**Q. Please state your name and business address.**

A. My name is Kenneth L. Elgin. My business address is Chandler Plaza Building, 1300 South Evergreen Park Drive SW, Olympia, Washington, 98504-7250.

**Q. By whom are you employed and in what capacity?**

A. I am employed by the Regulatory Services Division of the Washington Utilities and Transportation Commission as its Case Strategist.

**Q. Would you describe your education and relevant employment experience?**

A. I received a Bachelor of Arts from the University of Puget Sound in 1974 and a Master of Business Administration from Washington State University in 1980. In January, 1985 I was employed as a Utilities Rate Research Specialist for the Utilities Division. In that capacity, I was responsible for many diverse aspects of natural gas regulation including rate design, cost of service, purchased gas costs, and least cost planning. I was also responsible for financial analysis and rate of return issues for all regulated utilities. In December, 1989 I was promoted to the position of Assistant Director for Energy. In that capacity, I was responsible for the policy direction of the Utilities Division's electric and natural gas programs. In 1995 I assumed my present position as Case Strategist for the Division. In my current assignment I consult with or represent Staff on all aspects of energy cases presented to the Commission in the context of litigation.

I have testified before the Commission on many occasions as outlined in Exhibit 401 (KLE-1). Most recently, I presented policy testimony for Staff in Docket UE-990267

involving Puget Sound Energy's (PSE) application to sell its entire investment in the Colstrip generating station and related transmission facilities. I have testified before the Federal Energy Regulatory Commission on issues related to rate design and risk for interstate pipelines. I have also testified on several occasions in Superior Court regarding the regulation of investor-owned utilities pursuant to Washington's public service laws. I have been the lead analyst for numerous tariff filings and in this capacity I have presented Staff recommendations to the Commission at its regular open public meeting.

I also participated in Docket UE-960195 concerning the merger of Puget Sound Power & Light Company and Washington Energy Company (Merger). This complex docket required a comprehensive analysis of many diverse issues. I was responsible for coordinating Staff's recommendation to the Commission. Following the evidentiary phase of the case, I also led the Staff effort in negotiating a Stipulation with the Companies and Public Counsel. I testified for Staff in support of the Stipulation, which was adopted by the Commission.

During my fifteen years of experience working on energy and financial issues, I have developed a thorough working knowledge of both the operations and financial profiles of all three electric utilities operating in Washington.

**Q. Are you sponsoring any exhibits in this proceeding?**

A. Yes. In addition to my qualifications in Exhibit ___ (KLE-1), I sponsor Exhibit ___ (KLE-2).

**Q. Would you please summarize the proposal in this Docket?**

A. Avista, PacifiCorp, and PSE propose to sell their representative shares of the Centralia steam plant, associated transmission facilities, and related property to a subsidiary of TransAlta Corporation (TECWA), a Canadian company headquartered in Calgary, Alberta. The proceeds exceed the net book value of the Centralia steam plant and related transmission facilities. The utilities have also agreed that the sales price of the mine will be at net book value.

Each of the applicants present a slightly different accounting and ratemaking treatment. Avista requests that the entire gain be given to shareholders. PacifiCorp requests a sharing of the gain between ratepayers and shareholders based upon the depreciation reserve balance. PSE seeks to amortize the gain over a five-year period, which is identical to the treatment it sought for Colstrip.

**Q. Please summarize your recommendation in these proceedings?**

A. The Commission should authorize the sale of Centralia for each of the applicants, but only upon condition that each utility defer the entire gain on the sale and return the gain to ratepayers in a general rate case. The utilities should also be required to provide to ratepayers all near-term power supply benefits that arise from the sale. Since Avista and PacifiCorp each have a general rate case pending before the Commission, the Commission will be able to capture both the near-term power supply benefits and determine the precise method for returning the gain to ratepayers in those proceedings. PSE should receive identical treatment to what was ordered by the

Commission in Colstrip. As a condition of approval in Colstrip, PSE was ordered to defer the gain and all the near-term power supply benefits of the transaction, and return them to ratepayers in a general rate case to be filed no later than March 29, 2002. These same conditions should be applied to PSE's sale of its interests in Centralia.

