BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET NO. UE-991606
DOCKET NO. UG-991607

REBUTTAL TESTIMONY OF DON M. FALKNER
REPRESENTING THE AVISTA CORPORATION

WUTC
DOCKET NO. UE-991606
EXHIBIT # T-268
ADMIT W/D REJECT

Exhibit T-268(DMF-T)

INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corp.

A. My name is Don M. Falkner. My business address is East 1411 Mission Avenue, Spokane, Washington. I am employed by Avista Corp. (Company) as a Senior Rate Accountant.

Q. Have you previously provided direct testimony in this Case?

A. Yes. My testimony covered accounting and financial data in support of the Company's need for the proposed increase in rates. I explained pro formed operating results including expense and rate base adjustments made to actual operating results and rate base, as well as the Company's allocation methodologies.

Q: Are you sponsoring any Exhibits with this rebuttal testimony?

A: Yes. I am sponsoring Exhibit _____ (DMF-1) through Exhibit _____ (DMF-6)

Q. What is the scope of your rebuttal testimony in this proceeding?

A. My rebuttal testimony and exhibits will consolidate the Company's rebuttal position on all the adjustments proposed by Staff and Intervenor witnesses which impact the Company's proposed results of operations and will note which adjustments from the Company's original filing have been updated, or revised. I will also address which adjustments with which the Company concurs and most adjustments that are still at issue.

Q. What adjustments did Public Counsel and the Industrial Customers of Northwest Utilities (ICNU) propose with which the Company takes issue?

A. Public Counsel proposed an adjustments to A & G labor costs, an adjustment associated with the charging of a franchise fee for use of the Company's corporate name, an adjustment to depreciation expense for certain production plant, an adjustment to meter reading and billing expenses and the removal of amortization related to the Company's name change. Ms. Mitchell will address the proposed adjustment to A & G labor costs and Mr. Hirschkorn will address the proposed adjustment to meter reading and billing costs. I will address the remaining adjustments proposed of Public Counsel. Mr. Norwood will address power supply issues raised by Mr. Schoenbeck on behalf of ICNU. ICNU's other proposed revenue requirement adjustments for what they characterized as "non-recurring" costs are unsupported and duplicative of Staff's proposed adjustments. I will address them later in this testimony.

SUMMARY

Q. What are the Company's revised revenue requirements for its electric and gas systems after taking into account Staff adjustments that have been accepted and Company revisions to the originally filed adjustments?

A. After taking into account the accepted adjustments and adjustment revisions outlined in both my testimony and other testimony, the Company's revised electric revenue requirement is an increase of $18,168,000, or 7.20%, as detailed in Exhibit ____ (DMF-1). The Company's revised gas revenue requirement is an increase of $4,427,000, or 5.92%, as outlined in Exhibit ____ (DMF-2).

Q. Could you please list the various electric adjustments that are at still at issue or have changed from the Company's original filing and compare the Company's position for Net Operating Income (NOI) and Rate Base impacts with those of other parties..

A. Certainly. Please see the table below. For convenience, I will be using the

Column references that can be found in my Exhibit ___ (DMF-1) since it captures both the Company's originally filed electric adjustments as well as additional adjustments proposed by primarily the Staff. In addition to noting which of the Company's originally filed adjustments have been revised, it also displays both adjustments accepted by the Company and placeholder columns for those rejected by the Company.

Electric Adjustments at Issue or Otherwise Revised

Dollars are in thousands

COL DMF-1	DESCRIPTION	Company NOI	Company Rate Base	Staff NOI	Staff Rate Base
d.	Deferred Gain on Office Building	-	$(1,000)	-	$(1,150))
p.	Injuries and Damages	$(1,514)	-	$(32)	-
r.	Pro Forma Restate Debt Interest	$(2,492)	-	$(3,110)	-
PF1.	Pro Forma Power Supply	$(322)	-	$5,485	-
PF2.	Pro Forma Potlatch	$683	-	$405	-
PF4.	Pro Forma Hydro Relicensing	$(954)	$9,277	$(695)	$9,277
PF5.	Pro Forma Commercial Trade	$380	-	-	-
PF6.	Pro Forma Nez Perce	$(380)	-	$(341)	-
PF7.	Pro Forma Labor/Benefit	$(386)	-	$(83)	-
PF9.	Pro Forma Misc Adjustments	$679	-	$849	-
PF11.	Company Centralia Replacement	$(3,646)	$(12,460)	-	-
PF12.	Company Centralia Gain Amort.	$1,488	$(11,162)	-	-

COL DMF-1	DESCRIPTION	Company NOI	Company Rate Base	Staff NOI	Staff Rate Base
PF13.	Company Centralia Ice Storm Offset	$1,331	-	-	
PF14.	Restate Excise/Franchise Taxes	$443	-	$548	-
PF15.	Bonuses Adjustment	-	-	$1,435	-
PF16.	Staff Misc. Restating	$202-	-	$370	-
PF18.	Staff Relocation Expense	-	-	$108	-
PF20.	Pro Forma PGE Contract	-	-	$2,990	$(43,851)

Q. Could you please list the various gas adjustments that are at issue or have changed from the Company's original filing and compare the Company's position for Net Operating Income (NOI) and Rate Base impacts with those of other parties.

A. Yes. Please see the table below and again for convenience, I will be using the Column references that can be found in my Exhibit ___ (DMF-2) since it captures both the Company's originally filed gas adjustments as well as additional adjustments proposed primarily by the Staff. Here again, in addition to noting which of the Company's originally filed adjustments have been revised, it also displays both adjustments accepted by the Company and placeholder columns for those rejected by the Company.

