BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. AVISTA CORPORATION d/b/a AVISTA UTILITIES Respondent.	DOCKET UE-080416 DOCKET UG-080417 (consolidated)

AMENDED BRIEF OF COMMISSION STAFF

REDACTED VERSION

January 28, 2009

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I. INTRODUCTION

Avista Corporation ("Avista" or "the Company"), Staff, the Northwest Industrial Gas Users ("NWIGU"), and the Energy Project have brought forward before the Washington Utilities and Transportation Commission ("the Commission") a multiparty settlement stipulation that resolves all of the issues in Avista's pending general rate case. The settlement resolves the issues in a manner consistent with the public interest and results in rates that are fair, just, reasonable, and sufficient. Though the settlement has been challenged by both the Public Counsel Section of the Washington Office of Attorney General ("Public Counsel"), and, in part, by the Industrial Customers of Northwest Utilities ("ICNU"), Staff believes these challenges are without merit. For the reasons set forth more fully below, Staff requests that the Commission, accordingly, approve the parties' settlement.

II. PROCEDURAL BACKGROUND

1 On March 4, 2008, Avista filed tariff revisions with the Commission seeking general rate increases for electric and natural gas service in Washington. Avista requested an increase in electric rates of $36.6 million, or 10.3 percent, and an increase in natural gas rates of $6.6 million, or 3.3 percent. On March 6, 2008, the Commission suspended the tariff revisions and consolidated Dockets UE-080416 and UG-080417 for hearing and determination. In the prehearing conference order issued on April 3, 2008, the Commission granted the petitions for intervention of NWIGU, ICNU, and the Energy Project, and established a procedural schedule.

2 On July 25, 2008, Avista moved for leave to file supplemental direct testimony and exhibits in support of a revised claimed electric service revenue requirement of $47.4 million. The Company did not file revised tariff sheets, however, and continued to seek a rate increase of $36.6 million for electric service. Public Counsel filed a response asking that Avista's request to file supplemental direct testimony be denied. On August 8, 2008, the Commission entered Order 08 permitting the filing and denying Public Counsel's motion.

3 Following substantial discovery by Staff and the other parties on Avista's direct and supplemental testimony, a settlement conference was held on August 20, 2008, at which representatives of all the parties appeared. Subsequent telephonic settlement conferences were held on August 29, 2008, September 4, 2008, September 8, 2008, and September 9, 2008, for the purpose of resolving or narrowing the contested issues in this proceeding.

4 On September 15, 2008, Avista, Staff, NWIGU, and the Energy Project entered into a multiparty settlement stipulation ("settlement") that would resolve all issues in this proceeding. The settlement would effect an electric revenue requirement increase of $32.5 million, and a natural gas revenue requirement increase of $4.8 million. Although ICNU did not agree to all of the settlement's terms, it did join in several portions of the settlement, namely: (1) Power Supply-Related Adjustments; (2) Cost of Capital; (3) Rate Spread/Rate Design; (4) Low Income Bill Assistance Funding; (5) Demand Side Management (DSM) Expenditures; and (6) Prudency of Energy Efficiency Expenditures. ICNU reserved its right to contest other issues that were resolved among the stipulating parties. Public Counsel opposed the settlement in its entirety.

5 Public Counsel and ICNU filed joint testimony responding to Avista's filing on September 19, 2008, and response testimony to the settlement on October 10, 2008. Avista and Staff filed rebuttal and cross-answering testimony on October 22, 2008. The Commission convened a hearing on November 6, 2008, for purposes of considering the settlement, to convene a panel of witnesses to respond to Commissioner inquiry on the settlement, and to provide an opportunity for Public Counsel and ICNU to cross-examine witnesses for the settling parties.

III. THE COMMISSION SHOULD APPROVE THE MULTIPARTY SETTLEMENT STIPULATION

A. The Standard for Approval of the Multiparty Settlement Stipulation

6 The Commission reviews settlement agreements under WAC 480-07-740 to determine whether the proposed settlement "meets all pertinent legal and policy standards." The Commission may approve a settlement "when doing so is lawful, when the settlement terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to the commission."[1] This standard involves a three-part inquiry:

> (1) We ask whether any aspect of the proposal is contrary to law; (2) We ask whether any aspect of the proposal offends public policy; and (3) We ask if the evidence supports the proposed elements of the Settlement Agreement as a reasonable resolution of the issue(s) at hand.[2]

The Commission noted that settlements "are by nature compromises of more extreme positions that are supported by evidence and advocacy." It also observed that

[1] WAC 480-07-750(1).
[2] *Washington Util. and Transp. Comm'n v. Cascade Natural Gas Corp.,* Docket UG-060256, Order 05 at 8, ¶ 23 (January 12, 2007).

"ratemaking is not an exact science."[3] Accordingly, when examining a settlement "close scrutiny of individual adjustments is not required" so long as "the overall result in terms of revenue requirement is reasonable and well supported by the evidence."[4]

B. The Record in this Case Demonstrates that the Multiparty Settlement Stipulation is Consistent with Law and the Public Interest, and Represents a Reasonable Resolution of the Issues in this Proceeding.