**Q. Why does Staff recommend that the Commission reserve to a general rate proceeding the precise method to reflect the gain in rates, rather than resolving that issue in the current case?**

A. As a policy matter, it is appropriate to consider the disposition of the gain from the sale of utility property in a rate proceeding because that is the only time when all issues surrounding the utility's operations are under review. RCW 80.28.010(1) requires that the Commission fix rates that are fair, just, reasonable, and sufficient. The rate case process is the only arena where all relevant information is reviewed by the Commission in order to make the required statutory finding. In a transfer of property proceeding, the Commission does not have sufficient information to make such a finding, nor are all parties that might be impacted by such a finding adequately represented.

**Q. How is your testimony organized?**

A. My testimony is divided into three main topics. First, I discuss the economic and qualitative factors offered by the applicants in support of the sale, in light of the public interest test established in the Commission's recent decision concerning PSE's sale of its Colstrip interests. My testimony on these issues does not distinguish between any

applicant. Next, I discuss the underlying rationale for requiring all of the gain on the sale of any large central station generation and transmission facilities to be returned to ratepayers. I demonstrate that to do otherwise would provide excessive compensation to shareholders. I also explain why shareholders are treated fairly by receiving book value from the sale. Finally, I respond to the testimony offered by Avista and PacifiCorp, which argues that shareholders receive some or all of the gain from the sale, and I respond to PSE's proposal to amortize the gain on sale within five years.

**Q. Are there any other Staff witnesses testifying in this case?**

A. Yes. Mr. Martin discusses accounting issues for each company and Mr. Buckley provides a calculation of the near-term power supply savings that PSE should be able to achieve from the sale of Centralia. This calculation provides the basis for the amount of near-term power supply savings that should be deferred between closing and the time PSE files its next general rate case.

## I STANDARD FOR APPROVAL

**Q. What public interest standard did the Commission require for PSE in order to sell its investment in the Colstrip generation and transmission facilities?**

A. The Commission relied upon a four factor test to determine whether a sale or transfer of utility property is in the public interest. Briefly summarized, these standards are: (1) the transaction should not harm ratepayers by causing rates or risks to increase; (2) the transaction should strike a balance between shareholders, ratepayers, and the

broader public preserving affordable, efficient, reliable, and available service; (3) the transaction should not impair the development of competitive markets for the delivery of service; and (4) the transaction should not shift jurisdiction to another forum where Washington ratepayers may be adversely affected. In Colstrip, the Commission also affirmed its finding in Docket UE-981627 involving PacifiCorp and Scottish Power PLC, that the proper standard for approving the transfer of utility property is whether there is "no harm" to the public interest resulting from the sale. The test I relied upon is the Commission's "no harm" test in the context of the four standards just described. Many of these concepts were repeated in the Commission's Prehearing Conference Order in this case which states that the examination should consider how ratepayers, shareholders and the general public would be impacted by the sale, as compared to no sale.

**Q. What specific analysis did you rely upon in evaluating whether the sale of Centralia meets the first and second criteria of the Commission's no harm test?**

A. The first element of the analysis requires a review of the underlying economics of the transaction. Therefore, I relied upon the testimony and studies each company submitted to support their belief that ratepayers are best served if Centralia is sold and removed from rate base. (PSE: Exs. T-101, 105; PacifiCorp: Exs. T-209, 210, 211, 212; and Avista: Exs. T-303; Exs. No. T-303, 304, 305.) These studies focus specifically upon a comparison of the cost of energy from continued ownership of Centralia and the cost of a reasonable alternative energy supply if Centralia is sold.

**Q. What do these economic studies of the applicants show?**

Avista testifies to a twenty year study supporting a net present value of $7.7 million. PacifiCorp supports a twenty-three year study with a net present value of $10 million. Finally, PSE presents a series of studies. Its nineteen year study, which I would describe as the "base case" scenario, shows a net present value of $7 million from the sale.