Gas Adjustments at Issue or Otherwise Revised Dollars are in thousands					
COL DMF-2	DESCRIPTION	Company NOI	Company Rate Base	Staff NOI	Staff Rate Base
d.	Deferred Gain on Office Building	-	$(348)	-	$(400)
e.	Gas Inventory	-	$1,458	-	-
n.	Pro Forma Restate Debt Interest	$(297)	-	$(379)	-
q.	Restate Excise/Franchise Taxes	$(459)	-	$(73)	-
PF5.	Staff Bonuses Adjustment	-	-	$282	-
PF6.	Misc. Staff Restating Adjustment	$140-	-	$186	-
PF7.	Staff Relocation Expense Adjustmnt	-	-	$27	-
PF2.	Pro Forma Labor/Benefits Adj.	$(108)	-	$(32)	-
PF4.	Pro Forma Misc. Adjustment	$172	-	$214	-

Q. With which adjustments proposed by Staff does the Company concur?

A. The Company concurs with the following adjustments proposed by Staff:

ELECTRIC

- Deferred FIT Rate Base – (updates estimate to actual)
- Clearwater Hydro – (deferred amount completely amortized by rate year)
- Weatherization & DSM Investment – (updated to rate year)
- Settlement Exchange Power – (updated to rate year)
- Pro Forma Depreciation Expense – (reflects negotiated settlement)
- Staff Restate Excise/Franchise Tax – (Excise tax portion only – updated to actual)
- Staff Lease Expense Adjustment – (conforms electric adjustment with gas

adjustment)

- Staff Lost Revenue Fuel Efficiency – (eliminates non-recurring revenue)

GAS

- Deferred FIT Rate Base – (updated estimate to actual)
- Weatherization & DSM Investment – (updates to rate year)
- Pro Forma Depreciation Expense – (reflects negotiated settlement)
- Pro Forma Revenue Adjustment – (eliminates double counted revenues)
- Staff Hamilton Street Bridge Remediation – (environmental clean-up)

Q. Which adjustments proposed by Staff that are still at issue will you be addressing in your rebuttal testimony?

A. I will address the following adjustments that are still at issue with Staff:

- Injuries and Damages – Electric only
- Restate Excise/Franchise Taxes – Franchise Fee portion only
- Pro Forma Misc Adjustments
- Pro Forma Nez Perce Adjustment
- PGE Contract– (Electric only and appropriate deferred balance only)
- Staff Misc. Restating Adjustments
- Gas Inventory – Gas only

Injuries and Damages – Electric only

Q. Does the Staff take issue with certain components of the Company's Injuries and Damages Adjustment, represented as Column P in Exhibit ____ (DMF-1)?

A. Yes. Staff, through Mr. Schooley, submits that legal and other costs associated with obtaining a settlement of the 1991 Firestorm litigation, and the entirety of the 1996 Ice Storm costs should not be recoverable by the Company.

Q. Please address the Firestorm issue first.

A. Mr. Schooley provides the background of the Firestorm event itself on page 4 of his Exhibit T- ___ (TES-T). He then goes on to accept the final settlement of the 6-year litigation, net of insurance proceeds as recoverable in Injuries and Damages, but he excludes the costs associated with obtaining the settlement. His only argument is that,

> "Legal fees are an ongoing expense of a utility company. The subject of the litigation changes from year to year, but total legal expenses remain fairly consistent.... Recovery of specific legal fees is unnecessary and duplicative."

Q. Do you agree with this assertion?

A. Absolutely not. The Firestorm litigation was unique, highly complex, covered a span of 6 years and had the potential for a material level of damages. The legal and other settlement costs, such as claims investigation, surveys and outside consultants, are inextricably tied to the final settlement. They do not represent anything close to normal levels of year to year legal expenditures. All costs contributed to the ultimate settlement. They contributed to the Company being able to get a settlement well below the amount that could have resulted in a fully litigated case. Excluding the legal costs, but allowing settlement amounts, taken to the extreme, would seem to encourage early and perhaps premature settlement of complex issues since settlement payments are deemed reasonable for recovery, but not associated expenditures designed to reduce the level of the settlement payment.

Q. Please address the Ice Storm issue, as it relates to the Injuries and Damages Adjustment.

A. Certainly. Mr. Dukich's rebuttal testimony deals with the majority of the issues associated with Ice Storm, however, I would like to address two issues. First, on page 7, lines 3 through 7, of Mr. Schooley's Exhibit T-____ (TES-T), he states,

> "...It is only now, three years after the fact, that the Company presents a means to increase rates because of this expense."

Q. Is that statement correct?

A. No. Not at all. Ice Storm occurred in November of 1996. The Company provided the Commission a report entitled "Ice Storm '96 Overview—Two Months Later." This report was dated January 28, 1997 and it included an introduction signed by our then CEO, Paul Redmond. In section 3.7 Costs and Recovery, on page 14, the Company stated:

> "...The remaining $17.1 million ($11.1 million after-tax) will be included with other non-insured losses from storms and accidents. The annual expense level is determined through use of a six-year average. WWP will not seek a specific rate surcharge due to the costs of Ice Storm '96 restoration."

Q. Was there any other information provided to the Staff that indicated the Company's intended treatment of the Ice Storm Expenditures?

A. Yes. We file Semi-Annual Reports with the Commission based on twelve month operating periods ending June and December of each year. Starting with our report for the twelve months ended December 31, 1996, the Company has been including Ice Storm costs as part of its 6-year average for Injuries and Damages.

Q. Has Staff ever questioned that component of the adjustment?

A. No.

Q. What was the second issue you wanted to address?

A. On pages 5 and 6 of Mr. Schooley's Exhibit T-___ (TES-T), he makes the point that the Ice Storm damages were to Company-owned property, not that of third parties, and that the Commission order authorizing the injuries and damages methodology only addressed damages to third parties. In my opinion, that can only be construed as a meaningless distinction. The Ice Storm damages were extraordinary, uninsured property losses that are not unlike the Firestorm situation. Whether or not the damage was to the property of the Company or to third parties, the necessity for the expenditures is the same, and no one has challenged the prudence of these expenditures.

Restate Excise/Franchise Taxes

Q. Do you take issue with the portion of the Staff's adjustment to Restate Excise taxes from an accrual to the actual for the test period?

A. No. I do not. That is a reasonable normalizing adjustment.

Q. Do you agree with the Staff's position on separating Franchise Fees out of general operating costs and treating them the same way Business and Occupation taxes are treated.

A. No. I do not. In this particular proceeding, Staff takes issue with the Company's inclusion of Franchise Fees as general costs of operations and a component of the Company's conversion factor. It should be pointed out that the Company's current regulatory treatment and method of recovery from customers for Franchise Fee costs, both electric and gas, has been in place for decades.

