

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-010395

REBUTTAL TESTIMONY OF KELLY O. NORWOOD  
REPRESENTING AVISTA CORPORATION

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20

Q. Please state your name, the name of your employer and your business address.

A. My name is Kelly O. Norwood. I am employed by Avista Corporation at 1411 East Mission Avenue, Spokane, Washington.

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

A. Yes.

Q. Please briefly summarize your rebuttal testimony.

A. My rebuttal testimony will explain why it is imperative that the deferred accounting treatment extend beyond the June 30, 2001 termination date recommended by Staff. I will also explain why it would be difficult, if not impossible, for Avista to meet the filing dates proposed by Staff related to a prudence filing (September 17<sup>th</sup>) and a general rate case filing (September 28<sup>th</sup>). My testimony will explain why it is appropriate for the capital and O&M costs of the new small generation projects to be included in the deferral entries, i.e., to match the benefits from these projects that are also reflected in the deferral entries. I will respond to a number of statements of Mr. Schoenbeck related to projected costs, as well as his recommendation for a reduced surcharge of 11.9%. Finally, I will discuss some of the likely impacts on power supply operations if the Company's credit rating were to drop below investment grade.

Q. On page 4 of his testimony Mr. Elgin recommends that the existing deferred accounting treatment for power supply expenses end on June 30, 2001. Do you agree with this recommendation?

1           A. No. The impacts of the volatile wholesale market prices combined with the record low  
2 hydroelectric generation conditions continue to have a substantial impact on the costs to provide electric  
3 service to the Company's customers. Deferrals for July through September 2001 alone are projected to  
4 be \$74 million for the Washington jurisdiction. The \$74 million for the three-month period represents an  
5 extraordinary increase in costs over and above those included in base retail rates. The \$74 million  
6 represents 31% of the Company's gross annual retail revenue in the Washington jurisdiction of \$237  
7 million. The increased costs are driven primarily by record low hydroelectric conditions and  
8 unprecedented high wholesale market prices. Most of these costs are already known because of the  
9 commitments made to purchase power at fixed prices to replace the lost hydroelectric generation.

10           Staff has taken the position in the past that in order to have the opportunity to recover  
11 extraordinary costs, it should seek deferred accounting treatment and then address prudence at a later  
12 time. That is precisely what the Company has proposed in this filing. Staff Witness Schooley included  
13 the following question and answer on page 7 of his direct testimony, in opposing the Company's request  
14 for recovery of extraordinary storm damage costs that the Company sought to recover in Docket No.  
15 UE-991606:

16           Q. Did WWP or Avista attempt to establish an accounting basis for later recovery of this  
17 cost?

18           A. No. No accounting petitions were filed to capitalize this expense for later recovery. It is  
19 only now, three years after the fact, that the Company presents a means to increase rates  
20 because of this expense.  
21

22           In its testimony, Staff has acknowledged the extraordinary circumstances in this proceeding, the  
23 resulting high power costs, and is recommending an increase in rates, but then is recommending the

1 termination of the very mechanism that allows the Company to opportunity to seek recovery of the  
2 extraordinary costs.

3 One of Mr. Elgin's reasons (page 21 and 22 of his testimony) for terminating the deferral  
4 mechanism is to send a signal "to firmly reiterate that Avista does not have an approved Power Cost  
5 Adjustment Mechanism (PCA)." Avista is fully aware of the fact that it does not have an approved  
6 PCA in Washington. So are investors and bankers as indicated by numerous analyst reports over the  
7 past several years. We are also fully aware of the requirements stated by the Commission and have  
8 stated repeatedly that they will be addressed should the Company propose a PCA in its promised  
9 general rate case filing this November. A proposal to deprive the Company of the opportunity to show  
10 that over \$74 million of power supply costs are extraordinary and were prudently incurred, for the  
11 purpose of "reiterating" what is already clear to the Company and its investors, is completely without  
12 merit and unnecessarily exacerbates the very difficult financial situation facing Avista.