7 The settlement addresses each of the contested and uncontested issues in this proceeding, and recommends a result that is consistent with the law and the public interest. It is supported by the Joint Testimony of the settling parties, by the testimony and exhibits stipulated into the record, as well as by the testimony of the parties at the November 6 evidentiary hearing, both during the panel inquiry and during cross-examination.

1. The uncontested portions of the Multiparty Settlement Stipulation are lawful, supported by the record and in the public interest.

8 Several aspects of the settlement are uncontested and agreed to by the settling parties, ICNU, and Public Counsel. These include the following items, set forth in both the Multiparty Settlement Stipulation[5] and Mr. Majoros's response testimony (Ex. MJM-8T), at 1-2[6]:

- The stipulated return on equity (10.2%) and cost of debt (6.51%)

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[3] *Id.*, ¶ 24.
[4] *Id; Washington Util. and Transp. Comm'n v. PacifiCorp d/b/a Pacific Power & Light Co.,* Docket UE-032065, Order 06 at 26-27, ¶¶ 61-62 (October 27, 2004).
[5] Ex. 5, Multiparty Settlement Stipulation, at 4, *Summary Table of Adjustments to Electric Revenue Requirement; id.* at 5, *Summary Table of Adjustments to Natural Gas Revenue Requirement.*
[6] Staff notes that Mr. Majoros also states that he "does not object to" several negotiated adjustments in the settlement that concern various administrative and general expenses, including incentives, officers' salaries, union and non-executive salaries, and sponsorship costs. Majoros,, Ex. MJM-8T 1:20 – 2:9. Having done that, however, he then *adds* several other Public Counsel-recommended adjustments on top of these negotiated adjustments. *Id.* 3:20 – 5:3 (items 4-9). For the reasons set forth later in this brief, Staff believes this is neither a proper nor fair way to analyze the reasonableness of these negotiated terms of the settlement.

- The Spokane River relicensing and Montana riverbed litigation portions of the Relicensing/Litigation adjustment
- The customer deposits adjustment
- The Colstrip generation O&M expenses adjustment
- The Production Property adjustment, and
- The adjustment to restate debt interest

Furthermore, neither Public Counsel nor ICNU challenge several other features of the settlement in their direct or response testimony, including the following: (1) the modification to Avista's Energy Recovery Mechanism (ERM), which increases the "deadband" asymmetrically so that customers are given a greater share of the benefits when power expenses are lower than the authorized level; (2) rate spread and rate design; (3) low-income bill assistance funding; and (4) DSM expenditures.

9 The settlement provides for a 10.2% return on equity, which matches Avista's existing return on equity, and represents a substantial reduction from the Company's requested 10.8%. The settlement also contains a capital structure with an equity component of 46.3%, which is designed to target the capital structure at the end of 2008, and includes the issuance of new equity during the latter part of the year.[7] In addition, the settlement contains the parties' agreement that the costs associated with Avista's Spokane River relicensing efforts were prudently incurred. They have also agreed that once the Company receives the license, to defer as a regulatory asset Washington's share of the depreciation and amortization associated with those costs, together with a carrying

[7] Norwood, TR 180:14 – 181:5.

charge on the amounts not yet included in rate base.[8] The parties have also agreed with the Company's requested amortization of costs, together with recovery of accrued interest, associated with the Montana Riverbed litigation.[9]

10 Staff notes that the settlement also includes a modification to Avista's Energy Recovery Mechanism (ERM) that benefits customers. The ERM now incorporates an element of asymmetry that gives customers a greater share of the benefits when power expenses are lower than the authorized level, by changing the sharing level in the second ERM band ($4 million to $10 million) to 75% customer/25% Company when power supply expenses are lower (i.e. rebate direction). The ERM still maintains the 50%/50% sharing in the second band when power supply expenses are higher (i.e. surcharge direction).[10]

11 The settlement's rate design provides for an average increase of 8.7% in residential electric rates, and an average increase of 2.6% in residential natural gas rates,[11] a reduction from Avista's original rate request that benefits ratepayers. Finally, the settlement also includes provisions to adjust the Low Income Rate Assistance Program (LIRAP) portion of the tariff rider to provide an annual increase of $500,000, and increases low income Demand Side Management by $350,000 over the existing funding level. The Company and the Energy Project have also agreed to work with participating low income agencies to develop contract provisions to assure that the combined portfolio of electric and natural gas DSM expenditures remain cost-effective.[12]

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[8] Joint Testimony, Ex. 4T 26:6-23.
[9] *Id.* 27:15-28:2.
[10] *Id.* 28:6-12.
[11] *Id.* 31:1-3 and 31:13-15.
[12] *Id.* 28:18-29:16.

2. Contested portions of the Multiparty Settlement Stipulation

a. The Multiparty Settlement Stipulation's electric and gas revenue requirements result in fair, just, reasonable and sufficient rates.

