Exhibit 600T (LW-T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Docket Nos. UE-991255, UE-991262, and UE-991409

DIRECT TESTIMONY OF LINCOLN WOLVERTON

On Behalf Of

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

December 8, 1999

Q. PLEASE STATE YOUR NAME, AFFILIATION AND BUSINESS ADDRESS.

A. My name is Lincoln Wolverton~~,~~. My business address is East Fork Economics, P.O. Box 620, La Center, Washington 98629. I am an economist, and through East Fork Economics, I am a consultant for ~~the~~ Industrial Customers of Northwest Utilities (“ICNU”). My qualifications are summarized in Exhibit 601 (LW-1).

Q. PLEASE DESCRIBE ICNU.

A. ICNU is a non-profit trade organization comprised of forty-one industrial electric users in the Pacific Northwest. ~~Several~~ Many ICNU members purchase electric service in Washington from Avista Corporation (“Avista”), PacifiCorp, and Puget Sound Energy, Inc. (“PSE”).~~, including ____________________.~~ ICNU represents the common interests of its members in regulatory proceedings throughout the Pacific Northwest ~~region~~.

Q. WHAT IS THE PURPOSE OF ~~THIS~~ YOUR TESTIMONY?

A. ~~This~~ My testimony responds to the Applications and Direct Testimony filed by Avista, PacifiCorp and PSE (collectively “the Companies”) in these consolidated proceedings. The Companies are requesting approval from the Washington Utilities and Transportation Commission (“WUTC” or “Commission”) to sell their respective interests in the Centralia Power Plant (“Centralia”) to TECWA, a wholly owned-subsidiary of Transalta. ~~Since m~~My analysis assumes that the sale price received by the Companies for their respective interests in Centralia represents the full market value of the plant; therefore, my ~~asset, my~~ testimony does not address the prudency of the sale itself. Instead, my testimony addresses the regulatory ~~is intended to advise the Commission on the equitable~~

treatment of any proceeds from the sale of the plant that exceed the Companies' respective net book investments in Centralia. This net amount, which I will refer to as the gain from the sale, does not represent the creation of new value. Instead, the gain approximates the future value of the plant reduced to the present through the sale process.~~For ease of reference and for lack of a better term, in this testimony I refer to these above-book proceeds as the "gain" from the sale of Centralia. While it is semantically tempting to view this "gain" as a windfall of new value created by the sale, I urge the Commission to recognize the "gain" for what it is—the net present value of the benefits ratepayers could have received absent the sale.it is not; it is value realized by the proposed sale. I shall return to this point later in the testimony.~~

Q. PLEASE IDENTIFY THE MAJOR POINTS YOU MAKE IN THIS TESTIMONY.

A. The following major points are made in this testimony:

- Any allocation or other regulatory treatment of the gain from the sale of Centralia should be deferred and considered in the context of ~~a~~ the Companies' next rate cases.

- ~~Ratepayers are entitled to 100 percent of the gain.~~ Allocating ~~a~~ any portion of the gain to shareholders provides shareholders with an unjustifiable and excessive return on investment. Therefore, r~~R~~atepayers are entitled to 100 percent of the gain.

- The treatment of the gain from the sale of Centralia must be considered in the broader context of the Companies' and their customers' overall exposure to stranded costs that may occur through industry restructuring.

- In this broader context, any sharing of the gain between customers and shareholders is inappropriate because it provides an inappropriate incentive to the Companies to sell and profit from their below-market assets now, and then claim a right to be reimbursed for the stranded costs associated with their above-market resources when restructuring occurs. Allowing the Companies to share in the gains without demanding that the Companies also share in the losses embraces the "heads the utility wins, tails the ratepayer loses" approach to allocating stranded costs and benefits.

The Companies' proposals for sharing the gain are unpersuasive and ignore the salient fact that ratepayers must receive 100 percent of the gain for the sale to be in the public interest.~~to be held harmless from the sale of Centralia.~~

Q. WHY SHOULD THE COMMISSION DETERMINE THE ALLOCATION OF THE GAIN IN A RATE CASE RATHER THAN IN THIS PROCEEDING?

A.

