Exhibit ______ (MRL-3)
Docket No. UE-010395
Witness: Merton R. Lott

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Avista Corporation's) Petition for Recovery of Expenditures) Related to Electric Deferral Mechanism))	DOCKET NO. UE-010395

EXHIBIT OF

MERTON R. LOTT

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

RE: AVISTA PETITION FOR 37% EMERGENCY SURCHARGE

August 24, 2001

WUTC DOCKET NO. UE-010395
EXHIBIT NO. 503
ADMIT ☒ W/D ☐ REJECT ☐

Agenda Date:	August 9, 2000.
Item Number:	2B
Docket:	**UE-000972**
Company Name:	**Avista Corp.**
Staff:	Doug Kilpatrick, Electric Section Coordinator DK Thomas Schooley, Policy Research Specialist Alan Buckley, Senior Policy Specialist Dixie Linnenbrink, Regulatory Services Division Director

Recommendation:

Grant Avista's request to defer certain power cost expenses in the period from July 1, 2000, through June 30, 2001. Order that recovery of these deferrals will not be allowed until a demonstration of the prudency of the costs is made in a future filing, including that recovery of such costs through a deferral mechanism is appropriate. Direct Avista to include a footnote disclosure in all regulatory reporting or financial disclosure statements that include these deferrals, that regulatory approval of their recovery will not be received until the showing of prudence, including a demonstration that Company-owned facilities were optimized to the benefit of retail ratepayers.

Discussion:

Proposed Power Cost Deferral

On June 23, 2000, Avista Corporation ("Avista" or "Company") filed an accounting petition requesting authority to defer expensing certain power costs related to short-term wholesale power market prices. The petition requests an accounting order authorizing the Company to defer the increased expenses associated with recent dramatic increases in short-term wholesale market prices. Avista seeks to defer power costs through monthly journal entries beginning July 1, 2000, and ending June 30, 2001. The Company states it is requesting accounting treatment for a 12-month period in order to capture the seasonal impacts that can occur over the course of a full year.

The Company proposes that the balance of deferred excess power costs be amortized over ten years beginning July 1, 2001, or some other method as determined by the Commission, with a carrying charge equal to its authorized rate of return on the unamortized balance. The ratemaking treatment related to these deferrals would be the subject of a future rate filing. Avista understands that it bears the burden of proving the reasonableness of these costs prior to the recovery of the deferrals in rates. The petition does not ask for recovery or deferral of power costs prior to July 1, 2000.

Avista proposes to calculate the deferral monthly, by comparing the actual costs of three power cost variables versus what those costs would be under normalized conditions. The three power cost variables are short-term market prices, thermal generation, and hydroelectric generation. Based on data presented with the original petition, the Company claims potential deferrals of about $20 million in one year for the Washington jurisdiction.

Proposed Accounting Treatment

Avista requests the following specific accounting treatment:

- Record the monthly deferral of power costs by crediting Account 557 - Other Power Supply Expenses, thereby decreasing the recorded power supply expense, and debiting Account 186 - Miscellaneous Deferred Debits. Related deferred income taxes require the debiting of Account 410.10 - Provision for Deferred Income Taxes, and the crediting of Account 283 - Accumulated Deferred Income Taxes.

- Commencing in July 2001, amortize the balance of Account 186 by crediting Account 186 and debiting Account 557. The deferred taxes are commensurately recorded by debiting Account 283 and crediting Account 411.10 - Provision for Deferred Income taxes-Credit.

The Company proposes to provide reports to the Commission on a monthly basis, by the end of each succeeding month, related to the deferrals. The reports will include all calculations and accounting entries.

Staff Analysis - Accounting Issues

While Regulatory Division Staff ("Staff") supports deferral of these costs pending further investigation, it is important to clarify the specific regulatory accounting treatment proposed for the deferred costs. Following is a discussion of deferrals under Statement of Financial Accounting Standards No. 71..