12 The settlement provides for an Avista electric revenue requirement of $32.5 million. Public Counsel and ICNU contend that this amount is unreasonable, and argue instead, as their litigation position, that the electric revenue requirement is $24.8 million, a difference of $7.7 million. Notably, Public Counsel and ICNU originally argued for a $20.1 million figure, but have now amended it upward in light of a $4.4 million computational error in their proposed federal income tax (FIT) adjustment, and a second $0.3 million adjustment pertaining to depreciation.[13] On the natural gas side, the settlement provides for a revenue requirement of $4.8 million, while Public Counsel and ICNU argue for a natural gas revenue requirement of $3.5 million (again, revised upward from $0.6 million to account for the computational error in the FIT adjustment, and the adjustment for depreciation).

13 As demonstrated below, the settlement's adjustments are supported by ample evidence in the record, while Public Counsel's and ICNU's recommended additional adjustments are without merit and should be rejected.

b. The settlement's $7.4 million adjustment for power supply-related items is supported by substantial evidence in the record. Public Counsel has presented no evidence to the contrary, and no support for any alternative position, while ICNU has accepted this adjustment in its entirety.

14 The settlement includes a $7.4 million adjustment for power supply-related items. It consists of five parts: (1) an increase of $8.5 million to reflect a negotiated pro forma period natural gas price of $8.30/Dth (per dekatherm) for natural gas-fired generation, for

[13] Public Counsel and ICNU's Response to Bench Request 4; Ex MJM-9 (revised 11/21/2008).

the unhedged portion of the 2009 generation; and to include the actual 2009 calendar-year wholesale electric and natural gas transactions entered into through August 25, 2008; (2) an increase of $1.6 million to reflect the capital investment for the Noxon upgrade, scheduled for completion in March 2009; (3) a decrease of $1.6 million to remove the power supply expense from the 50-year average for months when the hydro generation was either higher or lower by more than one standard deviation from the average generation for that month (hydro filtering); (4) a decrease of $0.9 million to correct a mathematical error in the calculation of the Colstrip coal cost, and to properly reflect the 2009 pro forma period fuel price; and (5) a decrease of $0.1 million to reflect more energy purchased under the WNP-3 contract, which lowers power supply expense because the WNP-3 price is lower than market power prices in the AURORA model.[14]

15 Notably, ICNU has accepted this adjustment in its entirety.[15] Hence, only Public Counsel has not joined in support. But Public Counsel did not oppose the power supply adjustment in either its direct or response testimony. Neither Mr. King nor Mr. Majoros address the issue at all. Public Counsel has presented no evidence to demonstrate that any of the components of the adjustment are unreasonable, and has presented no alternative position on this matter. Indeed, the power supply adjustment is supported by the parties' joint testimony, as well as by portions of the supplemental testimony of Avista filed July 28, 2008. Moreover, this adjustment simply accomplishes two things that are routinely done in general rate cases: namely, providing updated calculations based upon known and measurable changes, using more recently available information; and correcting for mathematical or other errors or inadvertent omissions.

[14] Joint Testimony, Ex. 4T 20:6 -21:12: Multiparty Settlement Stipulation, Ex. 5 at 4.
[15] Multiparty Settlement Stipulation, Ex. 5 at 3, 4.

16 Nevertheless, Staff anticipates, based upon the previous pleadings in this case as well as certain questions from counsel and the bench during the hearing, that Public Counsel may argue that some or all of the power-supply adjustment should not be accepted. First, Public Counsel has argued that the Commission should not accept the filing of,[16] or the admission into evidence of,[17] Avista's Supplemental Testimony from four witnesses (Ms. Andrews, Mr. Kalich, Mr. Johnson, and Ms. Knox).[18] The Commission rejected both arguments.[19] Order 04 emphasized, "[T]he Commission's paramount interest is in having a full record with the best available evidence upon which to make a decision."[20] It noted that Avista's filing furthered this interest, by updating Avista's power costs for the 2009 rate year, correcting certain pro forma and restating adjustments from the original filing, and updating various adjustments based on more recent data. Balanced against this was the parties' need to have adequate time to conduct discovery and prepare their own testimony and exhibits, which was accomplished by modifying the procedural schedule.[21]

17 Any suggestion now that the supplemental testimony, now admitted, should be accorded little weight should be rejected.[22] To the contrary, it is highly relevant