Staff mistakenly interprets Subsection (1) of RCW 35.21.860 to preclude the Company's pre-1982 franchise agreements from somehow applying to amounts that are not related to "actual" administrative costs of the cities that have instituted the franchise fees. Below is the complete code:

> **"35.21.860 Electricity, telephone, or natural gas business—Franchise fees prohibited—Exceptions**
> (1) No city or town may impose a franchise fee or any other fee or charge of whatever nature or description upon the light and power, or gas distribution businesses, as defined in RCW 82.16.010, or telephone business, as defined in RCW 35.21.865 may be imposed and (b) a fee may be charged to such businesses that recovers actual administrative expenses incurred by a city or town that are directly related to receiving and approving a permit, license, and franchise, to inspecting plans and construction, or to the preparation of a detailed statement pursuant to chapter 43.21C RCW.
> (2) Subsection (1) of this section does not prohibit franchise fees imposed on electrical energy, natural gas, or telephone business, by contract existing on April 20, 1982, with a city or town, for the duration of the contract, but the franchise fees shall be considered taxes <u>for the purposes of the limitations established in RCW 35.21.865 and 35.21.870</u> to the extent the fees exceed the costs allowable under subsection (1) of this section." (emphasis added)

The electric and gas franchise ordinances that the Company has with the cities of Spokane, Millwood and Colville were all in existence <u>before</u> April 20, 1982 and fall under the authority of subsection (2) of RCW 35.21.860. Thus, there is no requirement that the above referenced franchise fees be tied, or limited to the "actual" administrative expenses identified in subsection (1) of RCW 35.21.860.

Additionally, these franchise fee costs which are all 3% or below, have since their inception, decades ago, been treated as system wide expenses in the Company's results of operations. This is consistent with the WUTC order in Cause Nos. U-79-43, U-79-49 and U-79-50, dated May 13, 1980, in which this very issue was addressed for all utility companies. A copy of that order is attached as Exhibit ____ (DMF-3). Findings of Fact No. 18, states,

> "Franchise fees which municipalities in the State of Washington have historically imposed on revenues derived from sales made by public utility companies within their corporate limits average approximately 2.5 percent. Expenses attributable to any such franchise fees not exceeding 3 percent are reasonable expenses to include in general

operating expenses; expenses attributable to franchise fees exceeding 3 percent of revenues from respective municipal sales should be passed on directly to customers in the municipalities collecting such fees."

Q. Based on the forgoing discussion, what does the Company recommend?

A. The Company recommends that the Commission reject the Staff's proposed change to its long-standing method of treating franchise fees for ratemaking purposes. Also, by rejecting the proposed change for franchise fee cost, there would be no necessary changes to the Company's proposed revenue conversion factor in this Case.

Pro Forma Misc Adjustments

Q. What issues does the Staff have with the Company's Pro Forma Miscellaneous Adjustment.

A. Staff, through Mr. Schooley, basically eliminates the two items contained in the adjustment, amortization of corporate name change costs and Y2K computer fix costs, premised on the argument that they are nonrecurring. Staff provides virtually no substantive argument that the costs were imprudent or unnecessary.

Q. Does Public Counsel, through Mr. Lazar, take a position on any portion of the Company's Pro Forma Miscellaneous Adjustment?

A. Yes. Mr. Lazar, on Page 8 of his Exhibit ____ (JL-T-RR) also argues that the Company's requested recovery of "name change" costs be disallowed stating on line 3, "...The name change is of no value to ratepayers, and, if anything, causes confusion for customers familiar with the Washington Water Power name.".

Q. Please address the Company's position on theY2K costs first.

A. Certainly. From a technical point of view, the Year 2000, or Y2K, problem existed because of the use of a two-digit date scheme to save storage space and reduce the complexity of calculations, yielding better system performance. Many software developers failed to anticipate that their systems would still be in service at the Year 2000, and did not account for the millennium change. Businesses with extensive information technology systems have tended to protect their technology investments by extending and evolving systems, not replacing them. Therefore, these technology systems rely on hardware and software for date-math calculations that have survived long past the life cycles anticipated by their creators. The concern was that hardware and software systems, when confronted with date-math calculations, would not be able to differentiate between the year 1900 and the year 2000, thereby become confused and either make operating errors or not operate at all.

Q. Did Avista's Y2K Project only address computer hardware and software issues?

A. No. Avista's Y2K Project included other peripheral efforts as well. For instance, in addition to looking at Desktop Computer Systems, Business Systems, and Embedded Systems, Avista took the opportunity to address such issues as: our energy suppliers "ability to deliver", our emergency services preparedness, our internal/external communications systems reliability, security at our physical facilities, and the emergency power distribution capabilities within our facilities, to name a few. Basically, we broadened our investigation to include peripheral systems. That meant we looked beyond the Y2K date-math issue, and addressed our ability to handle circumstances which might hinder or prevent our ability to deliver energy and energy services to our customers.

Q. How would you describe Avista's Y2K expenditures?

A. I would describe them as legitimate and necessary business expenditures in that they were prudently spent in carrying-out our utility responsibilities. I think the Commission would agree that it is a utility's responsibility to meet the public's continuing demand for energy and energy services. Avista's Y2K expenditures were an effort to meet those responsibilities and were in pursuit of our goal to have our customers experience no service disruptions, for any reason, Y2K or otherwise. As further testimony to the importance of these expenditures, SEC reporting guidelines required detailed disclosure to investors in the annual Form 10K concerning how a company was planning on addressing the issue.

Q. What was the specific treatment of your Y2K Project expenditures that you requested from the Commission?

A. Avista requested to amortize the Y2K Project costs, incurred during the test year, over a 5-year period to better reflect the costs long-term nature.

Q. Is the Company's requesting recovery all of its Y2K expenditures?

A. No. The Company also incurred expenditures in 1997 and 1999, however, those costs were excluded from our request.

Q. What treatment did Staff Mr. Schooley recommend?

A. Mr. Schooley recommended the Y2K operating expenses be completely eliminated from the results of operations. Mr. Schooley (at Pg. 15, Line 11) testified "[t]hese expenses are also non-recurring, and should be removed from operating expenses to arrive at representative on-going costs of operations." Mr. Schooley also testified (at Pg. 15, Line 14) that "It is the Company's responsibility to maintain all of its systems in proper functioning order regardless of the calendar numerals."