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

18 Avista has proposed that the deferred accounting treatment and the surcharge be in place  
19 through December 31, 2003. As Mr. Falkner explained in his direct testimony, this 27-month period  
20 was chosen to provide recovery of the deferred costs over a reasonable period of time, while also  
21 reducing the overall impact on customers, as compared to a shorter recovery period. By keeping the

1 deferred accounting treatment in place during the recovery period, it not only provides the opportunity  
2 to capture the continuing extraordinary costs, but also provides the opportunity for power cost offsets to  
3 the deferral balance to occur during the period. The 27-month recovery period also provides a plan  
4 for the financial community as to how the deferred costs would be reduced to zero.

5 In Avista's surcharge filing on July 17, 2001, it proposed that at the conclusion of the November  
6 2001 general rate case, the Company would modify the surcharge amount and the duration of the  
7 surcharge rate, if needed, in order to reflect the outcome of the general rate case. Therefore, all parties  
8 will have the opportunity in the general rate case to address both the duration and amount of the  
9 surcharge to be in place at the conclusion of the general case.

10 Q. On page 4 of his testimony, with regard to the prudence of the deferred power costs,  
11 Mr. Elgin recommends that Avista be ordered "on a September 17, 2001 deadline, to either file a  
12 pleading affirming that the evidence it submitted on March 23, 2001 is its direct case on those issues, or  
13 file a new direct case on those issues." Do you agree with this recommendation?

14 A. No. Major changes in wholesale market conditions and hydroelectric generation  
15 conditions have occurred since the March 23, 2001 filing. In addition, the months with the largest  
16 deferral entries occur subsequent to the March filing (April, June, and July-September). It was the  
17 changes in conditions following the March filing that required Avista to seek immediate rate relief.  
18 Therefore, it is important that Avista's prudence filing be updated so that the information provided to the  
19 Commission reflects information subsequent to the March 23, 2001 filing.

20 The September 17<sup>th</sup> deadline would clearly not allow Avista the opportunity to adequately  
21 address the issues that would need to be covered in the prudence filing. The deadline is only 11 days

1 following the completion of hearings in this proceeding on September 6<sup>th</sup>. Furthermore, Avista has  
2 hearings in Idaho on September 12<sup>th</sup> and 13<sup>th</sup> regarding its proposed rate increase in the Idaho  
3 jurisdiction. Between September 6<sup>th</sup> and 17<sup>th</sup>, Avista would literally have four business days to  
4 complete its filing and express-mail the filing for delivery on September 17<sup>th</sup>.

5 Q. Staff has also recommended that Avista be directed to file a general rate case by  
6 September 28, 2001. Do you have similar concerns regarding the timing of such a filing?

7 A. Yes. The Company has proposed to file a general rate case in November 2001 to  
8 address, among other things, the prudence of the deferred power costs. This general rate case filing will  
9 cover a broad range of power supply issues, and therefore, it is important that the Company have a  
10 reasonable period of time following this proceeding to complete that filing.

11 Q. What are the specific power supply issues that would be covered in the November  
12 2001 general rate case filing?

13 A. The Company's general rate case filing in November would address, among other  
14 things, the prudence of the deferred power costs, the regulatory treatment of the Coyote Springs II  
15 project that is scheduled for commercial operation in June 2002, and a long-term periodic power cost  
16 adjustment mechanism.

17 In addition, the general rate case would address the issues raised by the Commission Staff and  
18 other parties related to the deferral mechanism, including issues such as:

- 19 1. The optimization of Company-owned resources to the benefit of retail customers.
- 20 2. The appropriateness of recovery of power costs through a deferral mechanism.
- 21 3. The issue of cost of capital offsets related to a shift in risk between shareholders and  
22 ratepayers.
- 23 4. Company plans to mitigate the deferred power costs.
- 24 5. Whether the mechanism captures all the benefits of operating the Company's system.

1  
2 Furthermore, the general rate case would address the power supply related issues that the  
3 Commission ordered Avista to address in its Third Supplemental Order, dated September 29, 2000, in  
4 Docket No. UE-991606. These issues include:

- 5 1. The development of a more sophisticated hourly power supply model that more  
6 accurately reflects the dispatch flexibility inherent in Avista's resource base.
- 7 2. The normalized value for capacity purchases.
- 8 3. The results of the Company's request for proposals (RFP), from Docket No. UE-  
9 001081, and a clear description of the Company's resource plans, including plans to  
10 replace Centralia generation on a long-term basis.

11  
12 Q. Staff has proposed two separate filings by the Company, including a power supply  
13 prudence case and a general rate case. Do you have any comments on this proposal?