Each applicant produced a different study based upon the unique operating characteristics of its respective resource portfolio. It is also critical to note that the applicants treat the gain from the sale differently in their analyses. This is necessary to capture the unique accounting and ratemaking treatment proposals of each applicant. PSE's study includes the impact of its proposal to amortize the gain over a five year period beginning in 2000. PacifiCorp includes in its calculation of future revenue requirements its proposal to offset regulatory assets with the gain. Finally, Avista does not include any consideration of the gain in its study since it proposes to return all of the gain to shareholders.

**Q. Do you have any observations about these analyses?**

A. Yes. Each of the analyses use a different time horizon, all of which appear to be too short, and none of the applicants offer testimony supporting the period for which costs and benefits are studied. The applicants state that extending the time horizon over a longer period subjects their analysis to additional uncertainty, but this testimony does not justify the specific time frame utilized in the analysis. PSE and PacifiCorp

reference a ten-year net present value benefit of $17.7 million and $39 million, respectively. (Ex. T-101, p. 6; Ex. T-209, p. 5.) Even though there is uncertainty in extending any analysis, I believe it is still reasonable to justify the time period upon which each company actually relies.

**Q. What factors and considerations determine the proper time horizon for evaluating the economics of the sale?**

A. New pollution control equipment is being installed. It makes little sense for the majority of the plant owners to justify the installation of pollution control equipment at Centralia, which is a significant capital expenditure with an estimated thirty-year life, and not base the economic analysis over the same time horizon. At a minimum, this discrepancy should be thoroughly explained and justified. Moreover, PacifiCorp should explain why it used a twenty-three year time frame in this case but supported a thirty-year analysis of the same facility in seeking tax concessions from the Washington legislature for the purchase of the pollution control equipment. I believe a thirty-year time frame is reasonable for such an analysis despite the added uncertainty.

**Q. What impact would lengthening the time frame have upon each of the studies?**

A. I have not done that specific analysis. However, based upon the underlying assumptions of the models used by the applicants, extending the period of evaluation would favor keeping Centralia in rate base. This conclusion is based on the scenarios presented by the applicants which all show that the cost of keeping Centralia is less than the market price of replacement power under a medium price scenario. (PSE:

Ex. 105; PacifiCorp: Exs. 211, 212; Avista: Ex. 304)

**Q. What other observations do you have about the analyses presented by the applicants?**

A. First, each of the applicants uses different models and forecasts of future market prices for replacing Centralia energy and capacity, and all of the models rely upon very similar costs for Centralia. As it did in Colstrip, PSE relies primarily on AURORA for future market prices and it replaced Centralia with energy purchases that match the delivery of energy from Centralia. PacifiCorp's analysis estimates future revenue requirements based upon future market prices and an economic dispatch of its system. Avista also relies upon a similar re-dispatch of its system, but with lower estimates of future market prices that produce results that favor a decision to sell. In comparison to the AURORA estimates of future market prices for replacement energy, Avista's estimates appear aggressive. Therefore, its testimony that the transaction produces a net benefit to ratepayers is suspect. In fact, in response to Public Counsel Data Request No. 19, Avista provides new higher estimates of future energy prices, which further undermines its testimony that the economics of the transaction benefit ratepayers.

Second, with the exception of PSE, the studies show that there are near-term benefits of selling Centralia. In the intermediate-term, the studies show that replacement power is also likely to approximate the cost of Centralia, and at some point in the 2004-2008 time frame market prices are forecasted to exceed the cost of Centralia. In the long-

term, the studies all show that Centralia will cost less than alternate energy supply available in the market. Therefore, the net benefit of the sale is clearly a function of how aggressively an analyst estimates longer-term future energy prices and how far into the future the analyst studies the benefit of keeping Centralia in rate base. Looking at the economics of power supply costs and benefits, the sale of Centralia does not produce a net benefit to ratepayers.