Q. Do you agree with Mr. Schooley?

A. I agree with part of Mr. Schooley's testimony. I agree with his assertion that it's the Company's responsibility to maintain all of our systems regardless of the calendar numerals. That is, in fact, exactly what we did. Mr. Schooley's assertion falls in line with the Commission's position put forward in WUTC vs. Washington Water Power Co., Docket No. U-89-3105-T, First Supplemental Order (December 1989). In that order, the Commission wrote, "An electric utility's obligation to meet the public's continuing demand for power requires that the company continue to seek power sources; therefore, reasonable expenses incurred in pursuit of those resources should be recoverable." Both positions basically assert that it is our fundamental responsibility to meet our customers' energy delivery expectations and, if we follow the Commission's logic put forth in its First Supplemental Order, "reasonable expenses incurred in pursuit of those…[responsibilities should be recoverable.]

Q. Do you consider the benefits obtained through the Y2K process to be ongoing, rather than non-recurring, efforts that bring future value to Avista's customers?

A. Yes. I do. As stated earlier, if one examines the focus behind Avista's Y2K efforts, it was to meet customer's expectations and insure the delivery of energy and energy services. That's no different than what Avista's historical focus has been or future focus will be on a year to year basis. We think that is the expectation of our customers and this Commission, as well. The continuing benefits from the Y2K expenditures will help the

Company continue to meet those expectations.

Q. Is there testimony from any other Staff Witness which supports your position that the Y2K expenses should be normalized for recovery?

A. Yes, Staff Witness Parvinen's direct testimony supports our position where, at page 6, Lines 9-20, he outlined the Commission's policy with regard to restating and pro forma adjustments. Mr. Parvinen's testimony quotes WAC 480-09-330 (2) (b) (i) which reads "[e]xamples of restating actual adjustments are adjustments…to eliminate or normalize extraordinary items which have been recorded during the test period." Mr. Schooley doesn't even acknowledge that normalization is a possibility, but instead automatically jumps to the conclusion that the costs should be eliminated. Avista, on the other hand, because of the reasons stated in this rebuttal testimony, asserts that normalization is the more appropriate treatment.

Q. Did Avista ever consider petitioning the Commission for an accounting order regarding its Y2K expenditures?

A. Yes, we considered that option, but we decided not to proceed.

Q. Would you please explain why?

A. In the Washington Water Power Company, Docket Nos. UE-920351-T, UE-920352-P, UE-920354-P, Order Approving Tariff Revisions and Authorizing Accounting Treatment (May 1992), the Commission said, "A Commission order authorizing an accounting treatment of costs does not constitute <u>pre-approval</u> of recovery of such costs in subsequent proceedings. As with other adjustments, the company bears the burden of proving the fairness, justness and reasonableness of the costs in subsequent rate proceedings." Since an order authorizing an accounting treatment was not mandatory, and since we have to make our case before the Commission anyway, we decided not to pursue an accounting order for full deferral of our Y2K expenditures.

Q. Would you now please address the Company's position on the name change costs?

A. Yes. These arguments will address both Staff and Public Counsel's issues with recovery of these costs. Prior to our name change, consumers saw three basic organizational names under our corporate umbrella; Washington Water Power, Avista, and Pentzer. As a point of reference, the Avista name was established in early part of 1997 for use by our subsidiaries under our internal holding company called Avista Corporation, Inc. It was subsequently decided, however, that the entire corporate identity should be built around the "Avista" name. Therefore, in early 1999, almost two years after the Avista name had been established, the Washington Water Power name was retired as that of the parent. After the name change, consumers saw only one name under our corporate umbrella. That, in and of itself, served to reduce the level of consumer confusion.

Confusion due to the Washington Water Power name occurred with investors, analysts, third party contractors not within our service territory and in national publications where our utility has even been listed as a <u>water</u> utility. On page 8 of his direct testimony, Mr. Lazar suggests that confusion at least from a connection to the Washington Public Power System has been eliminated. The fact that WPPSS (Whoops) has changed its name has not removed its legacy. As an aside, and noting that I do not bring up this reference to embarrass Public Counsel attorney, Mr. ffitch, while cross examining our CEO, Mr. Matthews in regards to the name change, Mr. ffitch made the following acknowledgement that can be found on page 129, lines 14 through 17 of the transcripts:

> "Q. I will confess, Mr. Matthews, that my spouse thought that I was doing a water company rate case this week. I wondered why, but - -
>
> A. See."

Q. Could you please summarize and restate the Company's position on its Pro Forma Miscellaneous Adjustment?

A. Yes. Avista requests that the Commission recognize the prudency of its name change and Y2K expenditures and approve our proposal to normalize the name change and Y2K Project costs, incurred during the test period only, over a 5-year period to better reflect the costs long-term nature. In effect, the Company has already mitigated the request by only including expenditures that occurred within the test period, despite the fact that material expenditures were made in other years.

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Q. Having previously addressed name change recovery, and now turning to a separate but related issue, does Public Counsel propose another revenue requirement adjustment associated with the Company's name change?

A. Yes. On page 9 of Mr. Lazar's direct testimony, he proposes the Company's non-regulated operations contribute a franchise fee to the utility for use of the corporate name. In point of fact, the Avista name was originally developed and used by the Company's non-regulated operations. This proposal is completely without basis and should be rejected. If anything, the regulated business should pay a franchise fee to the non-regulated businesses according to Mr. Lazar's logic because that's where the name originated.

Q. Mr. Lazar, at page 9, Line 4 of his direct testimony, states that, "a precedent has been established before this Commission in Docket UG-931405, involving the use of the corporate logo and association by non-regulated subsidiaries…" Do you agree with that assertion?