14 A. Yes. Although the Company would not necessarily be opposed to two separate filings,  
15 the Company has proposed a single filing because there will be a lot of overlap of issues in the two  
16 filings, and we believe it makes sense to have one filing. Both proceedings would address wholesale  
17 market conditions (past, present and projected), hydroelectric generation issues, the variation of power  
18 costs from normal conditions, and other related issues.

19 Q. Mr. Elgin devotes a considerable portion of his testimony discussing his view of the  
20 guidelines outlined in the PNB order regarding emergency rate relief. Do you have any comments on  
21 this portion of his testimony?

22 A. Yes. Avista requested immediate rate relief based on a financial emergency, an  
23 emergency which the Staff itself acknowledges as evidenced by recommending a 32.6% surcharge.  
24 The Company has provided information through its direct case and through the discovery process that

1 has allowed Staff and other parties to conduct their own assessment of the Company's need for  
2 immediate rate relief under the "interim rate relief standards," and any other criteria that they might  
3 choose.

4 Commission Staff evaluated the Company's request under the "interim rate relief standards."

5 Mr. Schooley reached the following conclusions in his testimony:  
6  
7

8 Q. Given the above analysis, does Avista show a need for interim rate relief?

9 A. Yes. In my opinion, Avista needs cash from its utility operations in the very near future.  
10 (Schooley direct testimony, Page 20, Lines 13-15)  
11

12 Q. What is your recommendation concerning emergency rate relief request based on the  
13 Commission's interim relief standards?

14 A. Based on my analysis under the interim rate relief standards, Avista shows an immediate  
15 need for rate relief. I recommend a rate increase of 32.6%, subject to the other staff  
16 recommendations.  
17 (Schooley direct testimony, Page 23, Lines 1-6)  
18

19 Staff has recommended that the surcharge rate relief be terminated after 90 days, and that the  
20 Company has the option of seeking to continue the emergency rate relief upon its expiration in 90 days.  
21 The Company has demonstrated in this filing that its need for rate relief extends well beyond 90 days.  
22 Since that is the case, the Company would be right back before this Commission within one month of its  
23 order, with yet another Petition to continue the rate relief.

24 It is imperative that the rate relief continue beyond the 90 day period proposed by Staff to allow  
25 the Company the opportunity to access capital under reasonable terms to continue to fund the



1 operations of the Company, as testified by Mr. Eliassen. The Company has already agreed to make a  
2 filing in November 2001 to address the prudence and the recovery of the deferred costs.

3 Q. On page 24 of his testimony, Mr. Schooley recommends that the O&M and capital costs  
4 associated with certain Company-owned resources be excluded from the deferral calculations. Do you  
5 agree with this recommendation?

6 A. No. The Company undertook a number of measures to mitigate the impacts associated  
7 with the volatile market prices and the low streamflow conditions, including the installation of small gas-  
8 fired and oil-fired generation projects. The Settlement Stipulation in Docket No. UE-010395, related  
9 to deferred accounting treatment, states as follows:

10 Monthly deferral entries in the existing mechanism include both the total costs and total benefits  
11 of the measures taken by the Company to mitigate the deferred costs. (Paragraph 2)  
12

13 The benefits associated with the small generation projects are reflected in the net deferred costs,  
14 and it is appropriate to include both the benefits and the costs associated with these projects. The  
15 installation of these projects allowed Avista to avoid making high-cost purchases from the wholesale  
16 market. In addition, as the generation is dispatched, the benefits will be credited against the deferral  
17 balance. It would not be appropriate to credit the benefits, but exclude the costs associated with these  
18 projects.

19 Only the fixed and variable costs of the new small generation projects are included in the  
20 deferral mechanism. The Company is not including the changes in capital and O&M costs related to  
21 existing hydroelectric and thermal resources that were addressed in the Company's last general rate  
22 case. The Coyote Springs II project is scheduled to be in operation in June 2002. Avista will address

1 the prudence of Coyote Springs II in the November general rate case. Therefore, there will be  
2 opportunity to address the prudence of this project prior to the inservice date of the project.

3 In any event, the issue of prudence related to the deferred costs, including any capital and  
4 O&M costs, will be addressed in the upcoming November filing and it is not necessary to make a ruling  
5 in this phase of the proceeding related to these costs.