**Q. Do you have any other comments about the studies offered by the applicants?**

A. Yes. As I previously stated, PSE's study assumes that it will replace Centralia with "in kind" market-based purchases with energy shaped to match the loss of this resource.

**Q. Is this assumption valid?**

A. No. It is unreasonable to expect PSE to purchase replacement power with the same characteristics as Centralia. Mr. Gaines recognizes this fact. On page ten of his direct testimony he discusses the flexibility PSE will have in replacing Centralia purchases. On page eleven he states, "Replacing (Centralia) . . . will allow PSE to achieve a better match between . . . resources and the demands of its customers." He also testifies on page nine that PSE's 93.8 MW share of Centralia's output, ". . . is a minuscule portion of PSE's peak load of 5,146 MW." It is, therefore, very unlikely that PSE will actually purchase power to replace Centralia. It is necessary to correct this flaw in PSE's presentation to ensure that ratepayers receive the near-term benefits of the expected reductions in power supply expense from the sale. Mr. Buckley estimates these benefits which should be deferred under Staff's recommendation.

**Q. What conclusions have you reached from the economic analyses presented by the applicants?**

A. None of the economic studies demonstrate clearly that ratepayers will benefit from selling Centralia. The analyses show that Centralia should be sold only if long-term market prices for replacement energy remain in the low to medium forecast scenarios. If, on the other hand, long-term energy prices rise and begin to exceed the medium case scenario, the analyses support a decision to keep the resource.

In conclusion, the studies demonstrate that the sale of Centralia is, at best, a "push" and that the sale exposes customers to the risk of paying higher energy costs in the future.

**Q. Does this conclusion mean that the sale of Centralia fails the Commission's public interest test because it harms ratepayers?**

A. Standing alone, these economic studies support a conclusion that the sale of Centralia will expose ratepayers to increased risks of higher future energy costs. Therefore, the studies themselves warrant a conclusion that Centralia should not be sold. However, there are other factors that should be considered in determining whether the sale harms ratepayers.

**Q. What other factors should be considered?**

A. These are the qualitative factors discussed by the applicants' policy witnesses, Messrs. Miller, Gaines, and Ely. First and foremost, the future cost of the Centralia steam plant is highly uncertain. Second, there are future environmental remediation costs

related to the mine. Selling Centralia removes these uncertainties for both shareholders and ratepayers. Furthermore, Centralia is a highly valuable resource because of its location. Selling Centralia to TECWA provides certainty to the region that the pollution control equipment will be installed, the plant will continue to operate, and the region will continue to benefit from Centralia's strategic position in the Pacific Northwest grid.

Next, I would refer the Commission to testimony offered by Mr. Gaines of PSE. He states, ". . . the analyses do not reflect the significant potential technological or political changes that may occur within the planning horizon, including retail access, increased benefits from wholesale competition . . . ." (Exhibit T-101, p.13) This is a critical element of the decision-making process. I do not believe that forecasting models can fully account for technology changes or efficiency improvements, or fully capture all of the anticipated benefits from increased wholesale competition.

**Q. Are there any other factors that you believe should be considered in the context of evaluating the sale of Centralia?**

A. Yes. The decision to sell Centralia relates directly to the issue of open access and whether the Commission believes it is in the long-run best interests for consumers to purchase power in wholesale competitive markets, rather than to continue to rely upon the utilities to make those purchases or make new investments in power plants. In other words, the decision to sell Centralia concerns whether it is appropriate for the Commission to regulate electric companies as distribution companies. In Colstrip, I

testified that at the end of the current rate plan PSE should be regulated as a distribution company. I would also note, as a policy matter, that the Commission's third criteria evaluates the impact of a sale of utility property on competition and the ability to deliver affordable, reliable and, efficient electricity service. Competitive wholesale electric markets, I believe, will provide the public with better, lower-cost services. If the Commission agrees, then the sale of Centralia fits clearly within that policy framework. On the other hand, if the Commission believes that it is in the public interest to continue to regulate electric companies as vertically integrated utilities, then the economic studies do not support the sale of Centralia.

