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BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET NO. UE-010395

REBUTTAL TESTIMONY OF GARY G. ELY
REPRESENTING AVISTA CORPORATION

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Q. Please state your name, business address and present position with Avista Corporation (“Avista”).

A. My name is Gary G. Ely and my business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corporation as Chairman of the Board, President and CEO.

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

A. Yes, I have.

Q. By way of introduction, would you please summarize your rebuttal testimony?

A. Yes. We are pleased that the Commission Staff recognizes the critical financial situation faced by the Company and the need for immediate rate relief. However, we are very disappointed that other elements of the Staff’s proposal are not responsive to Avista’s situation. In our view — a view that I believe is shared by members of the financial community — Staff has proposed conditions which effectively negate what would otherwise have represented a necessary step in resolving the extraordinary, emergency situation faced by Avista. In contrast, the Company’s approach has been viewed favorably by the investment community and still preserves for future determination of all significant issues raised by the parties in this case. Stated differently, under the Company’s proposal no one is precluded in the upcoming prudence case from taking any position they wish, as concerns the surcharge dollars that are being collected subject to refund.

I wish to convey in the strongest terms that the Company’s proposed surcharge, without the conditions proposed by Staff, is a prerequisite for the Company to issue new equity financing and to complete the financing of the Coyote Springs II generating plant currently under construction.

Even if the Commission were to approve the 36.9% surcharge proposed by the Company, if the remaining Staff recommendations were adopted by the Commission, the Company would not be able to access capital at reasonable terms to fund the ongoing operations of the Company. The inability to access capital at reasonable terms would likely lead to a drop in Avista’s credit rating to below

1 investment grade, which would result in adverse impacts to the Company, our customers and our
2 investors, as explained by Mr. Eliassen. Such an outcome would be truly unfortunate for all involved,
3 after having implemented a 36.9% rate increase. This assessment is based on concerns already
4 expressed by lenders to the Company regarding the Staff recommendations.

5 Q. What are the “conditions” recommended by Staff?

6 A. While the Staff has recommended a 32.6% rate increase, it is conditioned upon the
7 following: (1) that the surcharge should only continue for a period of 90 days; (2) that the deferred
8 accounting treatment previously authorized for power supply expenses should terminate effective
9 June 30, 2001; (3) that any revenues collected under emergency rate relief not be credited against the
10 deferral balance, thereby frustrating the very purpose of the surcharge collection; and (4) that Avista
11 should be directed to file by September 17, 2001 a new direct case on the so-called Phase II issues, if
12 it does not otherwise wish to rely on its previous evidence submitted on March 23, 2001, and should
13 otherwise be directed to file a general rate case by September 28, 2001. Mr. Norwood will discuss the
14 procedural impracticalities of the recommended timing of the filing of any Phase II evidence or a general
15 rate case as recommended by Staff to be filed Sep. 28th (a little over a week after the Commission
16 issues its order in this case).

17 I wish to emphasize in my testimony that the other conditions recommended by Staff will
18 frustrate the intended purpose of the surcharge, with a result that, while rates would increase by 32.6%
19 under the Staff’s proposal, the necessary financial relief would not be provided to the Company.

20 Q. Mr. Ely, turning now to the first of the conditions discussed above, would you please
21 comment on Staff’s proposal to terminate the deferral accounting mechanism on June 30, 2001?

22 A. Yes. A continuation of the deferred accounting mechanism beyond June 30, 2001 is
23 necessary to preserve the issue of cost recovery for later determination. The Company’s surcharge
24 proposal, on its face, provides that any revenues collected are subject to refund in the event that a
25 subsequent prudence determination results in the disallowance of certain costs. Accordingly, no party is

1 prejudiced by continuing the deferred accounting mechanism in order to preserve the issues for later
2 determination.

3 Eliminating the deferred accounting mechanism, effective June 30, 2001, could preclude future
4 consideration by the Commission of the possibility of recovery of \$74 million of expenses, during the
5 months of July-September alone, that the Company believes were prudently incurred to meet its load
6 requirements under the extraordinary hydro and market conditions being faced by the Company. Staff
7 has in the past criticized the Company for failure to obtain a deferred accounting order for the purpose
8 of considering the recoverability of extraordinary expenses, as explained in Mr. Norwood's rebuttal
9 testimony. (Indeed, in the Company's most recent general rate case (Docket No. UE-991606) the
10 Commission disallowed both the 1991 Firestorm and 1996 Ice Storm adjustments, noting that "Avista
11 did not seek timely accounting orders for either event.") (See Third Supplemental Order in Docket No.
12 UE-991606 at p. 57, ¶ 207.) To preclude the dollars expended to meet load requirements from being
13 considered in a future determination of prudence is inconsistent with Staff's prior positions.