~~**Q. WHY SHOULD THE COMMISSION DETERMINE THE REGULATORY TREATMENT**~~**ALLOCATION** ~~**OF THE GAIN IN A RATE CASE RATHER THAN IN THIS PROCEEDING?**~~

~~A.~~ Deferring a determination of the ratemaking treatment of the gain from the sale of Centralia ~~of the gain~~ until a rate case will allow the Commission to address the allocation and disposition of the gain within the broader context of each of the Companies' ~~entire~~ operations~~and in the light of present or future restructuring~~. The Commission may not have sufficient information in this proceeding to a~~cc~~ssess the effects any sharing of the gain might have on each of the Companies' overall rate structures.

Furthermore, waiting until the next rate case will not unreasonably burden any of the Companies. Since PacifiCorp and Avista have recently filed general rate cases in Washington, the disposition of the gain with respect to those two Companies ~~will~~ could ~~happen~~ occur in proceedings that have already commenced.

~~While~~ PacifiCorp has indicated that it would like to be able to make a business decision regarding the sale with knowledge of how the Commission will allocate the gain (*See* Exhibit 602 (LW-2), Excerpts from Anne Eakin's Rebuttal Testimony in Oregon PUC Docket No. UP 168 at PPL/16, Eakin/7 lines 13-21); however, the decision to make the sale should not be tied to the disposition of the gain. ~~PacifiCorp has offered no persuasive rational for why it would be entitled to that knowledge.~~ In fact, if the Commission finds that the sale is prudent and in the public~~rate payers'~~ interest, it would be difficult for PacifiCorp to back out of the sale without incurring consequences in its current rate filing. As for PSE, the proposed sale of Centralia is very similar to PSE's sale of Colstrip. In that case, the Commission ~~not only~~ found that the gain should be deferred and~~, but also found that the gain would be~~ returned to ratepayers with interest. ~~Thus,~~ Third Supplemental Order Approving Sale; Ordering Deferral of Gain and Deferral of Power Cost Changes, Docket No. UE-990267 (September 30, 1999), at 16. Thus, d~~d~~eferring a determination of the allocation of the gain until the next rate case is not prejudicial to any of the Companies.

Q. WHY ARE RATEPAYERS ENTITLED TO 100 PERCENT OF THE GAIN?

A. Ratepayers are entitled to one hundred percent of the gain because ratepayers have historically borne the risk and the financial burden of the costs associated with Centralia. Ratepayers have been paying for 100 percent of the costs associated with Centralia since it was first placed in Washington rate base. Since ratepayers have assumed the risk of loss associated with this rate based asset, ratepayers should also enjoy all of the benefits associated with Centralia.

This “benefits follows the risk” analysis is consistent with the Commission Staff’s analysis in the Colstrip case. In that case, the Commission Staff explained that the Commission has consistently held that gains should be provided to ratepayers. Third Supplemental Order at 16. ~~Docket No. UE-990267, Third Supplemental Order Approving Sale; Ordering Deferral of Gain and Deferral of Power Cost Charges (September 30, 1999) at 16. This “benefits follows the risk” analysis is also supported, counsel informs me, by the theory of Democratic Central Committee, a 1972 D.C. Court of Appeals case, a theory the Commission was not required to apply in the Colstrip case. Id. at 19 note 5.~~

In return for paying all of the costs associated with constructing, operating and maintaining Centralia, ratepayers have historically been entitled to the benefits of the power produced at Centralia. ~~These b~~Benefits ~~historically enjoyed by ratepayers~~ include ~~both~~ the actual use of the power produced and any profits associated with the market sale of surplus power. It would be inequitable for these ratepayer benefits to be cut-off or diminished by the utility’s decision to sell the asset. ~~happenstance of an asset sale.~~ If the proposed sale of Centralia occurs, the only equitable treatment is to return to ratepayers the full benefits they would have received absent the sale.

Q. ARE YOU MAKING A DISTINCTION BETWEEN: (1) THE BENEFITS OF CENTRALIA; (2) THE GAIN FROM THE SALE OF CENTRALIA; AND (3) THE

BENEFITS FROM THE SALE OF CENTRALIA?

A. Yes. The benefits of Centralia ~~exist~~ have now been defined whether or not the asset is sold. As ~~the~~ ultimate risk takers, ratepayers are entitled to receive all of these benefits, which, assuming that the value of Centralia was maximized through the auction process, are equal to the market sales price less the Companies' ~~net book~~outstanding investment in the plant.