[16] Public Counsel Answer to Avista Motion for Leave to File Supplemental Testimony (August 4, 2008).
[17] Public Counsel Objection to Avista Admission of Supplemental Testimony (November 5, 2008).
[18] Andrews, Ex. EMA-4T; Kalich, Ex. CGK-4T; Johnson, Ex. WGJ-6T; Knox, Ex. TLK-7T.
[19] Order 04, *Granting Motion for Leave to File Supplemental Testimony* (August 8, 2008); Ruling from Judge Clark, TR 160:11-19.
[20] Order 04 at 4, ¶ 7 (citing *Washington Util. and Transp. Comm'n v. Puget Sound Energy, Inc.,* Dockets UE-072300 and UG-072301, *consolidated*, Order 08, ¶ 10).
[21] *Id.* at 4, ¶¶ 8-10.
[22] Public Counsel has previously argued that the supplemental testimony should be disregarded because, while Avista's filing stated that this testimony would support a $47.4 million increase in electric revenue requirement, rather than the $36.6 million it has requested, Avista did not file revised tariff sheets. This is not significant. First, the Commission's authority upon receiving a general rate increase filing is to determine rates that are fair, just, reasonable, and sufficient. RCW 80.28.020. The Commission's authority is not bounded by Avista's tariff filing. Second, the supplemental testimony contains information relevant to both the Company's original $36.6 million request, as well as the current settlement amount of $32.5 million.

regarding the volatility of the price of natural gas for the unhedged portion of the 2009 generation. The settlement uses a negotiated price of $8.30/Dth. Mr. Johnson's unrebutted supplemental testimony shows that the price varied between $7.91/Dth at the time of the Company's original March 2008, filing, to as high as $10.20 (during a 3-month period) earlier this year.[23] While the natural gas price has gone down overall in recent weeks,[24] it also spiked upward by over 10% during the week of the hearing.[25]

18 Additional testimony given at the hearing demonstrates that the use of an $8.30/Dth price took into account several factors, including the price for calendar year 2009 at the time of settlement negotiations, the 30- and 90-day averages, and the volatility of the market. This compares to $8.50/Dth price that was used in the recently approved settlement involving Puget Sound Energy's general rate case.[26] Furthermore, and significantly, 95% of Avista's 2009 power supply is hedged, leaving only 5% unhedged;[27] this would minimize the effect of any decline in fuel prices, should that occur. The evidence, thus, amply shows that the settlement's use of an $8.30/Dth price is reasonable and supported by the record.

19 The $7.4 million power supply adjustment contains additional items, three of which *decrease* the Company's overall electric revenue requirement (hydro filtering, Colstrip coal cost, and the WNP-3 contract). These items are all supported by the settling parties' joint testimony, as noted above, and have not been rebutted. The last item, an increase of $1.6 million to account for Noxon capital investment inadvertently excluded

[23] Johnson, Ex. WGJ-6T 2:13-17.
[24] Norwood, TR 190:21-24.
[25] Norwood, TR 183:13-15.
[26] Norwood, TR 193:8-13.
[27] Kalich, TR 182:13-20; Kalich, TR 183:18- 184:1.

by the Company in its original filing, is supported by both Avista's direct testimony,[28] its supplemental testimony,[29] and the joint testimony referred to above.

20 As a result, the Commission should accept the $7.4 million power supply adjustment contained in the settlement. This one change alone, when added to the $24.8 million electric revenue requirement advocated by Public Counsel, raises the total amount to $32.2 million—a difference of only $300,000 from the settlement's amount of $32.5 million. This is prior to examining other adjustments recommended by Public Counsel, which Staff believes are without merit, as set forth more fully below, and which, if not adopted, would actually raise Public Counsel's revenue requirement *above* the amount in the settlement.

c. Public Counsel and ICNU's $2.9 million depreciation adjustment to the electric revenue requirement and $1.1 million depreciation adjustment to the natural gas revenue requirement are without merit and should be rejected.

21 Public Counsel and ICNU, through their witness Mr. King, propose to adjust Avista's electric and natural gas revenue requirements by having the Commission modify the manner in which net removal costs are incorporated into depreciation rates.[30] Staff recommends that these adjustments, which would cause a decrease of $2.9 million for electric and $1.1 million for natural gas,[31] should be rejected. This Commission has historically used the straight-line, remaining life methodology to determine the net salvage component for depreciation rates in Washington. This method, which levelizes the cost of removal, most closely matches the rate base being depreciated, and leads to

[28] Vermillion, Ex. DPV-1T 6:21 – 8:17; Kalich, Ex. CGK-1T 13:19 – 14:5.
[29] Andrews, Ex. EMA-4T 3:4(table), 10:20 – 11:11.
[30] King, Ex. CWK-5T 2:20-21.
[31] Majoros, Ex. MJM-9 11, schedule 5 (revised 11/21/2008).

equitable results. It is the approach used by the vast majority of other states as well.[32] There is neither any need nor any justification to change that method now.