14 In its testimony, Staff has acknowledged the extraordinary circumstances in this proceeding, the
15 resulting high power costs, and is recommending an increase in rates, but then is recommending the
16 termination of the very mechanism that allows the Company the opportunity to seek recovery of these
17 extraordinary costs.

18 It is imperative that the deferred accounting mechanism continue beyond June 30 to allow the
19 Company the opportunity to seek recovery of extraordinary costs subsequent to June 30. The deferred
20 accounting mechanism is designed to set aside extraordinary costs for the opportunity for later recovery.
21 The Company has already agreed to make a filing in November 2001 to address the prudence and the
22 recovery of the deferred costs.

23 For Staff to now recommend that it be terminated also ignores the very real and significant
24 consequences of an adverse reaction in the financial community and its impact on the Company's
25 financial well-being. As explained by Mr. Eliassen in his rebuttal testimony, Staff's position to terminate
26 the deferral accounting mechanism on June 30, 2001, could conceivably require the Company to write-

1 off all deferred energy costs subsequent to June 30, 2001. The risk that a write-off of this magnitude
2 could occur (approximately \$74 million for July –September alone) would preclude us from issuing
3 equity and quite possibly additional debt. Therefore this issue must be clearly resolved in the surcharge
4 order so that the Company will be able to access financing.

5 We urge the Commission to reject the Staff’s recommendations to terminate the deferred
6 accounting mechanism on June 30, 2001. In Avista's surcharge filing on July 17, 2001, it proposed that
7 at the conclusion of the November 2001 general rate case, the Company would modify the surcharge
8 amount and the duration of the surcharge rate, if needed, in order to reflect the outcome of the general
9 rate case. Therefore, all parties will have the opportunity in the general rate case to address both the
10 duration and amount of the surcharge to be in place at the conclusion of the general case.

11 Q. Would you please comment on Staff’s recommendation that the surcharge remain in
12 place for only 90 days?

13 A. Such a proposal will simply not “advance the ball” in the eyes of the financial community
14 and does not provide necessary ongoing cash relief. Staff suggests that the Company has the option of
15 seeking to continue emergency rate relief upon its expiration in 90 days. I can foresee no reasonable set
16 of circumstances under which the Company would not be seeking to extend this surcharge relief were it
17 scheduled to expire in 90 days. The Company continues to need surcharge relief throughout the period
18 contained within the Company’s original proposal — i.e., through December 31, 2003. Since that is
19 the case, the Company would be right back before this Commission within one month of its Order, with
20 yet another Petition to continue the rate relief. The timing of such a filing would be necessary to allow
21 this Commission to have a sufficient opportunity to process the Company’s renewed request for
22 surcharge relief before its scheduled termination in 90 days. In that event, the Commission and the
23 parties have accomplished very little through the instant proceeding, because we would be right back
24 before you with a similar showing of a need for interim relief; meanwhile, this will create needless
25 confusion and concern within the investment community, as well as with our customers.

1 Again, I wish to emphasize that the surcharge relief should continue beyond any arbitrary 90 day
2 period. It should be remembered that the Company proposes that any surcharge revenues collected
3 will be subject to refund at the culmination of the Company's November general rate case.

4 Q. Would you please comment on the additional recommendation of Staff that would
5 require that any surcharge revenue be recorded in a liability account, and not be used to reduce the
6 deferral balance itself?

7 A. Yes. Such a proposal undermines one of the primary purposes of the surcharge.
8 Staff's recommendation, taken as a whole, means that customers would experience a 32.6% rate
9 increase, but without otherwise improving the Company's ability to meet its financing covenants.
10 Lenders are concerned not only with the absence of rate relief, but also the size of the deferral balance.

11 As explained by Mr. Falkner, the deferred balance would not be offset or reduced by what
12 Staff recommends in its accounting treatment. Stated differently, if we are to increase rates substantially
13 to our customers, it should, at least, accomplish its intended purpose of improving the financial standing
14 of the Company in the eyes of the investment community. For reasons explained by Mr. Falkner and
15 Mr. Eliassen, on rebuttal, the revenues collected from the surcharge should be directly applied to offset
16 the deferral balance, which would serve to help the Company meet its covenant requirements.

17 Q. What do you believe would be the impact on Avista's credit ratings if recommendations
18 of Staff and other parties were adopted?

19 A. If the Commission were to adopt Staff's conditions, or the recommendations of Public
20 Counsel or ICNU, I believe that it would significantly increase the possibility that Avista's credit rating
21 would be downgraded to BB, which is below investment grade. As explained later in the rebuttal
22 testimony of Mr. Eliassen, the Company has barely maintained a BBB- with Standards and Poor's, and
23 a downgrade to BB would likely cause the Company to be unable to access capital under reasonable
24 terms. That would mean the Company may not be able to issue common stock or fund the construction
25 of the needed Coyote Springs II project.