~~The gain from the sale of Centralia is also equal to the market sales price minus the Companies' net book investment.~~ The gain from the sale of Centralia does not represent new value created as the direct result of the sale; it merely reduces the future value of the asset to present terms. . ~~An argument can be made that the sale provides a benefit over and above that obtainable from continued operation by the Companies, and that it would be better for the rate payers to have the Companies sell the plant than to retain it. While these arguments may be true, it is not true that the sale itself creates value. Rather, t~~The value of the asset is realized in the market when Centralia is put up for sale. There is no additional value created by the Companies.

~~Conversely, the benefits from the sale of Centralia are those benefits that are directly attributable to the sale itself. While the gain from the sale of Centralia is an amount that is easily calculable, the benefits from the sale, if any, are much more difficult to ascertain.~~

~~Since it is nearly impossible to measure the difference in power costs with and without the sale over the lifetime of the facility, the full sale price of Centralia is the most~~

~~accurate proxy for the benefits ratepayers would have received absent the sale. The gain must, therefore, be equal to the net present value of the benefits customers would have enjoyed absent the sale.~~ To allocate less than 100 percent of the gain to ratepayers would ~~decrease the benefits~~ deprive ratepayers ~~would have enjoyed absent the sale~~of the benefits of the asset they have paid for over time, and which they will otherwise receive if the sale is not completed.

Q. ARE THERE ANY OTHER REASONS RATEPAYERS ARE ENTITLED TO 100 PERCENT OF THE GAIN?

A. Yes. The costs associated with Centralia were front-loaded in rate base. Ratepayers paid a disproportionate amount of the costs in the early years of Centralia's operation based upon an understanding that a similarly disproportionate share of the benefits would accrue to ratepayers toward the end of the asset's life. Ratepayers anticipated receiving relatively more benefits as the asset depreciated. It would not be equitable to award ratepayers less than 100 percent of the benefits they anticipated when agreeing to pay the relatively higher costs in the early years of Centralia's operation.

Q. WILL SHAREHOLDERS BE DISADVANTAGED IF RATEPAYERS RECEIVE 100 PERCENT OF THE GAIN?

A. Absolutely not. If shareholders receive any portion of the gain they will be receiving an excessive return on their investment in Centralia. As a fundamental principle of ratemaking, the Companies are entitled to receive a return <u>of</u> their investment as an asset is depreciated, and an opportunity to earn a reasonable return on the undepreciated portion of their investment. In the case of Centralia, the Companies' have been provided the opportunity to earn a fair return on the capital that the shareholders provided. Each of the Companies have also received a partial return of its capital through depreciation. The undepreciated value of the plant will be netted from the gross proceeds of the sale and returned to the Companies as part of the proposed transaction. Thus, the Companies' have been adequately compensated for the use of their money, and as a result of the transaction will have 100% of ~~its~~ their investments returned.

Q. WHY IS INDUSTRY RESTRUCTURING RELEVANT TO THIS PROCEEDING?

A. Each of the Companies has a varied mixed of generation resources which are currently used to serve ratepayers. These generation resources include physical depreciable resources and purchased power resources, such as ~~PURPA~~ contracts entered into with Qualifying Facilities ("QF") pursuant to the Public Utilities Regulatory Policy Act of 1978 ("PURPA"). Some of the resources provide relatively high-cost power, while other resources provide relatively low-cost power. Currently, the Companies are able to recapture the costs of both the high-cost and low-cost resources through regulated retail rates. In a competitive marketplace, however, some of the benefits of the low-cost resources may not be delivered to ratepayers and some of the expenses of the high-cost resources may not be recovered by the Companies. To make sure that neither ratepayers nor shareholders are unfairly benefited or burdened by retail open access, it is prudent to adopt policies now that balance the interests of shareholders and ratepayers regarding potential stranded costs or benefits.

Q. WHAT DO YOU MEAN BY THE TERM "STRANDED COSTS"?

A. Stranded costs are investments and contractual obligations that are no longer recoverable in a competitive, deregulated energy market. The National Association of Regulatory Utility Commissioners ("NARUC") provides a common usage definition of stranded costs. NARUC defines stranded costs by reference to the definition of Embedded Costs Exceeding Market Prices ("ECEMP"), which is defined as follows:

> Embedded costs of utility investments exceeding market prices are:
>
> 1) costs incurred pursuant to a regulatory or contractual obligation; 2) costs that are reflected in cost-based rates; and 3) cost-based rates that exceed the price of alternatives in the marketplace. ECEMPs may become "stranded costs" where they exceed the amount that can be recovered through the asset's sale . . . .