22 Avista's depreciation rates and parameters have been set in accordance with the 2007 uncontested settlement stipulation entered into by all parties, including Public Counsel, in Avista's last general rate case. Those rates, effective January 1, 2008, were based on a depreciation study performed by the Company, and modified for changes proposed by Staff.[33] The rates were calculated in accordance with the straight-line, remaining life method of depreciation. Although the settlement included Staff- proposed reductions in the net salvage values used in determining depreciation rates, the methodology was not at issue.[34]

23 Mr. King now proposes that the Commission discard its use of the straight-line methodology in favor of using a discounted value accrual method for determining net removal costs. He contends that the straight-line method is "unfair to current ratepayers because it creates an intergenerational inequity by accelerating the accrual of future net removal costs."[35] To the contrary, Staff witness Mr. Parvinen demonstrates that this is not so. In response to Public Counsel's Data Request No. 7, which inquired why it would be acceptable ratemaking practice to charge more to current ratepayers than Avista's actual expenditures, Mr. Parvinen replied:

> This is a false statement. The method employed for ratemaking purposes charges current ratepayers for their portion of the actual cost of removal expenditures. It does not charge more. Also, since

[32] Spanos, Ex. JJS-1T 6:16-18 ,19:14:16.
[33] *Washington Utilities and Transportation Commission v. Avista Corporation,* Dockets UE-070804, UE-070805, and UE-070311, Full Settlement Stipulation, at 6 (referencing Partial Settlement Stipulation, particularly Appendix 1, Issue 4 (Depreciation Study (Electric and Gas) and Footnote 1) (November 5, 2007). *See also* Spanos, Ex. JJS-1T 8:2 – 10:6.
[34] Spanos, Ex. JJS-1T 9:7-20.
[35] King, Ex. CWK-1T at 16:3-5.

> current ratemaking practice is to collect for cost of removal before the costs are actually incurred, customers get the benefit of the company's authorized rate of return on this investment.[36]

24 The straight-line approach is preferable because it comports with the matching principle of ratemaking. As Mr. Parvinen explains, under this methodology, as the estimated service life, salvage value, or cost of removal changes over time, those changes are reflected going forward over the remaining life of the asset. This levelizes the effects of the changes so that at the end of the service life, all costs have been recovered from ratepayers. It appropriately matches dollars collected with the dollars spent. Public Counsel and ICNU's method, on the other hand, creates a mismatch in timing of the actual dollars collected, since fewer dollars are collected in the early years and more dollars will have to be collected in the later years,[37] thus creating a mismatch with the levelized approach of the straight-line depreciation recovery methodology.

25 If the cost of removal actually experienced at some point in time indicates that the Company has collected more than is needed to remove the asset, the remaining life methodology will adjust the depreciation rate going forward to correct the balance over the remaining life. In the meantime, customers will get the benefit of a reduced rate base by virtue of an overstated accumulated depreciation reserve. Again, however, over time the remaining life approach will levelize the imbalances.[38]

26 Mr. King argues that fewer dollars should be charged in the early years of depreciation to account for inflation.[39] The theory is that the monies collected earlier will not be spent until far later, when they are worth far more. But, as Mr. Parvinen pointed

[36] Parvinen, Ex. MPP-9 (Response to Public Counsel Data Request No. 7).
[37] Parvinen, Ex. MPP-1T 7:9-12.
[38] *Id.* 7:14-23.
[39] *See* King, Ex. CWK-1T at 9:23 – 11:2.

out at the hearing, this theory assumes that Avista actually puts those monies into the bank, so that they would be available later for paying the cost of removal for future plant retirement. In fact, that is not the case. Rather, those monies have been used to run the Company's day-to-day operations.[40] Thus, the inflation rationale is not persuasive. The straight-line methodology, which this Commission has historically adopted, remains the more accurate and equitable method of applying net removal costs. Public Counsel and ICNU's proposed depreciation adjustment to reduce Avista's electric revenue requirement by $2.9 million and its natural gas revenue requirement by $1.1 million should, therefore, be rejected.

d. Public Counsel and ICNU's proposal to create a regulatory liability account based on SFAS 143 should be rejected because it is not required by UTC or FERC rules, it creates no greater safeguards for customers, and it has no revenue requirement impact. If such a regulatory liability account is created, however, the Commission should only permit it to be used for the cost of removal portion of accumulated depreciation.

27 As of December 31, 2007, Avista had a $209.4 million collection of future cost of removal within the accumulated depreciation balance. Avista has recognized this as a regulatory liability for Generally Accepted Accounting Principles (GAAP) reporting purposes. Mr. Majoros, on behalf of Public Counsel and ICNU, argues that Avista should likewise be required to create a regulatory liability account for *ratemaking* purposes. As Mr. Parvinen persuasively demonstrates, this is neither required nor necessary to protect the interests of ratepayers. Moreover, Mr. Majoros's proposed use of such a regulatory liability account for purposes other than the cost of removal is inappropriate and should not be permitted.

[40] Parvinen, TR 325:2-9.