A. No. I do not. In fact, the case resulted in a stipulation that specifically stated that it was **NOT** precedent setting. In the Fourth Supplemental Order Accepting Settlement Agreement, Docket No. UG-931405/ UG-931442, on page 2, the Commission accepted the settlement agreement as presented. On page 9 of that stipulation, which was signed by representatives of Washington Natural Gas, Public Counsel, and the Commission Staff, the last part of paragraph sixteen (16) reads, "the parties individually and collectively…agree that this stipulation and the Commission's acceptance thereof shall not be cited by any party as constituting an approval of, or precedent regarding, any concept, theory, method, principle or issue in this or any other proceeding before the Commission." This clearly contradicts Mr. Lazar's testimony.

Finally, if one looks at the amount of royalty imputation in Docket No. UG-931405/ 931442, at page 6, Paragraph 8, the stipulation reads, "Notwithstanding the above, if the annual calculation generates an imputed amount greater than $240,000, then the amount imputed for purposes of this paragraph shall be $240,000." Despite Mr. Lazar's recommendation that a "smaller level" of a fee be attributed to utility operating income, the amount proposed by Mr. Lazar in this proceeding is approximately 12 times higher than the above referenced $240,000. Clearly, this is an unreasonable result. nominal amount

In summary, the Avista name was first used by non-regulated operations, not the other way around. Moreover, the name change was designed to eliminate customer confusion and confusion among analysts and the investment community at-large, and in doing so, the customer benefits. For all these reasons, this proposal from Public Counsel should be rejected.

Pro Forma Nez Perce Adjustment

Q. What is the Staff position with regards to the Company's Pro Forma Nez Perce adjustment, represented in Column PF6 in my Exhibit ____ (DMF-1)?

A. Mr. Schooley, on pages 12 and 13 of his direct testimony, proposes a reduction of the Company proposal as the result of a "derived" assignment of costs to the Idaho electric distribution.

Q. Do you agree with this adjustment?

A. No. Even though the Staff adjustment does not materially reduce the Company proposal, it is not supported by the premise of the settlement. As I stated upon cross examination, despite there being several litigated issues that were resolved by the Settlement, it was global settlement amount with no breakdown of the dollar value of individual issues. The Nez Perce tribe alleged losses of up to $625 million. The Settlement results in nominal payments of approximately $39 million over a 45-year period. It could reasonably be assumed that the cash payments related to only the operations of the dams, which was the vast majority of the alleged losses, and that the right of way and tax issues were simply eliminated as part of the negotiation process.

Staff Misc. Restating Adjustments

Q. On pages 16 through 20 of his direct testimony, Exhibit ___(TES-T), Mr. Schooley suggests certain test year expense should be removed. He categorized them as political advertising, promotional advertising, non-recurring, subsidiary expenses and duplication. Do you concur with his recommendations contained in the adjustment entitled

Staff Restating Adjustments?

A. I concur with portions of his adjustment and strongly disagree with others.

Q. Please explain.

A. Referring to Exhibit ____ (DMF-6), page 1, I have reworked Mr. Schooley's Exhibit ____ (TES-5) to show areas of acceptance and areas that are contested. Starting with political advertising, there is no basis for complete disallowance of corporate memberships in outside organizations. I am not aware of any requested information for these items that the Company has not provided. Phone calls to two of the organizations referenced by Mr. Schooley on page 16, lines 20 and 21 of his testimony, the Montana Tax Foundation and the Western Environmental Trade Association, determined that their stated lobbying levels are zero and 6%. Calls to the third organization were not returned. Zero and 6% do not support a blanket disallowance of corporate memberships. The Company endeavors to account for all true lobbying costs to non-utility accounts.

Without arguing the merits of promotional advertising, we accept the Staff's recommendation for promotional advertising.

In regards to non-recurring items, the Company accepts the Montana Power payment, shown on line 17 of Exhibit ____ (DMF-6), despite the fact that participation in review of potential sale or purchase of assets can occur in any year. However, we disagree that the Redmond Tribute, line 9 of this exhibit, should be excluded. The tribute film was important for employee morale and is an appropriate type of expenditure for any company that, in the ordinary course of business, would honor a long-time employee and CEO of the stature of Mr. Redmond.

Regarding subsidiary expenses, Website design, line 8 of the exhibit, is accepted after a correction to the calculation. The original calculation incorrectly utilized the inverse of the utility allocator. Without a detailed review of the web site, the Company is willing to accept the subsidiary allocator proposed by the Staff for this item. The Paine Hamblen amount on line 16 of the exhibit was obviously a coding error by the Company, and is accepted.

However, with regards to the CEO Search, while the concept of assigning a portion of the costs to non-regulated operations has some merit, the 47.70% allocation has absolutely no reasonable basis and clearly inappropriate for this item. By no stretch of the imagination can that allocation be portrayed as "conservative and reasonable." Company witness Ms. Mitchell, in her rebuttal testimony, points out the flaws in the derivation of the 47,70%. Ms. Mitchell corrects the original derivation and arrives at a more reasonable subsidiary allocation of 15.22%. It goes without saying that with or without subsidiaries, the Company would have gone through the same rigorous, national search for a new CEO. With the above noted modification, the Company accepts the CEO Search adjustment.

Lastly, with regards to duplication, Staff is incorrect in their assertion. Payments to Toronto Dominion Bank are for maintenance of short-term debt lines of credit. These amounts are not factored into short-term rates by the Company or the consultants in this case. These costs are general operating costs that are not captured into the cost of capital calculations. There is no duplication and those costs should not be excluded.

PGE Contract– (Electric only)

Q. What are you testifying to in regards to the Staff's proposed PGE Contract adjustment?

A. I am going to address the appropriate balance of the regulatory liability, or deferred revenues, that are available to be used for regulatory offsets if the Commission should choose to adopt all or a portion of the Staff proposal. Mr. Norwood addresses in detail the numerous other issues associated with the PGE Contract proposal.

Q. Did Staff use the appropriate starting balance of the deferred revenues in the calculation of their adjustment, which is represented in Mr. Parvinen's Exhibit ___ (MPP-1), column nn?