NARUC website (**http://www.naruc.org/glossary.htm**). Consistent with NARUC's definition, I am referring to stranded costs as both utility investments and contractual obligations that would not otherwise be recoverable in a competitive market, including PacifiCorp's PURPA QF contracts and other purchased power obligations.

Q. HOW COULD IGNORING THE EFFECTS OF INDUSTRY RESTRUCTURING IN THIS PROCEEDING BE POTENTIALLY HARMFUL TO RATEPAYERS?

A. Allowing the Companies to share in the gain from the sale of Centralia provides an inappropriate incentive to the Companies to sell -off their low-cost assets. The

Companies have an incentive to sell off the assets that have a market value in excess of net book now in order to retain some of the net proceeds for shareholders while keeping their high-cost resources in rates. In addition, when restructuring occurs, the companies will undoubtedly ~~; then~~ seek 100% recovery of any stranded costs associated with the high-costs retained ~~assets~~ resources when industry restructuring occurs. This result would inequitably benefit shareholders at the expense of ratepayers. The proposed sale of Centralia should, therefore, not be considered in isolation.

Q. DOES ICNU OBJECT TO SELLING-OFF RESOURCES PIECEMEAL?

A. No. As part of the restructuring process, the Companies should be allowed to sell~~-off~~ generating resources as long as 100 hundred percent of the gains from selling such resources are returned to ratepayers, which will ensure that sales of below market resources will be netted against the Companies' <u>total</u> stranded costs, if any. ~~[~~At a minimum, ~~a~~ a symmetry should be maintained between the allocation of potential stranded costs and benefits, including any stranded costs associated with the so-called regulatory assets, such as the PURPA QF ~~purchases~~contracts.~~]~~

Q. DO YOU HAVE COMMENTS ON EACH OF THE COMPANIES INDIVIDUAL PROPOSALS FOR ALLOCATING THE GAIN?

A. Yes. While each Companies' proposal for sharing the gain is slightly different, none of their proposals are equitable for ratepayers. Each of the individual proposals are analyzed below.

<u>PACIFICORP</u>

Q. BRIEFLY, HOW DOES PACIFICORP PROPOSE TO ALLOCATE THE GAIN FROM THE CENTRALIA SALE?

A. PacifiCorp's proposal is contained in the very brief testimony of Ms. Anne Eakin. In essence, PacifiCorp proposes to share the $83 million system-wide gain by using a depreciation reserve method. Exhibit 213T at 2-4. The result is that ratepayers receive 64% of the net gain, and shareholders receive the remainder.

Q. HOW DOES THE DEPRECIATION RESERVE METHOD WORK?

A. The depreciation reserve method divides the share of the net proceeds between shareholders and ratepayers based on the ratio of net book value to original book value. For example, if the plant is 64% depreciated, the net proceeds would be allocated 64% to ratepayers and 36% to shareholders. The ratepayers' share is apportioned based on the percentage of the plant's costs that have been depreciated, whereas the shareholders' portion is based on the percentage of the plant's costs that have not been depreciated. Id. at 3.

Ms. Eakin contends that the depreciation reserve method represents a "compromise" between ratepayers and shareholders that takes into account PacifiCorp's contention that there is an argument for shareholders' retaining 100% of the gain. PacifiCorp's argument is based on the fact that shareholders have "placed up-front capital at risk to construct and maintain this generating facility." Id., lines 4-5.

Q. PLEASE DISCUSS PACIFICORP'S CONTENTION THAT IT MAY BE ENTITLED TO 100% OF THE NET GAIN.

A. PacifiCorp appears to want its shareholders to be treated just like the shareholders of non-monopoly corporations that sell in competitive markets. Non-monopoly shareholders are entitled to the entire amount of any gain associated with the up-front capital they put at risk. However, those shareholders also bear the entire amount of any loss associated with investments or purchase contracts that have costs in excess of the price obtainable in the market. Shareholders of companies operating in competitive markets enjoy symmetrical treatment of their gains and losses, and have no claim to stranded costs.