1 Q. How do you believe the investment community would react to an Order which adopts
2 Staff's recommended conditions?

3 A. Previously, we provided as an exhibit in this proceeding Moody's July 26, 2001,
4 comments on Avista's recent surcharge filing, in which it stated that:

5
6 "Moody's believes that regulatory support for the surcharges requested would go a
7 long way toward helping stabilize credit quality, subject to satisfactory prudence
8 determinations expected to be dealt with as part of a base rate proceeding later this
9 year. Moody's also notes that regulatory support would improve Avista's ability to
10 access both debt and equity capital at a reasonable cost."
11

12 Subsequently, on August 2, 2001, Standard and Poor's lowered Avista Corp.'s ratings to BBB- on its
13 senior unsecured debt and stated:

14
15 "The ratings downgrade reflects the increasing business risk at subsidiary Avista
16 Utilities, coming from the continuation of significantly deteriorated hydro generation
17 conditions, increasing financial risk resulting from mounting power-cost deferrals, and
18 uncertainty regarding the outcome of the Company's recent filing for a rate surcharge
19 with the Washington Utilities and Transportation Commission (WUTC) and the Idaho
20 Public Utilities Commission (IPUC). The Credit Watch listing addresses the potential
21 for the assignment of speculative-grade ratings, unless the Company receives adequate
22 relief in the form of a rate surcharge within the next few months, completes a proposed
23 equity offering, and closes financing for the Coyote Springs 2 plant. Without these
24 events, Avista's liquidity may be compromised and ratings will be further lowered."
25 (Emphasis supplied.)
26

27 Accordingly, S&P has described the steps which the Company must take to avoid a further
28 lowering of its ratings, steps which include the issuance of a rate surcharge, the completion of proposed
29 equity offerings, and the financing of the Coyote Springs plant. As I testified to earlier, however, a rate
30 surcharge with the conditions attached by Staff, likely would not allow the Company to complete the
31 other necessary steps, which include the proposed equity offering and the financing of Coyote Springs

32 II.

1 Q. Has the Company already experienced an impact from the August 2, 2001, S&P rating
2 downgrade?

3 A. Yes. Even though the Company thus far has avoided speculative-grade ratings, several
4 counterparties that the Company relies upon to provide short-term and real-time energy were unwilling
5 to transact business with Avista absent prepayments or other credit terms. Mr. Norwood in his rebuttal
6 testimony will further describe these actions taken by counterparties as a result of the S&P ratings
7 downgrade.

8 Q. Staff and other parties appear to be concerned that the Company is asking to collect
9 revenues based on projected deferral balances. Would you please comment?

10 A. Yes. The financial community has advised us that it is important for the Company and
11 the Commission to address the projected deferral balance and to create a plan for prudence
12 determination and possible recovery. That being said, in no way does this indicate that the Company
13 would collect from customers anything but actual, prudently incurred expenses. The Company has
14 previously outlined how this will be assured through the “subject to refund” provision and through a
15 balancing-type account for the deferral recovery. If costs do not materialize, they will not be collected.
16 If costs turn out to be lower than anticipated, the surcharge will end sooner. We believe customers are
17 fully protected by the mechanisms we have already proposed. Furthermore, the Company’s proposal
18 rightly preserves for future determination all significant issues for all parties in this case, and no one is
19 precluded from taking any position they choose in the prudence filing with regard to the surcharge
20 dollars that are being collected subject to refund.

21 Q. Has the Idaho Commission Staff submitted its case regarding the Company’s request
22 for a PCA surcharge to Idaho customers.

23 A. Yes. The Staff in Idaho has recommended to the Idaho Commission that the
24 Company’s request be approved basically as filed and concluded that the power supply purchase and
25 sale transactions appeared reasonable at the time they were entered into.

1 Q. Since the Company's direct case was filed, have any other utilities in the region filed
2 requests for rate increases for reasons similar to Avista's request?

3 A. Yes. As the Commission is no doubt aware, Puget Sound Energy filed for an overall
4 18% increase in rates. Portland General Electric has filed for approximately a 30% increase in rates to
5 residential customers and approximately a 50% increase in rates to their industrial customers.

6 Q. Do you have any concluding remarks?

7 A. Yes. The situation facing the Company is unprecedented, given the volatility in the
8 energy markets and the record low hydroelectric conditions. We ask this Commission to continue to be
9 supportive of our efforts to work through these financial difficulties. Strong regulatory support for the
10 Company's proposal, affirmatively expressed, will go a long way toward reassuring the investment
11 community and allowing the Company to continue to access the capital markets under reasonable terms.
12 That access is necessary to not only fund ongoing operations so that the Company can meet its public
13 service obligations, but also to plan for the future through the construction of needed generating facilities.

14 Q. Does that conclude your rebuttal testimony?

15 A. Yes.
16