A. No. They did not.

Q. Please explain.

A. I will begin by taking a Question and Answer from Mr. Parvinen's direct testimony filed in this case. It relates to the Staff's proposal to adjust the Company's filed Weatherization and DSM Investment rate base level downward to reflect additional amortization between the end of the test period and when new rates are scheduled to take affect. Starting on page 8, line 19 and going through page 9, line 7 of his Exhibit T-____ (MPP-T), it reads:

> "Q. Why did you adjust to the rate year and isn't that inconsistent with prior treatment of the DSM investment?
>
> A. I proformed the balance to the beginning of the test period to reflect the actual balance at the beginning of the period in which rates will be in effect. This treatment is different than in past rate cases, however, since the formation of the rider mechanism the balance is no longer subject to additional investment or change other than the amortization. It is a constantly reducing balance. Since this is a regulatory asset that has no offsetting factors, unlike typical rate base investment, it is entirely appropriate to proforma to a rate year balance. Staff is being consistent with the treatment of other regulatory assets and other items in this case." (emphasis added)

It is fair to assume the Mr. Parvinen meant "rate year" in the above referenced response versus "test year" since rate year was in the question. This lowered the level of electric DSM rate base by approximately $5 million. Staff also applied this same logic to the Company's filed Settlement Exchange Power adjustment, thereby reducing the Company's pro forma net operating income by approximately $1 million. As I noted back on page 5 of this rebuttal testimony, the Company has accepted those adjustments. The Company concurs that assets or liabilities that are reduced by constant or scheduled amortization amounts would meet the known and measurable requirements and could be pro formed to the rate period.

However, there is no question that this methodology must be applied to **ALL** regulatory assets and other items in this case. For consistency, the Company has applied this methodology and updated its originally filed Deferred Gain on Office Building. This will be discussed later in my testimony.

Q. Would you please explain how Staff did not properly apply this rate year pro forma methodology to the PGE Contract adjustment?

A. Yes. Referring to my Exhibit ____ (DMF-4), which is a replication of the Staff workpaper used their adjustment calculation. I added a column entitled, " Balance as of," and the "Revised Calculation" section on Lines 16 through 24. The very starting point of their rate base offset calculation, Line 1, Contract Buyout Revenue (System), was an amount representing the contract buyout's deferred revenue balance as of the end of the **test year**, December 31, 1998, **not** the beginning of the **rate year**, October 1, 2000. It should be noted that the exact amount as of December 31, 1998 should actually have been $145,000,000, as outlined in Mr. Norwood's rebuttal testimony.

Regardless, Staff then goes forward with their calculation by netting or offsetting two regulatory assets, Line 3, Wood Power Buyout and Line 8, Weatherization & DSM Investment. What should be noted is that both of these balances have been pro formed to the beginning of the rate year, October 1, 2000. Clearly a mismatch.

Continuing down the worksheet, a remaining deferred contract amount is obtained on Line 10. Line 11 then reflects the proposed annual amortization of the remaining rate base reduction over a proposed 16-year period. At this point Staff calculates an accumulated amortization balance, out to the rate year, on Lines 12 through 15, however, the starting balance on Line 10 was incorrect to begin with.

Q. How should the remaining rate base reduction represented on Line 10 of this worksheet have been calculated?

A. The simplest approach would be to replace the starting deferred revenue balance on Line 1, initially shown as a December 31, 1998 balance of $143,400,000, with corrected amount of $145,000,000 for December 31, 1998, pro formed out to the beginning of the rate year, October 1, 2000. That corrected amount for Line 1 would be $129,486,250 as shown on Mr. Norwood's Exhibit ____ (KON-2). The remaining items that were already pro formed out to the rate year would remain unchanged and the calculation of an accumulated amortization balance would not be needed. This calculation is shown on Lines 16 through 23 of Exhibit ____ (DMF-4).

Q. What would be the "Remaining Rate Base Reduction" on Line 10 be if the methodology of pro forming balances out to the rate year were properly applied?

A. The Remaining Rate Base Reduction would be $17,279,077. If the Commission were to adopt the Staff proposal for PGE Contract, the Revised Calculation as shown on my Exhibit ____ (DMF-4) properly reflects the rate year levels for the adjustment.

Gas Inventory – (Gas only)

Q. On page 15, lines 13 through 17 of Ms. Joanna Huang's direct testimony, she states that,

> "After implementation of the Gas Benchmark beginning September 1, 1999, Avista Energy (subsidiary) assumed operational management of Jackson Prairie and Plymouth LNG. The inventory volume balance and the cost of inventory is controlled by Avista Energy, not Avista Utilities. The funds to purchase the inventory are now provided by Avista Energy, not Avista Utilities."

Do you agree with this assertion?

A. No. Staff is incorrect. First of all, at the inception of the experimental Benchmark Mechanism, Avista Energy did not pay Avista Utilities for the current gas inventory balances. There is no question that Avista Utilities had previously provided all funds associated with its gas inventory amounts. Moreover, as outlined in the Benchmark Tariffs, Avista Utilities continues to provide the funds for ongoing injections and receives credits for ongoing withdrawals. Please refer to my Exhibit ____ (DMF-5) which contains the tariff sheets for the Natural Gas Benchmark Mechanism. Section 3 of Tariff Sheet 163A, the Natural Gas Benchmark Mechanism, states,

> "Avista Utilities shall pay Avista Energy for the cost of gas added to inventory on a monthly basis, per the Benchmark Schedule, and will receive a credit from Avista Energy for withdrawals under the Benchmark Schedule."

It is quite clear that Avista Utilities is continuing to provide the funds for its gas inventories. The Staff proposal should be rejected.

Public Counsel-Production Depreciation Expense

Q. Starting on page 10, line 27 of Mr. Lazar's direct testimony, referring to the Company's hydroelectric production plants, he states, " There is no justification for accumulating additional depreciation at this time, as it will only exacerbate the excess depreciation accumulation about which the Commission expressed concern that a future Commission would be unable to recapture for the benefit of ratepayers." Do you agree with this assertion and Mr. Lazar's associated recommendation to "defer" depreciation expense?

A. No. Not at all. Historical cost based accounting, accrual accounting and depreciation expense are principles of Generally Accepted Accounting Principles (GAAP) and are also utilized by the FERC in its guidelines established for regulatory accounting. Accounting for long-lived assets based upon market value <u>is not</u>. Depreciation is the recognition that some consumption of the economic benefit of a long-lived asset is occurring. Specifically, FASB Statement of Concepts No. 5, in paragraph 86 (c) states that, "Some expense, such as depreciation and insurance, are allocated by systematic and rational procedures to the periods during which the related assets are expected to provide benefits." Mr. Lazar is associating the difference between fair market value and net book value of hydroelectric plants as the main support to defer depreciation expense. This violates a fundamental aspect of GAAP since he is recommending that the Company would not reflect any expense relating to assets that are being consumed. They are being consumed since they are operating and thereby providing benefits (energy) to ratepayers.