~~**Q. IS PACIFICORP PROPOSING THAT THE DEPRECIATION RESERVE METHODOLOGY BE APPLIED TO ASSETS WITH STRANDED COSTS?**~~

~~**A.** No. It is my understanding that the depreciation reserve sharing proposal would apply only to assets or contracts which have a stranded benefit. Thus, the only risk faced by PacifiCorp in investing its up-front capital is the uncertainty associated with whether shareholders will merely receive a just and reasonable return, or whether shareholders will receive an even larger return. Under my understanding of PacifiCorp's approach to stranded costs, PacifiCorp's shareholders face no risk of loss.~~

~~PacifiCorp seems to be saying that if an investment turns out to be particularly lucrative or profitable, shareholders should have the right to capture the benefit of that good investment. On the other hand, if a resource, such as a PURPA contract, produces a loss, the shareholder investment should be reimbursed by the ratepayers. This theory is, of course: heads, PacifiCorp wins; tails, the ratepayer loses.~~

~~If PacifiCorp's position is that all generating resources—owned and purchased, including~~

~~PURPA resources—are the shareholder's responsibility in terms of risk, then this case would take on an entirely different dimension. PacifiCorp, however, has indicated that ratepayers should be held 100% responsible for any stranded costs associated with what PacifiCorp terms "regulatory assets."~~

~~**Q. PLEASE ELABORATE.**~~

~~A. I strongly oppose PacifiCorp's views on stranded costs generally, and its contention that shareholders are entitled to 100 percent of the net gain from the sale of Centralia. Ratepayers have been paying for PacifiCorp's cost of owning and operating the Centralia since it was first placed in rate base. It is, in effect, a ratepayer asset. Because ratepayers have been responsible for paying all the costs associated with Centralia, ratepayers should receive all of the benefits from the sale. Applying PacifiCorp's stranded costs approach to this context, it is ratepayers, not shareholders, who should receive 100 percent of the net gain on the sale of Centralia.~~

Q. HOW DOES PACIFICORP'S POSITION REGARDING NET BENEFITS COMPARE TO YOUR UNDERSTANDING OF ITS POSITION REGARDING NET LOSSES?

A. PacifiCorp's argument that it is entitled to 100% of the gain on Centralia is totally at odds with any claim it might ~~its apparent claim~~have to recovery of ~~to~~ stranded costs associated with its generation resources, including ~~from resources and power purchase contracts with above-market costs—~~the so-called regulatory assets, such as~~or~~ PURPA QF contracts~~assets~~. PacifiCorp~~'s 100% benefits for shareholders argument~~ seems to say that the utility can sell off any profitable investment and retain the entire net gain for the shareholders. Meanwhile, of course, PacifiCorp is allowed an opportunity to earn a just and reasonable return on its other investments, including above-market resources.

PacifiCorp contends that it is entitled to keep the gain because it has placed up-front capital at risk. Exhibit 213T at 3. However, if PacifiCorp puts capital at risk for assets that have stranded benefits, then it must also put capital at risk for assets that have stranded costs. ~~When the up-front capital was initially invested, neither PacifiCorp nor its ratepayers could have foreseen whether the investment would result in a stranded cost or a stranded benefit with respect to today's market.~~ This rationale also applies to PacifiCorp's PURPA QF contracts because those contracts were priced at the cost of the investments PacifiCorp would have made but for the QF contract. While no up-front capital was initially invested in power purchase contracts, as contractual commitments they may also produce unforeseen costs or benefits with respect to today's market, and therefore require the same symmetrical treatment. The only logical conclusion is that stranded costs and stranded benefits be symmetrically allocated between shareholders and ratepayers.

Although PacifiCorp contends that its asymmetrical treatment of stranded costs and stranded benefits is valid, it offers a "compromise" approach instead: something it calls the depreciation reserve method.

Q. IS THE DEPRECIATION RESERVE METHOD A FAIR APPROACH?

A. Absolutely not. PacifiCorp's theory results in excessive returns to shareholders.

PacifiCorp has been provided the opportunity to earn a fair return on the capital that the shareholders provided. PacifiCorp has received a partial return of its capital through depreciation. The undepreciated value of the plant has been netted from the gross proceeds of the sale and is being returned to PacifiCorp in this transaction. Thus, PacifiCorp has been adequately compensated for the use of its money, and as a result of the transaction will have 100% of its investment returned.

Q. IS THE DEPRECIATION–RESERVE METHOD CONSISTENT WITH WHAT WOULD HAVE HAPPENED ABSENT THE SALE OF CENTRALIA?

A. No. Absent a sale, the above-book market value of Centralia ~~due to market price projections~~ would accrue to ratepayers through lower power costs. Instead of paying the market price for replacement power in the future, ratepayers would enjoy the cost-based output of the Centralia plant. The market apparently considers the value of Centralia to be higher than the estimated accounting costs of the system; the positive net value ~~represented~~embodied in the sale price represents the present value of the purchaser's view of the market versus the costs of operating the plant. Without a sale, ratepayers likely would receive the value that PacifiCorp is proposing be allotted to shareholders.