**Q. Do these qualitative factors lead you to conclude that the sale of Centralia meets the Commission's public interest test?**

A. The qualitative factors do support the decision to sell Centralia. However, as demonstrated by the economic analyses, there are long-term risks to ratepayers of higher energy costs if Centralia is sold. Therefore, in order for the public not to be harmed from the transaction, all of the gain and all of the near-term power supply benefits must accrue to ratepayers. This conclusion is very similar to that reached by the Commission in its analysis of Colstrip.

**Q. The fourth criteria of the Commission's public interest test is whether the transaction may adversely affect Washington ratepayers by shifting jurisdiction to another forum. Would the proposal to sell Centralia shift jurisdiction to another forum adversely affecting ratepayer's interests?**

A. No. The Commission would either continue to regulate the fully bundled rates of the applicants or, in an open access environment, the Commission would rely upon competitive markets to determine the reasonableness of power supply costs.

**Q. Please summarize your testimony regarding whether the sale of Centralia meets the Commission's public interest test?**

A. The economic studies do not demonstrate long-term economic benefits of the transaction. The decision to sell Centralia is heavily weighted by consideration of non-monetary factors and near-term benefits that are very likely to occur. I also believe the decision to sell is supported by the potential long-term benefits of moving regulated utilities to an environment where ratepayers receive the benefits of wholesale competition in electric commodity markets. In order for ratepayers to assume the risk of capturing these potential benefits of access to competitively priced power supplies, the near-term benefits of the transaction must be returned to ratepayers. Therefore, the Commission should approve the sale of Centralia for each applicant, but only on condition that ratepayers receive all of the gain and all of the near-term power supply benefits which result from the sale. The Commission will be able to capture the near-term power supply benefits for PacifiCorp and Avista customers in their pending rate cases. PSE should defer the near-term power supply benefits of the sale due to its operation under the Merger rate plan. Each company's proposed accounting and ratemaking treatment should, therefore, be rejected.

## II. SOUND REGULATORY POLICY SUPPORTS RETURNING THE GAIN TO RATEPAYERS

**Q. Are there other reasons for requiring that all of the gain goes to ratepayers from the sale of Centralia?**

A. Yes. It is reasonable and sound regulatory policy to return the gain to ratepayers under any circumstance.

**Q. Why is that?**

A. The Commission's use of rate base, rate of return regulation provides shareholders an opportunity to earn a fair rate of return on utility investment. The policy is consistent with the seminal Supreme Court cases of *Hope & Bluefield.* In a rate case, the Commission evaluates all used and useful utility property and provides a market based return as compensation to investors for the public's use of the facilities. At all times investors are allowed an opportunity to earn a fair return on and of these investments. Furthermore, embedded in the calculation of compensation to investors is a return on equity component which compensates shareholders for the risk of ownership. Therefore, whenever the Commission sets rates, it makes a prospective determination that shareholders will be compensated fairly. Anytime a utility believes it is not receiving adequate compensation with respect to its investments, including the Centralia property, it may seek to change rates. This prospective look at market based returns on net book value is the time-honored test for measuring fair compensation to shareholders.

**Q. What happens to shareholders once a utility sells property, such as Centralia?**

A. Once the utility sells its remaining investment and receives the net book value of the facility at the time of closing, shareholders are treated fairly based upon management's decision to use the cash from the proceeds. There are two choices: (1) management may return the cash to shareholders; or (2) management may reinvest the proceeds in other assets. In the first instance, shareholders re-invest the cash dividend and seek a fair rate of return on any alternate investment. In the second instance, management must make decisions to re-invest in new projects that presumably will provide a fair return to investors. Indeed, if any of the gain is kept by the utility, shareholders will be provided excessive returns through accretion in the utility's book value.

