results of operations. This reduces test year operating expense by $529,000 in electricity and $133,000 in gas.

Q: Why?

A: First, this is a one-time non-recurring item. It is not representative of current or future utility costs. Second, there is no consumer benefit from the Company's new name. The name Avista was created for and first used by the unregulated subsidiaries of the Company as early as 1997. The Company presents only shallow arguments for including the name change expense at all. It uses such arguments as the need for "building a cohesive identity . . . across markets," or that "Washington Water Power . . . lacked versatility." It claims the name Avista is "not specific as to resource or geography and has been successfully launched and favorably received in many new markets." (Ex. T-226, p. 27) (Emphasis added.) These arguments lack any relevance to maintaining a long-time quality utility system in eastern Washington, an area with a specific geography and specific resources.

Q: What do you propose for the so-called Y2K computer fix?

A: I eliminate the Y2K operating expenses from the results of operations. This reduces test year expense by $777,000 in electricity and $197,000 in gas.

Q: Why?

A: These expenses are also non-recurring, and should be removed from operating expenses to arrive at representative on-going costs of operations. In his testimony Mr. Falkner claims the Y2K projects create "new value" by assuring "the systems will continue to perform properly, instead of failing." It is the Company's responsibility to maintain all of its systems in proper functioning order regardless of the calendar numerals.

Q: How does your adjustment compare to Avista's?

A: As shown in Exhibit ____ (TES-4), I propose reducing test year expenses in electricity by $1,306,000 versus Avista's reduction of $1,045,000. In gas operations I propose an expense level reduction of $330,000 compared to Avista's reduction of $264,000.

STAFF RESTATING ADJUSTMENTS

Q: Do you propose any further adjustments?

A: Yes. The test year contains several expense items that should be removed. These expenses are for lobbying, promotional advertising, subsidiary operations, non-recurring expenses, or misclassifications. Exhibit ____ (TES-5) presents a table of the items in question.

Q: Please describe your proposed adjustments.

A: I'll proceed by type of exclusion.

Political Advertising/Lobbying

WAC 480-90-032 and 480-100-032 state that "every public service company incurring any direct or indirect expense associated with or in furtherance of any political information or political education activity, shall account for such costs separately in a nonoperating expense account. No such expense shall be permitted for ratemaking purposes." Traditionally, the Commission considers the lobbying, or political education, activities engaged in by organizations to which a utility pays dues as an indirect lobbying expense.

Exhibit 29 shows a table of corporate memberships. The company's representations of the organizations' purposes neglects to mention the lobbying activities of most of these groups. Organizations such as the Association of Washington Businesses, the Montana Tax Foundation, and the Western Environmental Trade Association exist primarily to lobby legislatures or to influence public opinion in various ways. However, Avista presents insufficient evidence to determine any specific degree of lobbying by these groups. Therefore, I elect to exclude all the corporate membership dues. This reduces operating expenses in electricity by $135,000 and in gas by $40,000.

Promotional Advertising

Promotional advertising is prohibited from inclusion in rates by WAC 480-90-043 and 480-100-043. The definition is fairly broad, but well-described. Customers should not pay for activities designed to encourage or promote the use of electricity or natural gas, nor for activities which promote the image of the regulated utility. I audited a small sample of invoices and found many payments for services that are designed to increase sales of electricity and natural gas. Also, many services are specifically for corporate image building. Exhibits 246-249 each mention the purpose of attracting new business to the area. This is an example of promoting the use of the Company's products, electricity and natural gas, and violates the WAC. Exhibit 253 presents payments to the WhiteRunkle Company. I removed selected programs as contrary to the WAC. For example, the stated purpose of the "Corporate Positioning Campaign" is "to create customer awareness of utility brand and enhance loyalty." I find this of no value to regulated customers. In total, I remove from electric operations $176,000, and from gas operations $202,000 for promotional activities. For the specifics of each vendor see Exhibits 246-249 and 253. Page 2 of Exhibit ____ (TES-5) shows the WhiteRunkle payments proposed for exclusion and the accounts charged.

Q: Does your proposed adjustment include all or a substantial portion of the Company's promotional advertising from the test year?

A: No. Record Request 15 asked Avista to prepare a list of payments made for purposes identified in WAC 480-090-043 and 480-100-043. The Company has not responsed by May 4 in spite of the mid-April due date. My adjustment is based on a brief review of Avista invoices, is quite conservative, and may change upon receipt of the response to Record Request 15.

Q: What else do you propose in this adjustment?

<u>Subsidiary operations expenses</u>

A payment to Avista's legal firm, Paine Hamblen, for services concerning "180 Communications" is in error. (Ex. 254) This is removed from the test year.

Two other particular items were charged to utility operations but serve subsidiary operations as well. The Avista website is highly oriented to non-utility businesses. A quick look at the site (www.avistacorp.com) shows more paths to subsidiaries and more space to items such as "unlocking the value" of Avista Corp.'s "affiliated companies like its business-to-business e-commerce subsidiary Avista Advantage" than any space devoted to regulated utility operations. (Per website on April 30, 2000.) An exhaustive study of the website could easily show virtually all of the cost belongs to subsidiary operations. The suggested allocation of 48% to the non-utility business is conservative and reasonable.

The other similar item is the cost to find a new chief executive officer. The total CEO search cost Avista over $400,000. (Tr. 485) Again, Avista charged all of this expense to the utility and none to the subsidiaries. Mr. Falkner's rationalization of "whether we had unregulated operations or not, we would still have been searching for a CEO" is not persuasive. (Tr. 486) The new CEO is responsible for the total organization. The cost to find a new executive must be allocated among all the corporate businesses. An allocation of 48% of the CEO search costs to the subsidiaries is conservative and reasonable.

Q: Why do you use 48% as an subsidiary allocation factor?

A: This number is the same one used by Ms. Huang to allocate executive wages between Avista Utilities and Avista Capital. See her testimony for the calculation of this factor.

Q: What other items do you remove from test year expenses?

<u>Non-recurring expenses</u>

I excluded certain items because they will not occur again in the foreseeable future. the first is a project to produce a film called "Tribute to Paul Redmond." (Ex. 251) Mr. Redmond was the CEO prior to Mr. Matthews. The costs of this project will not occur again and are not related to utility operations. The second item is a payment to Montana Power (Ex. 258) for participating in the sale of the Colstrip generation plant. Avista paid $125,000 to engage in the initial talks to sell its portion of Colstrip. Later, it withdrew its interest in Colstrip from the sale. This expense will not occur again, and it is reasonable to remove it from the test year.

Duplicated expense

Lastly, I removed from the test year an expense which is a duplication. The payment to Toronto Dominion Bank is a fee associated with revolving lines of credit. (Ex. 259) This type of expense is taken into account in the cost of money and should not be included in the test year. This reduces test year expenses by $24,000 in electric and $6,000 in gas.

Q: What is the impact of these restating adjustments?

A: Altogether, these test year restatements reduce electric operating expenses by $570,000 and gas operating expenses by $286,000. Therefore, electric net operating income increases by $370,000 and gas net operating income increases by $186,000.

Q: Does this conclude your direct testimony?

A: Yes, it does.