Q. IS PACIFICORP PROPOSING THAT THE DEPRECIATION RESERVE METHODOLOGY BE APPLIED TO ASSETS WITH STRANDED COSTS?

A. Not necessarily. PacifiCorp has not clarified its understanding of the effect that adopting the depreciation reserve method in this proceeding would have on future proceedings involving the allocation of stranded costs between shareholders and ratepayers.

PacifiCorp is apparently willing to concede that if the depreciation reserve method is used to allocate the gain in this case, that the same method should be used in future proceedings involving the sale of a plant at a book loss. *See* Exhibit 603 (LW-3) (Excerpts from the Rebuttal Testimony of Anne Eakin in Oregon PUC Docket No. UP 168 at PPL/16, Eakin/5 lines 20-22). Of course, the symmetry of this proposal is illusory given that PacifiCorp would not have any reason to sell a plant and incur a loss when it can simply retain the plant in rate base and receive its full return on and return of investment. Moreover, PacifiCorp is apparently not willing to extend the same reasoning to the allocation of any future stranded costs associated with its so-called regulatory assets, such as the PURPA QF contracts. Id. at PPL/16, Eakin/6 lines 1-8. Thus, the only risk faced by PacifiCorp in investing its capital is the uncertainty associated with whether shareholders will receive a just and reasonable return or an even larger return. Under my understanding of PacifiCorp's approach to stranded costs, PacifiCorp's shareholders face no risk of loss.

PacifiCorp appears to take the position seems to be saying that if an investment turns out to be particularly lucrative or profitable, shareholders should have the right to capture the benefit of that good investment. On the other hand, if a resource, such as a PURPA QF contract, produces a loss, the shareholder investment should be reimbursed by the ratepayers. This theory is, of course: heads, PacifiCorp wins; tails, the ratepayer loses.

If PacifiCorp's position is that all generating resources—owned and purchased, including

PURPA QF resources—are the shareholder's responsibility in terms of risk, then this case would take on an entirely different dimension.

Q. PLEASE ELABORATE.

A. I strongly oppose PacifiCorp's views on stranded costs generally, and its contention that shareholders are entitled to 100 percent of the net gain from the sale of Centralia. Ratepayers have been paying for PacifiCorp's cost of owning and operating the Centralia since it was first placed in rate base. It is, in effect, a ratepayer asset. Because ratepayers have been responsible for paying all the costs associated with Centralia, ratepayers should receive all of the benefits from the sale. Applying PacifiCorp's stranded costs approach to this context, it is ratepayers, not shareholders, who should receive 100 percent of the net gain on the sale of Centralia.

Q. IS THE DEPRECIATION RESERVE METHODOLOGY CAPABLE OF ALLOCATING THE STRANDED COSTS OR BENEFITS ASSOCIATED WITH REGULATORY ASSETS, SUCH AS PURPA QF CONTRACTS, AND OTHER PURCHASED POWER RESOURCES?

A. No. Another reason for rejecting PacifiCorp's so-called "compromise" for allocating the net gain from the Centralia sale, is that the depreciation reserve methodology is not capable of allocating any stranded costs or benefits associated with the PURPA QF contracts and other purchased power resources between shareholders and ratepayers. Purchased power contracts generally are not included in the utility's capital-asset accounts and therefore face no utility depreciation and rate base treatment. Rather, those costs are incorporated into rates through the recovery of the purchase cost.

Q. DO YOU AGREE WITH PACIFICORP'S PROPOSAL TO USE THE CUSTOMER'S PORTION OF THE GAIN TO WRITE DOWN GENERATION-RELATED REGULATORY ASSETS?

A. No. The customer's portion of any gain should not be used to write down generation-related regulatory assets. Moreover, this is not the appropriate proceeding in which to determine how PacifiCorp should return the ratepayers' portion of the gain. That decision should be made in PacifiCorp's recently-filed general rate proceeding.