28 No UTC or FERC rule requires Avista to book the cost of removal component of accumulated depreciation as a regulatory liability for ratemaking purposes. As Mr. Parvinen states, the Financial Accounting Standard Board's Statement of Accounting Standard No. 143 (SFAS 143) is not applicable in the ratemaking context. In fact, Avista is booking the cost of removal consistent with traditional ratemaking principles, as well as all other utilities in the state.[41]

29 Moreover, creating a regulatory liability account is unnecessary to protect ratepayers. Under the approach applied by the Commission, when an asset is finally retired and the actual cost of removal is known, if there has been an overcollection, the amount stays in the accumulated depreciation account to reduce the overall cost of removal to be recovered on all other assets within the account through the remaining life approach. The Company does not have the ability to keep any unspent funds, if there are any; rather they would be used to benefit ratepayers.[42] In addition, creation of a regulatory liability account creates no revenue requirement impact, as Mr. Majoros agrees.[43]

30 However, if the Commission nevertheless decides to order Avista to record the cost of removal as a regulatory liability, it is inappropriate to use these amounts for any purpose other than the cost of removal. Mr. Majoros proposes that such a regulatory liability be used to offset confidential litigation costs.[44] As Mr. Parvinen points out, the funds at issue are specifically collected for the future cost of removal, and it is not stated

[41] Parvinen, Ex. MPP-1T 3:10-14, 17 – 4:6.
[42] *Id.* 3:15-16, 4: 11-20.
[43] *Id.* 5:9-11; Majoros, Ex. MJM-1T 11:16-18
[44] Majoros, Ex. MJM-1TC 18:10-14.

from where the actual cost of removal will come when it is time to pay removal costs if the funds have, instead, been used to offset other current costs.[45] Public Counsel and

e. The Settlement's treatment of the Coeur d'Alene litigation costs as prudently incurred is reasonable, and Public Counsel and ICNU's proposal to disallow recovery of any of these costs should be rejected.

i. Summary of the Coeur d'Alene litigation and settlement agreement

31 In the multiparty settlement, the parties agreed to the treatment of Avista's costs incurred in the settlement of litigation with the Coeur d'Alene Tribe. As set forth in detail in the confidential direct and rebuttal testimony of Avista witness Ms. Pessemier,[46] this complex litigation concerned the Tribe's claims for damages from Avista for its storage of water on Coeur d'Alene Lake. The lake is used by Avista in connection with the Post Falls Hydroelectric Project and the Spokane River Project, in providing energy service to Avista customers.

32 The Tribe has made claims for trespass, and for compensation under section 10(e) of the Federal Power Act, for Avista's storage of water on Coeur d'Alene Lake over a period spanning more than 100 years. These claims stem from a United States Supreme Court decision in 2001, which held by a 5-4 ruling that the United States holds, in trust for the Tribe, the portion of the lake (approximately the lower one-third) that is located within the reservation boundaries.[47] However, between 1907 and 1972, the State of Idaho exercised exclusive ownership of the lake, and the use of the lake for storage by Avista was not challenged by any parties during this time.[48] The Tribe first made a claim to partial ownership of the lake in 1973, when it sought to intervene in FERC proceedings

[45] Parvinen, Ex. MPP-1T 5:15 – 6:8.
[46] Pessemier, Ex. TEP-1TC and Ex. TEP-4TC.
[47] *Idaho v. United States*, 533 U.S. 262, 121 S. Ct. 2135, 150 L. Ed. 2d 326 (2001).
[48] Pessemier, Ex. TEP-1TC 3:1-5.

concerning licensing of the Spokane River Project. In 1979, Avista stipulated to allow FERC to decide the issue, which held in 1980 that the State of Idaho owned the lake. In 1983, FERC reversed itself; then, in 1988, FERC determined that it did not have jurisdiction to resolve the lake ownership issue. In 1992, the Tribe then sued the State of Idaho in federal court for ownership of the lake, but because of Idaho's sovereign immunity the suit was ultimately dismissed.[49]

33 As Ms. Pessemier points out, Avista was essentially caught in the middle of a controversy between the United States, the Tribe, and the State of Idaho, and had no legal standing to bring an action to determine ownership of the lake. The only party that had such standing was the United States, and it did not bring an action against Idaho in federal court until 1994.[50] And it was not until 2001, as indicated above, that the Supreme Court issued its decision on the matter. At that point, Avista agreed to mediation with the Tribe over a period of several years. [redacted][51]

34 Avista then entered into a settlement agreement with the Tribe. While Avista did not admit liability, it did agree to make a payment of $25 million in 2008, $10 million in 2009, and $4 million in 2010 for resolution of the claims for past trespass and past § 10(e) charges. For future § 10(e) payments, Avista agreed to make $400,000 flat annual

[49] *Id.* 3:6-13.
[50] Pessemier, Ex. TEP-4TC 5:5-17.
[51] Pessemier, Ex. TEP-1TC 4:4-22.

payments for the first 20 years of the FERC license for the Spokane River Project, and $700,000 flat annual payments for the remaining 30 years of the license.[52] [redacted][53]

ii. Public Counsel and ICNU's arguments that the Coeur d'Alene settlement payments should be disallowed on the basis of "imprudence" or "retroactive ratemaking" should be rejected.