Statement of Financial Accounting Standards No. 71 establishes the general standards of accounting for the effects of regulation. Paragraph 9 of SFAS 71 states,

> "Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
> a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate making purposes.
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost."

Avista requests that the excess power costs be posted to Account 186-Misc. Deferred Debits.

This account is a catch-all account in the FERC Uniform System of Accounts. As the USofA declares:

> "this account shall include all debits not elsewhere provided for, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, which are in process of amortization and items the proper final disposition of which is uncertain."

Also available for use within the USofA is account 182.3 - Other Regulatory Assets. This account is defined as:

> "A. This account shall include the amounts of regulatory-created assets, not includible in other accounts, resulting from the rate making actions of regulatory agencies.
>
> B. The amounts included in this account are to be established by those charges which would have been included in net income determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing the rates that the utility is authorized to charge for its utility services. ... The amounts recorded in this account are generally to be charged, concurrently with the recovery of the amounts in rates, to the same account that would have been charged if included in income when incurred, ..."

These very deliberate definitions from both the Financial Accounting Standards Board and from the Federal Energy Regulatory Commission presume that a regulatory asset, once created, will probably be recovered in rates at a later time. Staff believes the accounting entries proposed by Avista in Account 186 are appropriate since they recognize that the "proper final disposition" of the deferred costs "is uncertain." For that reason Staff recommends the Commission approve deferral pending demonstration of the prudence of the increased costs and that recovery of such costs through a deferral mechanism is appropriate.

Staff Analysis - Power Cost Issues

Staff has reviewed the supporting materials provided by Avista estimating the level of what the Company has referred to as "extraordinary costs." In addition, Staff has sought answers to a number of informal data requests to further understand the Company's proposal. Avista has worked to supply answers to these data requests as quickly as possible. Staff has concerns about the issues involved here that fall into two basic categories - general policy issues and deferral mechanism issues.

First, Staff is concerned that three general policy issues need to be addressed before the Commission should consider granting recovery of the deferred costs.

1) When and to what extent should power supply costs be considered "extraordinary" versus "non-extraordinary" variations from normalized power supply costs?
2) Does such a consideration require first that a Company show that the standards for emergency relief have been met?
3) Should responsibility for recovery of any extraordinary costs incurred should be somehow split between captive retail customers and system wholesale customers.

Staff has some unresolved questions regarding the actual deferral mechanism that Avista will use but is willing to work with the Company to assure that actual transactions are being monitored and reported appropriately, starting immediately.

Regarding eventual recovery of the deferrals, Avista has stated that it intends to bear the burden of proof for prudency. Staff believes that Avista will need to affirmatively show that not only were the expenses tracked and deferred correctly, it will also need to answer at least the following:

1) Does Avista's native load or its net system load cause any shortfall in resources available to serve all obligations?
2) What was the level of retail customer sales during the period of deferral?
3) What was the level of wholesale customer sales during the period?
4) What power purchases or sales were made during the period?
5) How were native resources optimized to meet retail customers' loads?
6) Does the mechanism capture all the benefits of operating the Company's system?

Summary:

Staff is willing to support Avista's request for a deferral mechanism that allows it to track the costs currently being incurred for short-term energy purchases. Staff believes additional investigation and analysis is required before the Commission should allow the Company to recover these deferrals. Prior to allowing recovery in rates, Avista will bear the burden of showing that any increases in costs above normalized levels were prudent, that use of such a deferral mechanism is appropriate, and that Company-owned native resources were optimized to benefit retail ratepayers.

Conclusion:

Staff recommends the Commission grant the request to defer increased power costs and order that recovery of these deferrals will not be allowed until a demonstration of prudency of the costs is made in a future filing. Further, the Company should be required to include a footnote in all regulatory reporting or financial disclosure statements that include these deferrals, that regulatory approval of their recovery will not be received until the showing of prudence, including a demonstration that Company-owned facilities were optimized to the benefit of retail ratepayers.