<u>Avista</u>

Q. WHAT IS AVISTA'S POSITION REGARDING DISPOSITION OF THE GAIN FROM THE CENTRALIA SALE?

A. ~~The~~ Avista's position regarding how the gain is shared is contained in the testimony of Thomas D. Dukich (Exhibit 306T). ~~In that testimony, Avista~~Mr. Dukich takes the extremely "aggressive" position that 100 percent of the gain should be retained for shareholders. Exhibit 360T at 3 lines 8-9. Alternatively, Avista believes an amount greater than PacifiCorp's depreciation method is supportable. <u>Id.</u>

Mr. Dukich contends that the Commission should balance the interests of Avista customers and shareholders in determining disposition of the gain. Mr. Dukich argues that awarding all or most of the gains to shareholders is equitable given Avista's failure to earn its authorized return on equity in the past. <u>Id.</u> at 4. Mr. Dukich also argues that Avista is entitled to the gain because Avista's residential rates have been "consistently . . . among the very lowest in the United States." <u>Id.</u>, line 21.

Finally, Mr. Dukich identifies write-offs that Avista has taken since 1985. Id. at 5. While he explains that he is not second guessing the Commission's application of the prudence and "used and useful" standards, Mr. Dukich believes these write-offs warrant a sharing of the gain from the sale of Centralia with Avista's shareholders. Id. at 6.

Q. DO YOU AGREE WITH HIS ARGUMENTS?

A. Absolutely not. I will take them one at a time.

First, as to balancing the interests of the shareholders and ~~rate payers~~ratepayers: As I indicated earlier, Avista has been authorized a fair rate of return for all of its rate-base assets. That authorized return by its definition balances the interests of ~~rate payers~~ratepayers and shareholders. No further balancing is necessary.

In addition, Avista's shareholders' investment in Centralia has been partially returned through depreciation, and ~~their~~ its remaining investment will be returned through payment for the remaining net book value of the plant when the proposed sale closes. Avista and its shareholders have been able to take the mon~~ey~~ies returned to them in the past and invest those funds in whatever they think will yield them a fair return; they can do the same with the remaining net book investment. There is no need for ~~rate payers~~ratepayers to provide a "balance" to what ~~shareholders or their agent~~ Avista on behalf of its shareholders decides to do with the money in ~~their~~ its own hands. ~~Rate payers do not need to provide additional impetus so they can put their money in their investment of choice. They can buy their own Microsoft, Amazon.com or Treasury bonds and balance their own investment in a "fair and equitable" manner. No balancing~~

~~at all should be made between shareholder and ratepayer with regard to the investment that is returned to rate payers.~~

The issue boils down to whether or not Avista shareholders should obtain a higher return on their investment than the fair return authorized by the Commission from time to time—the ~~mathematical~~ result of awarding the gain to shareholders.

Q. PLEASE ADDRESS THE ISSUE OF AVISTA'S OVERALL EARNED RATE OF RETURN OVER THE YEARS.

A. The issue of whether Avista has earn~~s~~ed its authorized rate of return historically is between Avista shareholders and Avista management (or, in the past Washington Water Power). It is not an issue for the Commission unless company operations ~~affect~~ impact safety or reliability. If Avista is unable to meet cost targets or develop used and useful investments, which would be prime causes of under-earning, it should either operate more efficiently or prudently or it could seek rate relief. Avista management's decision to do neither is certainly not a rate-payer responsibility, and the rate-payers should not be financially penalized for an Avista shareholder/management problem. It is simply not appropriate to award Avista a gain from this sale on the basis of historical under-performance.

Q. SHOULD AVISTA BE AWARDED A GAIN BECAUSE OF ITS HISTORICAL LOW RATES?

A. If the question were phrased "Should Avista be awarded the gain because a large river runs through its service territory?" the answer would ~~be~~ clearly be no. Avista's rates are low primarily because it is largely a hydro-based utility with resources that were built long ago. In fact, if one looks around the country, the prime reason for differences in utility rates is due to the differences in generation resources. The Northwest long has been known for its low rates as a result of its hydro-based generation. The accident of geography does not automatically make Northwest utilities better than their national counterparts. Mr. Dukich's argument ~~would imply~~ implies that ~~they are~~Avista is extremely efficient.

With resource costs varying greatly between utilities depending on their geography or generation choices, a better measure of efficiency might be the non-production costs of the utility.