In addition, depreciation is systematic recognition and recovery of previously expended funds. Current market valuation is not a component of depreciation. If market value is to be taken into consideration in regulatory decisions regarding rate recovery, as Mr. Lazar is suggesting, and one accepts the contention that the net book value of electric utility assets understates their market value, shouldn't then utility rate base for these same assets be increased to reflect "true" market value of the common equity investment made by the Company?

Q. Do you have any other observations of Mr. Lazar's recommendation?

A. Yes. His market-value assessment was solely focused on hydro production assets.

Couldn't it be true that this same relationship of market value to net book value would apply to any and all categories of utility plant in service? Also, in theory, the market value may be higher or lower than net book value for various items in utility plant in service. Mr. Lazar made no attempt to recognize this valuation to assets other than hydro generation plants. Furthermore, if the assets were recognized for their market value, there would still be a need to recognize a periodic cost on the Company's financial statements that would be associated with the consumption of these assets, since they are providing benefits to end-users. Mr. Lazar's argument relating market-value of generation assets being higher than net book value of those same assets, suggests that the output of the plants is of more value than what the current price (rates) charged to ratepayers reflect, since the rates are based upon net depreciated historical/original cost.

Therefore, a consistent application of Mr. Lazar's argument would result in market-value rate base and market value (or replacement cost) based depreciation expense. The depreciation expense would be derived from the depreciation parameters developed in a study performed by Deloitte and Touche, for which Mr. Lazar states in his direct testimony on page 14, line 8,

> "It [adjustment]does not seek to second-guess the mechanical calculation of the "remaining life" concept that underlies estimation of depreciation rates. Public Counsel does not object to the agreement, as expressed in Mr. Damron's testimony."

Q. Did the Commission Staff perform a review of the Company's support for the proposed depreciation changes?

A. Yes. Mr. Tom Spinks and Mr. Mike Parvinen reviewed the entire depreciation study that was performed by Deloitte and Touche, in cooperation with the Company's. The Company provided the depreciation study reports and all the supporting detailed workpapers to Commission Staff and Public Counsel for their review. There was considerable exchange between Commission Staff and Company staff in analyzing the results of the study. In addition, Company Staff and the Deloitte and Touche consultant met at the Commission offices to further analyze the components of the depreciation study.

Q. Mr. Parvinen is recommending adjustments to the Company's depreciation request that serve to reduce the overall Company request. Do you agree with his adjustments?

A. Yes. As stated in Mr. Parvenin's direct testimony on page 13, line 3, "The Company and Staff have reached a negotiated agreement as to the depreciation parameters and rates to be used for depreciating Avista's plant and equipment." The Company filed a revised Exhibit No. 291, reflecting this agreement.

Q. Have other parties recognized the negotiated agreement?

A. Yes. Mr. Robert L. C. Damron, consultant on behalf of Public Counsel has recognized the stipulated agreement between the Company and Commission Staff and has included the effect of the recommended depreciation rates in his recommended revenue requirement adjustments, as referred to in his direct testimony on page 9, lines 10 through 19.

Q. What is the Company's recommendation regarding depreciation expense?

A. The Company recommends that the Commission adopt the new depreciation rates and associated parameters that resulted from negotiations between Staff and Company, and that the Commission reject Public Counsel's proposed extreme departure from standard regulatory and financial accounting practice in regards to depreciation expense on hydroelectric power plants.

REVISIONS TO ORIGINAL REVENUE REQUIREMENT

ELECTRIC

Q. Now, handing you Exhibit ____ (DMF-1), would you please outline what is shown in this exhibit?

A. Yes. Exhibit ____ (DMF-1) is actually an updated version of my Exhibit No. 228 that I sponsored in my direct testimony. It has been updated for revisions to the Company's originally filed revenue requirement. The revisions reflect proposed changes from any party that the Company has adopted. Ultimately, it shows actual and pro forma electric operating results and rate base for the test period for the Company's Washington jurisdiction. With the exception of columns that I added on pages 9 and 10, all explanations outlined in my direct testimony would still apply.

Column (b) of page 1 of Exhibit ____ (DMF-1) shows twelve months ended December 31, 1998 operating results and components of the average-of-monthly-average rate base as recorded; column (c) is the total of all adjustments to net operating income and rate base; and column (d) is pro forma results of operations, all under existing rates. Column (e) of page 1 of Exhibit ____ (DMF-1) shows the revised revenue increase required which would allow the Company an opportunity to earn a composite 9.97% rate of return. Column (f) reflects pro forma electric operating results with the requested increase of $18,168,000.

Q. Would you please go through pages 4 through 11 of Exhibit ____ (DMF-1) and indicate where changes have occurred from the original Exhibit 228?

A. Yes. On the top of the columns (b) through PF10, I have noted whether one of the Company's original adjustments have been revised. In the later columns where I have added columns for Staff proposals, the top of the column will note whether the Company "Accepted" or "Rejected" the proposals.

Starting on page 4, Column (c), Deferred FIT Rate Base, was revised to actual based on Staff recommendation. Column (d), Deferred Gain on Office Building, was revised to reflect the balance as of the start of the rate year versus the test year to be consistent with later revisions. Turning to page 5, Column (h), Clearwater Hydro, has been completely eliminated since the rate base amount has been completely amortized. Column (i), Weatherization and DSM Investment, was revised to a rate year balance based on Staff recommendation. Column (k), Settlement Exchange Power, has been revised to reflect rate year levels as proposed by Staff. On page 6, Column (r), Pro Forma Restate Debt Interest, reflects the impact of rate base revisions on the debt interest calculation. Turning to page 7, Column PF1, Pro Forma Power Supply, has been revised by adoption of two proposed Staff adjustments, as explained in Mr. Norwood's rebuttal testimony. On page 8, Column PF3, Pro Forma Depr., has been updated to reflect the negotiated settlement between the Company and Staff. Column PF5, Pro Forma Commercial Trade, has been revised to reflect inclusion of associated FERC fees, as proposed by the ICNU through Mr. Schoenbeck. Mr. Norwood also address this change in his rebuttal testimony.