**Q. Are there any other ways in which the Commission's prior rate treatment of these facilities requires that ratepayers receive the entire gain from the sale?**

A. Yes. As I testified in the Colstrip proceeding, these generation and transmission facilities were expected to produce long-term benefits to customers. Since rates reflect early year capital costs, rather than levelized costs, the benefits to ratepayers of Centralia must be considered over the entire life of the resource. The effect of traditional rate base regulation causes ratepayers to incur the high cost of these facilities in the early years and the lower costs in later years as these facilities are depreciated over time. Therefore, it is very important that the Commission insure that ratepayers receive all of the benefits from the transaction since consumers have paid in the early years of Centralia the significant portion of the total life-cycle cost of these

facilities. Now, and for the remaining life of Centralia as it becomes fully depreciated, the benefits of lower fixed capital costs begin to accrue to ratepayers. The applicants studies in this proceeding all demonstrate this fact.

**Q. Are there any other factors that support the decision to provide ratepayers all of the gains from this transaction?**

A. Yes. RCW 80.04.350 requires the Commission to determine the depreciation rates to apply to all utility property used to serve the public. This ensures that shareholders are provided a return of capital over the economic life of all utility property. Setting depreciation rates is a prospective process, and the Commission is never able to accurately determine the depreciation rate of long-lived assets like Centralia. It is reasonable to consider the gain as the inability to accurately provide for the depreciation reserve. In other words, Centralia was depreciated too quickly. Therefore, ratepayers paid excessive depreciation expense and shareholders benefitted since capital was returned too quickly. Returning the gain to ratepayers establishes equity.

**Q. Are there any final elements concerning the gain that warrants Commission consideration?**

A. Yes. Each of the applicants presented testimony that the continued ownership of Centralia exposes both shareholders and ratepayers to considerable risk. This testimony stands for the proposition that, without the sale, it is possible that Centralia would no longer continue to be a viable source of power. If that is the case, the owners

should be pleased with a transaction that returns the net book value from the remaining investment. If Centralia is not sold and later a decision is reached to abandon the facility, shareholders are faced with the prospect of asking ratepayers to continue to pay for an abandoned facility. If these risks are real, management has a fiduciary responsibility to sell Centralia now and return to shareholders the net book value of the facilities or reinvest the proceeds in other capital projects.

## III. RATEMAKING PROPOSALS

**Q. Do you have any comments about the specific proposals of PacifiCorp and Avista to allow shareholders to receive some or all of the gain?**

A. Yes. My comments should be considered in the broader context of whether these proposals are reasonable for all applicants. The Commission's treatment of the gain should be uniformly applied to each applicant.

**Q. Would you please summarize Avista's justification for its proposal to return the gain to shareholders?**

A. First, Avista argues that it is fair and equitable to give shareholders the entire gain given the historical balance between ratepayers and shareholders. (Ex. T-306, p. 4.) Second, Avista argues that shareholders receive asymmetrical treatment from the Commission when it comes to evaluating resource decisions, and that a more equitable outcome is for shareholders to benefit from occasional gains rather than exclusive losses from developing new resources.

Avista presents Exhibit 307. This exhibit is a comparison of Company "earnings" and "authorized rate of return." On the basis of this exhibit, Avista asserts that its actual rate of return for its Washington electric operation is more often than not below what is considered fair and reasonable and authorized return during the period of time Centralia has been in service to the public. (Exhibit T-306, p. 4.) This argument should be rejected by the Commission.

**Q. Why should this argument be rejected?**

A. Exhibit 307 is based upon several false premises. First, Avista assumes incorrectly that the authorized rate of return adopted by the Commission in a rate case is synonymous with a fair rate of return until changed by the Commission in a subsequent rate order. However, an authorized rate of return may or may not be a fair rate of return, depending upon market conditions as they change over time.

Exhibit 307 demonstrates this problem. The Commission has not determined a fair rate of return for Avista since 1986 in Cause U-85-36. In early 1987 in Cause U-86-99, the Commission accepted a settlement establishing a revenue deficiency for the Company's investment in WNP-3. That $15.5 million revenue deficiency was based primarily upon a 10.67% rate of return applied to 64.1% of the Company's investment in WNP-3.