35 Section III (A)(n)(ii) of the multiparty settlement stipulation (p. 11) provides that the stipulating parties agree that the pro forma costs incurred by Avista in connection with the Coeur d'Alene litigation are prudent, and that they agree to defer as a regulatory asset Washington's share of the depreciation and amortization associated with these costs, with a 5.0% carrying charge on the deferral as well as a carrying charge on the amount of costs not yet included in rate base for subsequent recovery in rates. Mr. Majoros, on behalf of Public Counsel and ICNU, argues that these costs should not allowed to be recovered in rates. He contends that (1) Avista's actions were not prudent; and (2) to allow recovery now would constitute "retroactive ratemaking."[54] Staff believes that neither of these positions have merit.

36 First, Mr. Majoros argues that "Avista has admitted to trespass, which is not prudent."[55] This is incorrect. As Avista points out, it did not admit to trespass in entering into the Coeur d'Alene settlement agreement. Though the Company has agreed to make

[52] Additional terms of the settlement agreement are summarized in Ex. TEP-1TC at 5-6 (Pessemier).
[53] Pessemier, Ex. TEP-4TC 17:15-19; 21:8-10.
[54] Majoros, Ex. MJM-1TC 16:14-21.
[55] *Id.* 16:14.

payments to the Tribe to settle claims for past damages, it did not admit liability.[56] This is not uncommon in settlement agreements. Moreover, Avista has stated that in balancing the risks involved, it was motivated to settle in part by its potential exposure to far greater liability, though it also of necessity gave up its ability to possibly pay less were it to have continued to litigate the matter.

37 Furthermore, there is no basis to declare that Avista should have addressed this situation differently than it has. In fact, for 66 years (from 1907 to 1973), no other party even made any *claim* that any part of Coeur d'Alene Lake was owned by the Tribe. From 1973-2001, there were lengthy litigation battles during which it was unclear who had jurisdiction, who had standing to pursue a claim, and who, in fact, owned the lake. Even the 2001 Supreme Court opinion in *Idaho v. United States* was decided by a narrow 5-4 ruling in which the dissent argued that "decisions of this Court going back over 150 years establish . . . beyond the shadow of a doubt" that Idaho owned the lake.[57] Avista should not be faulted for not knowing whether, in fact, any compensation was payable for its use of Coeur d'Alene Lake.

38 Even after 2001, the amount of compensation due was the subject of prolonged mediation, and could not reasonably be deemed ascertainable until the recent settlement agreement Avista entered into with the Tribe. Once that settlement was reached, and the amount of compensation to settle past and future claims was determined, Avista came before the Commission to seek recovery for costs incurred in the provision of regulated utility service, which Staff believes is prudent.

[56] Pessemier, Ex. TEP-4TC 3:21 – 4:6.
[57] *Idaho v. United States,* 533 U.S. at 281 (Rehnquist, J., dissenting).

39 Mr. Majoros's second claim is that to allow recovery of the Coeur d'Alene settlement-related costs would constitute "retroactive ratemaking." But this claim ignores both the unique, 100-year long factual history of this case and the litigation posture in which it has existed. It is true that this Commission has denied recovery of certain costs on the basis of retroactive ratemaking. However, those cases are distinguishable from the present circumstances. For example, in Avista's 1999-2000 general rate case,[58] the Commission agreed with Staff that Avista should not be allowed to recover, in rates, costs associated with a 1996 ice storm, because the Company at the time made clear that it would not seek cost recovery. As the Commission also noted:

> Companies also have an opportunity to seek an accounting order from the Commission if they want permission to amortize a cost for the purpose of regulatory accounting, and an opportunity to seek recovery in a future rate case. This practice gives notice to the Commission and parties who may wish to examine, in a timely manner, the Company's earnings and other circumstances.

Avista did not seek such an accounting order in 1996, though it clearly could have done so at that time.

40 Likewise, in 2001, the Commission denied Puget Sound Energy's petition to amend a prior accounting order, which had established a conservation incentive credit of $.05 per kilowatt-hour (kWh) for every kWh a customer saved beyond a 10% threshold, to run from May 1 through December 31, 2001. PSE proposed in October and November 2001 to retroactively reduce the credit to $.02 per hour, and then to zero. The Commission held that "the retroactive ratemaking doctrine prohibits the commission

[58] *Washington Utilities and Transportation Commission v. Avista Corporation*, Dockets UE-991606 and UG-991607, Third Supplemental Order, 204 P.U.R.4th 1, 38 (September 29, 2000).

from authorizing or requiring a utility to adjust current rates to make up for past errors in projections."[59]

41 And in PacifiCorp's 2007 general rate case, the Commission denied the Company's proposed tax adjustment to reflect amortization of a settlement with the Internal Revenue Service (IRS) in which PacifiCorp agreed to pay an additional $64 million in federal income taxes, following an IRS audit, for tax years 1991 through 1998. The Commission agreed that to do so would constitute retroactive ratemaking for a recovery of a cost incurred, but not recovered, in rates before the test period.[60]