Q. HOW DOES AVISTA FARE IN A COMPARISON OF NON-PRODUCTION COSTS?

A. Poorly. In a calculation of non-production costs per customer, Avista isn't even among the ~~lowest~~ top 50% of utilities in the nation. In the~~ir~~ ScottishPower/PacifiCorp merger proceeding~~application~~, ~~ScottishPower~~ Andrew MacRitchie~~and PacifiCorp developed~~submitted an analysis of non-production costs per customer for 1996 based ~~up~~on EIA summary data from FERC Form 1 reports of 72 utilities. Exhibit 604 (LW-4)~~by utilities of all costs but production costs calculated on a per-customer basis.~~. T~~Data for 1996 were used. In this ranking, t~~he top 10 utilities averaged about $190 per customer~~—~~. Puget Sound Energy at $200.07 per customer was in the top 10, and

PacifiCorp at $300.13 per customer was ranked fifty-sixth.~~-~~ Other utilities ranked among the top 72 utilities were Sierra Pacific at $247.33 and Idaho Power at $322.31. By contrast, Avista~~'s~~ did not appear in the ranking because its non production costs per customer for 1996 were too high for inclusion in the table. An independent review of Avista's 1996 FERC Form 1 report, however, shows that Avista's non-production costs per customer were $390.75. ~~[Other utilities were Sierra Pacific at $247.33, PacifiCorp at $300.13 and Idaho Power at $322.31.]~~ Removing an estimate of the higher non-production costs Avista incurred in 1996 due to an unusual ice storm, Avista had an adjusted non-production cost per customer of $342.01 Exhibit 605 (LW-5). Even after adjusting for the ice storm, Avista's non-production costs per customer exceed the ~~The~~ national median for 1996, which was $328.85.

On the basis of non-production costs per customer~~s~~, Avista is among the least efficient utilities ~~worst~~ in the nation.

Q. PLEASE SUMMARIZE YOUR POSITION WITH REGARD TO AVISTA.

A. It would be inappropriate to provide Avista shareholders a gain from Centralia because of geographical and historical accident and in the face of a poor record on non-production costs.

Q. HOW SHOULD THE GAIN BE ASSIGNED TO ~~RATE PAYERS~~RATEPAYERS?

A. The gain should be assigned as part of the Avista rate case currently under way.

<u>Puget Sound Energy</u>

Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF PSE'S RATEMAKING PROPOSAL FOR GAIN FROM THE CENTRALIA SALE.~~.~~

A. PSE proposes the same ratemaking treatment for the gain from the sale of Centralia that it proposed for the gain from the sale of Colstrip. PSE proposes to amortize the net gain over a five-year period commencing January 1, 2000. ~~1.~~ Exhibit 108T at 4, lines 20-21. PSE's proposal has the effect of delivering a substantial portion of the gain to shareholders over the remainder of the Rate Plan.

Q. DO YOU AGREE WITH PSE'S PROPOSAL?

A. No. The arguments made above with respect to Avista and PacifiCorp ~~hold~~ also apply to ~~with~~ PSE. There is no persuasive case to make for retention of any benefits by shareholders who historically have already been allowed an authorized ~~their~~ return for their investment in Centralia and have had or will have their investment returned to them in full through depreciation and final payoff of the net book value. The key difference with PSE is its Rate Plan, which prescribes rates for the next few years.

The Commission recently addressed the affect of PSE's Rate Plan on the allocation of the gain from the sale of PSE's interest in Colstrip in Docket No. UE-990267. The sale of Centralia is directly analogous to the sale of Colstrip; therefore, ~~The Commission's decision in that case should be applied here. In that case, the Commission noted the uncertainty of the financial prudence of the sale, correctly identifying how reliant the final cost/benefit figure is on choice of discount rate or market~~

~~price forecast. [cite from third order] That uncertainty is compounded by the lack of agreement regarding the appropriate time horizon over which to calculate the costs and benefits of the sale. Final cost/benefit results would obviously depend on whether a 19-year, 25-year or some other period of time was used in the analysis. The costs or benefits associated with the proposed sale of Centralia being considered in this case are equally uncertain.~~

~~The Commission should therefore order the same regulatory treatment for the gain associated with the PSE's proposed sale of is interest in Centralia that the Commission ordered in for PSE's sale of its interest in Colstrip. T~~the allocation of the gain should be deferred and distributed with interest to ratepayers in PSE's next rate case and treated in a consistent manner with the sale of Colstrip.

Q. DOES THIS CONCLUDE YOUR TESTIMONY.

A. Yes.