It is unreasonable to consider the Commission's acceptance of an 10.67% rate of return in 1987 as representative of a fair return for Avista each and every year through 1998. A 10.67 % rate of return for Avista has not been reasonable for many years.

Second, Avista assumes incorrectly that the column representing the achieved rate of return would have been accepted by the Commission as a fair representation of the Company's earnings for ratemaking purposes. What the exhibit does show clearly is that Avista's electric operations have not been fully reviewed since 1985 and its decision not to seek rate relief is *prima facie* evidence that existing rates provided adequate compensation to shareholders throughout the time period.

**B. Do you have any preliminary evidence regarding Avista's earnings during the past ten years?**

A. Yes. Exhibit 402 (KLE-2) shows Avista's market-to-book ratio and return on common equity for the period 1989-1998. Even though these figures are summary figures for the total company, they support the exact opposite conclusion: Avista was over-earning.

**Q. Do you have a preliminary estimate of what would be a fair rate of return for Avista during the 1990's?**

A. Yes. The cost of capital declined dramatically during the 1990's. For example, in the early 1990's, the Commission determined that 10.5% was a fair return for shareholders for both an electric and gas utility. Applying a 10.50% return on common equity to Avista, and assuming a reasonable capital structure consistent with prior rate decisions for the Company, produces an overall rate of return in the 8.75% to 9.25% range. I would also note that a 10.50% return on equity itself may be too high for Avista under current market conditions.

**Q. Please summarize your conclusions regarding Exhibit 307?**

A. Avista's exhibit and corresponding testimony that shareholders have not enjoyed the efficiency gains achieved by management is incorrect. An accurate study of the Company's earned returns for the 1990's would show that shareholders have captured the efficiency gains achieved by management during this last decade.

My previous testimony in this regards still stands: the Commission's use of rate of return regulation principles is fair to shareholders. At any time Avista determines that its rates provide inadequate compensation from the public's use of its utility property, it may seek rate relief from the Commission. The Commission will then evaluate all the facts and circumstances, and establish rates in accordance with the statutory principles of fairness and equity.

**Q. Avista also discusses the fact that it has experienced substantial disallowance of prior investments in generation facilities. (Ex. T-306, pp. 5-7.) Would you please comment on this testimony that returning the gain to shareholders from the sale of Centralia restores equity because Avista was denied full recovery of these prior investments?**

A. The 1970's and early 1980's were a period of time when ratepayers and shareholders suffered losses due to significant problems in the electric industry and the inability of the industry to develop efficient resources at that time. The testimony fails to mention that some of these investments were for resources that never reached commercial operation. Ratepayers lost because they paid for resources that never were developed.

The testimony leaves a false impression that only shareholders lost from the development of these resources. This is not the case. Furthermore, all three electric utilities have experienced losses from prior investments in developing new resources. It is also critical to note that prior Commission decisions regarding these "losses" were based upon substantial evidentiary records in order to develop public interest findings that treated all parties fairly. The Commission grappled with the consequences of these resource decisions and the impacts to all parties. It is simply incorrect to consider the Commission's prior treatment of Avista, or any other utility during this period, as asymmetrical and exclusively burdening shareholders with losses. Any attempt to "re-establish equity" by giving the gain from Centralia to shareholders, in essence, undermines these prior decisions of this Commission.

**Q. Are there any other issues related to Avista's testimony which you would like to discuss?**

A. Yes. The testimony fails to recognize that investors in utility equities are compensated for accepting the risk of developing new resources. In particular, during the periods when utilities were making investments in new resources, the market recognized these risks and discounted utility stocks accordingly. Shareholders were compensated for accepting the risk of developing new resources through equity risk premiums. Returning any of the gain from the sale of Centralia to shareholders amounts to excessive compensation for shareholders.

**Q. Please summarize your conclusions about the policy discussion contained in Avista's testimony as it applies to all of the applicants?**

A. Avista's arguments should be rejected. The testimony stands for the proposition that prior Commission decisions and current practices create unfair treatment to shareholders: all downside with no upside. I disagree. Prior decisions by this Commission evaluated all relevant evidence and treated all parties fairly. Unfortunately, all parties suffered losses due to the failure of utilities to develop these resources during this period. It would be inequitable and unfair to the parties in those prior rate proceedings to revisit those prior decisions. Finally, returning the gain to shareholders would provide excessive compensation to shareholders.