42 In contrast to each of these cases, Avista has not unreasonably delayed its proposal for recovery of Coeur d'Alene related costs, which have only now been ascertained. It is not seeking to retroactively undue inaccurate past projections, or to recover payments of taxes that were the subject of an IRS audit. Avista could not have reasonably come before the Commission at any time prior to 1972 (when no claim for any damages or compensation for the use of Coeur d'Alene Lake had ever been made by anyone) or prior to 2001 (when *Idaho v. United States* was decided), to attempt to seek recovery or a deferral account for the costs at issue here. One cannot state that ascertainable past costs had been incurred up to that point. From 2001-2007, while the case was still in litigation and extensive mediation as to the extent and amount of any liability, it likewise is not reasonable to hold that Avista was obliged to come to the Commission during that time to establish a deferral account, or seek recovery, of an

[59] *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,* Docket UE-010410, Order Denying Petition to Amend Accounting Order, ¶ 7 (November 9, 2001) (citing *Town of Norwood, Mass, v. FERC* 53 F.3d 377, 381 (D.C. Cir. 1995)).

[60] *Washington Utilities and Transportation Commission v. PacifiCorp d/b/a Pacific Power & Light Company,* Dockets UE-061546 and UE-060817, Order 08, ¶ 157 (June 21, 2007).

unknown amount of costs. Moreover, such a requirement would certainly have compromised Avista's litigation position on the matter.

43 Mr. Majoros's proposed remedy would essentially leave Avista without any remedy to seek the recovery of costs that have only now been ascertained, and that have been incurred in the provision of regulated utility service. Staff believes that the proposal of Public Counsel and ICNU to disallow the recovery of the Coeur d'Alene settlement-related costs should, therefore, be rejected.

f. The settlement's overall treatment of several categories of administrative and general expenses, resulting from negotiation and compromise, are reasonable. Public Counsel and ICNU's attempt to challenge the settlement by examining only selected individual items while disregarding others should be rejected.

44 The multiparty settlement contains adjustments to Avista's electric and natural gas revenue requirements covering several categories of administrative expenses. These include executive pay, incentive compensation, non-officer and union wage increases, and sponsorship expenses. Staff and other parties negotiated these items as part of an overall package, with compromises from all sides, to arrive at a settlement amount that Staff believes is fair and reasonable. In fact, the total amount of the adjustments in the settlement, compared with Public Counsel and ICNU's *litigation* position, differs by only $44,000 in the effect on Avista's electric revenue requirement ($1,852,000 reduction in the settlement versus $1,896,000 reduction for PC/ICNU); and the total amount differs by only $93,000 in the effect on Avista's natural gas revenue requirement ($466,000 reduction in the settlement versus $559,000 reduction for PC/ICNU).[61]

45 Public Counsel and ICNU attempt to challenge the settlement by examining only selected individual items while disregarding certain others that have far greater overall

[61] Andrews, Ex. EMA 7T at 3 (Table) and 8 (Table).

revenue requirement impact. Most notably, they challenge the treatment of executive pay, incentives, directors' compensation, and directors' and officers' insurance, as well as certain amounts for advertising, dues and membership fees, sporting events, and charitable contributions. All of these areas would certainly be the subject of individual scrutiny by Staff were this case to be fully litigated. However, it must be emphasized that the settling parties have presented this case to the Commission as a settlement, where Staff believes it achieved significant concessions in many areas that might be at risk were the case to be litigated.

46 Most significantly, Public Counsel and ICNU have chosen to disregard the fact that the settlement includes a reduction of $1,508,000 to Avista's revenue requirement ($1,188,000 for electric and $320,000 for natural gas), due to the settlement's removal of 2009 non-officer and union wage increases. This amount far overshadows the adjustments that Public Counsel and ICNU argue for on an individual basis. Moreover, Mr. Majoros stated in his direct testimony that he would have supported *inclusion* of the 2009 wage increases in Avista's revenue requirement:

> I have made this change because I am not objecting to the increase to 2009 levels. Ordinarily I would object to Avista's increase to 2009 levels on the grounds that it is beyond the test year. Because the rates resulting from this proceeding will not be in effect until 2009, I have not challenged the increase of wages to a 2009 level.[62]

In sum, when viewed as a whole and as part of a negotiated agreement, the settlement's overall treatment of administrative and general expenses is reasonable and should be upheld.

[62] Majoros, Ex. MJM-1T 19:10-14.

IV. CONCLUSION

47 The settling parties have presented to the Commission a multiparty settlement stipulation that resolves all of the issues in Avista's pending general rate case. The settlement resolves the issues in a manner consistent with the public interest and results in rates that are fair, just, reasonable, and sufficient. In fact, if Public Counsel's litigation position on revenue requirement is adjusted to account for the settlement's unrebutted power supply adjustment and exclude Public Counsel's depreciation adjustment as recommended by Staff, the resulting electric revenue requirement is actually *greater* than that in the settlement. Staff, therefore, respectfully requests that the Commission approve the parties' multiparty settlement.

DATED this _____ day of _____, 2009.

Respectfully submitted,

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