Q. Please turn to page 9 of Exhibit ____ (DMF-1) and continue with your explanations?

A. All columns after PF10 reflect new adjustments not included in my original Exhibit 228. Columns PF11, PF12 and PF13 are related to the Company's proposal associated with the sale of the Centralia Thermal Plant. Mr. McKenzie explains all the Centralia Sale issues in his rebuttal testimony. Column PF11, Company Replacement Power, reflects the net operating and rate base impacts of eliminating operating revenues, expenses and plant investment associated with owning Centralia and replacing it with purchased power contract. Net operating income is reduced by $3,646,000 and rate base is reduced by $12,460,000.

Column PF12, Company Gain Amortization, reflects the net operating income and rate base impacts of the Company's proposed treatment of the gain on the sale of Centralia. Net operating income is increased by $1,486,000 and rate base is reduced by $11,141,000.

Column PF13, Company Ice Storm Offset, reflects the Company's proposed offset of a portion of the gain on the sale of Centralia with elimination of Company's Ice Storm Expenditures. Since Ice Storm amortization was incorporated in the Company's Injuries and Damages adjustment, Column (p), that amount would have to backed out. This increases net operating income by $1,331,000.

Column PF14, Staff Restate Excise Tax, reflects acceptance of Staff's recommendation to adjust the expense accrual to actual. This increase net operating by $443,000.

Turning to page 10, Column PF15, Staff Bonuses, is rejected by the Company.

Column PF16, Staff Misc Restating, was partially accepted and it increased net operating income by $202,000.

Column PF17, Staff Lease Expense, reflects acceptance of Staff's recommendation to make the same lease adjustment (from accrued expense to cash expenditure) for the electric system that has previously been adopted for the gas system. This increases net operating income by $53,000.

Column PF18, Staff Relocation Expense, is rejected by the Company.

Column PF19, Staff Lost Revenue Fuel Efficiency, reflects acceptance of Staff's recommendation of eliminating certain non-recurring revenues. The Company and Staff collaborated on this adjustment.

Column PF20, Staff PGE Contract, is rejected as explained in Mr. Norwood's rebuttal testimony.

On page 11 of Exhibit ____ (DMF-1), the final column, Column PF20, shows the total revised 1998 pro forma results of operations and rate base levels for the Company's Washington jurisdictional electric operations, consisting of 1998 actual results and the total of all adjustments.

Q. After taking into account all the changes outlined above, what was the impact on the Company's originally filed electric revenue requirement?

A. The Company's originally filed electric revenue requirement was $26,253,000. As currently revised, the electric revenue requirement is $18,168,000. That is a reduction of $8,085,000.

NATURAL GAS

Q. Now, handing you Exhibit ____ (DMF-2), would you please outline what is shown in this exhibit?

A. Yes. The concept is identical to what I explained earlier for the electric exhibit. Exhibit ____ (DMF-2) is actually an updated version of my Exhibit No. 230 that I sponsored in my direct testimony. It has been updated for revisions to the Company's originally filed revenue requirement. The revisions reflect proposed changes from any party that the Company has adopted. Ultimately it shows actual and pro forma gas operating results and rate base for the test period for the Company's Washington jurisdiction. With the exception of columns that I added on pages 8 and 9, all explanations outlined in my direct testimony would still apply.

Column (b) of page 1 of Exhibit ____ (DMF-2) shows twelve months ended December 31, 1998 operating results and components of the average-of-monthly-average rate base as recorded; column (c) is the total of all adjustments to net operating income and rate base; and column (d) is pro forma results of operations, all under existing rates. . Column (e) of page 1 of Exhibit ____ (DMF-2) shows the revised revenue increase required which would allow the Company an opportunity to earn a 9.93% rate of return. Column (f) reflects pro forma gas operating results with the requested increase of $4,427,000.

Q. Would you please go through pages 4 through 9 of Exhibit ____ (DMF-2) and indicate where changes have occurred from the original Exhibit 230?

A. Yes. The same as on the electric exhibit, Exhibit ____ (DMF-1), on the top of the columns (b) through PF4, I have noted whether one of the Company's original adjustments have been revised. In the later columns where I have added columns for Staff proposals, the top of the column will note whether the Company "Accepted" or "Rejected" the proposals.

Starting on page 4, Column (c), Deferred FIT Rate Base, was revised to actual based on Staff recommendation. Column (d), Deferred Gain on Office Building, was revised to reflect the balance as of the start of the rate year versus the test year to be consistent with later revisions. Column (f), Weatherization and DSM Investment, was revised to a rate year balance based on Staff recommendation. Turning to page 6, Column (n), Pro Forma Restate Debt Interest, reflects the impact of rate base revisions on the debt interest calculation. On page 7, Column PF1, Pro Forma Depr., has been updated to reflect the negotiated settlement between the Company and Staff. Turning to page 8, Column PF3, Pro Forma Revenue Adjustment, eliminates some revenues that were double counted, as proposed by the Staff.

Staying on page 8, Column PF5, Staff Bonuses, is rejected by the Company.

Column PF6, Staff Misc Restating, was partially accepted and it increased net operating income by $140,000. Column PF7, Staff Relocation Expense, is rejected by the Company. On page 9, Column PF8, Staff Hamilton Street Bridge Remediation, reflects acceptance of Staff's recommended level of recovery for certain environmental cleanup costs. The Company and Staff collaborated on this adjustment.

On page 9 of Exhibit ____ (DMF-2), the final column, Column PF9, shows the total revised 1998 pro forma results of operations and rate base levels for the Company's Washington jurisdictional gas operations, consisting of 1998 actual results and the total of all adjustments.

Q. After taking into account all the changes outlined above, what was the impact on the Company's originally filed gas revenue requirement?

A. The Company's originally filed electric revenue requirement was $4,899,000. As currently revised, the gas revenue requirement is $4,427,000. That is a reduction of $472,000.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.