**Q. If the Commission accepts Avista's arguments and decides to return the gain to shareholders, should this treatment be applied only to Avista?**

A. No. If the Commission is persuaded by the arguments offered by Avista and decides to return the gain to shareholders, Staff believes the results of this policy decision should apply equally to all of the applicants. Avista is no different in this regard than any other applicant.

**Q. Avista also provides testimony regarding the Company's low rates and high quality service in an effort to support the proposal that all the gain on the sale be returned to shareholders. Do you have any comments regarding this testimony?**

A. Yes. The comparison of rates between utilities is not a relevant factor for the Commission in its consideration of the sale of Centralia or whether electric rates meet

the standard under RCW 80.28.010 (1), which requires rates to be fair, just, reasonable and sufficient. Indeed, comparing the electric rates in Washington to national averages leads one to conclude that all Washington ratepayers enjoy low electric rates. However, low rates are the function of many diverse factors, which may include efficient management. Furthermore, section 2 of the this same statute requires Avista to deliver efficient electric service. Management should be pleased with the results of the customer surveys and continue its efforts to provide high quality service to customers. These results go a long way to demonstrate the reasonableness of the Company's expenses for customer service, but for purposes of determining the treatment of the gain from the sale of Centralia, this fact is irrelevant.

**Q. PacifiCorp proposes to share the gain based upon the reserve depreciation methodology. Would you please describe this proposal?**

A. This method treats the undepreciated amount of the original investment as "at risk," and, since shareholders continue to bear the risk of recovery of the undepreciated amount, they are entitled to that portion of the gain.

**Q. Please summarize Staff's position regarding this proposal?**

A. The Commission should also reject this methodology. My prior testimony discusses the reasons why this proposal is not acceptable. I think it fair to say that both shareholders and ratepayers bear the risk of ownership Shareholders are compensated for accepting this ongoing risk of prudently managing the resource while it is in rate base, and as long Centralia continues to produce power, ratepayers will pay rates that

reflect the ongoing reasonable costs of power produced by the plant. These costs include compensation to shareholders for the risks of ownership.

**Q. Is your conclusion about PacifiCorp's proposed treatment of the gain applicable to all applicants?**

A. Yes. The Commission's ratemaking practices provide shareholders an opportunity to earn a return on and of used and useful utility property. This policy is fair and equitable. If there is a gain on the transaction, such as with Centralia, the gain should be returned to ratepayers. The proposed treatment of Avista and PacifiCorp would provide excessive compensation to shareholders for the public's use of utility property and should be rejected.

**Q. Please summarize your conclusion regarding PSE's ratemaking proposal to amortize the gain over a five year period?**

A. PSE's proposal suffers from the same problems identified by Staff in the prior Colstrip proceeding and should also be rejected by the Commission.

**Q. Would you briefly summarize the problems Staff identified in Colstrip which apply equally to PSE's proposal to sell Centralia?**

A. PSE, similar to its testimony in Colstrip, asserts that the sale of Centralia is consistent with its commitment to reduce power supply costs in the context of the Merger commitment to achieve "power stretch" goals. The sale of Centralia, however, is not a "power stretch" goal. The Commission ruled that the sale of Colstrip was not contemplated in the Merger and it did not grant PSE permission to sell used and useful

generation to achieve power stretch goals. The same conclusion should be apply here. The second problem is the interaction of the Merger rate plan with the savings resulting from the transaction. The rate plan was based upon a premise that PSE's thermal resources were included in prospective power costs and justified annual rate increases for PSE. If near-term power supply savings are not deferred, ratepayers are harmed since the rate plan precludes the Commission from recognizing in PSE's rates the lower costs of selling the resource.

**Q. Does this conclude your direct testimony?**

A. Yes.