6 Q. On page 2 of Mr. Schoenbeck's testimony he states as follows: "So, in essence, the  
7 Company is seeking recovery of resources yet to be put into service and short-term power costs that  
8 would not be reflected in traditional normalized ratemaking." Do you have any comments on this  
9 statement?

10 A. Yes. The Company has requested the surcharge rate increase to begin recovery of the  
11 extraordinary power costs on a subject to refund basis. The deferral balance for the Washington  
12 jurisdiction at June 30, 2001 was \$109 million. At the time of this filing, the expected balance at  
13 September 30, 2001 was \$186 million, and more current estimates show that the balance will be slightly  
14 higher than \$186 million at September 30<sup>th</sup>. The majority of the costs for this period are known  
15 because of commitments already made to purchase power at fixed prices to cover resource deficiencies  
16 caused primarily by record low hydroelectric conditions.

17 If the upcoming prudence review of the deferred costs were to occur over a nine-month period,  
18 the dollars collected by the Company during the nine-month period, under the 36.9% surcharge, would  
19 be approximately \$63 million (9 months of an annual revenue increase of \$84 million). The dollars  
20 collected during the prudence review period would be only 58% of the actual deferral balance at June  
21 30, 2001 of \$109 million, and only 34% of the expected balance at September 30, 2001 of \$186

1 million. Thus, the dollars collected during the prudence review period would be a fraction of the actual  
2 costs already incurred by the Company.

3 Projections of deferrals were included in this filing for the 27-month recovery period for  
4 informational purposes. As stated earlier, the 27-month recovery period was chosen to provide  
5 recovery of the deferred costs over a reasonable period of time, while also reducing the overall impact  
6 on customers, as compared to a shorter recovery period.

7 Q. On page 10, line 21, Mr. Schoenbeck states that the new resource fixed costs represent  
8 54% of the projected deferrals. Do you have any comments on this statement?

9 A. Yes. It appears that Mr. Schoenbeck's analysis is incomplete. The percentage of fixed  
10 costs for new resources to total deferrals does not represent the contribution of the new resources to  
11 the deferral balance since it ignores both the value of the generation and fuel costs of the new resources.  
12 The value of the generation and the fuel costs of the new resources are embedded in Line 1 of his  
13 exhibit DWS-3.

14 In any event, the Company is not asking for "pre-recovery" of the fixed costs in this  
15 proceeding. The issue of prudence related to the deferred costs, including any capital and O&M costs,  
16 will be addressed in the upcoming filing and it is not necessary to make a ruling in this phase of the  
17 proceeding related to these costs.

18 Q. On page 11, line 7, of Mr. Schoenbeck's testimony, with regard to implementing the  
19 proposed surcharge, he states that, "If that were to occur, the Company would receive ratepayer  
20 capital based upon speculative forecast assumptions, highly questionable power purchase transactions  
21 and fuel costs." Do you agree with this statement?

1           A. No. Mr. Schoenbeck's reference to any of the costs as "highly questionable" is  
2 completely misplaced and inappropriate at this time, since the case to address the prudence of the costs  
3 is yet to come.

4           Q. On page 3 of Mr. Schoenbeck's testimony, he recommends an 11.9% surcharge for a  
5 15-month period. Do you have any comments on this recommendation?

6           A. Yes. Mr. Schoenbeck derives his surcharge revenue figure by cutting off deferrals at  
7 June 30, 2001, and making a "risk adjustment" to lower the surcharge to 11.9%. Mr. Schoenbeck's  
8 proposal ignores the substantial power costs that we know the Company will incur beyond June 30,  
9 2001, especially the costs during July, August and September of approximately \$74 million that I  
10 discussed earlier. The magnitude of these costs are one of the primary reasons that it is necessary to  
11 have an immediate substantial rate increase to allow Avista to continue to access capital under  
12 reasonable terms to fund the ongoing operations of the Company, as testified by Mr. Eliassen.

13           The so-called risk adjustment proposed by Mr. Schoenbeck is not an appropriate adjustment.  
14 Mr. Schoenbeck's recommendation, among other things, ignores the overall financial condition of the  
15 Company, the unusual circumstances under which the costs were incurred, and the extraordinary  
16 measures taken to by the Company to mitigate the costs. These issues, including Mr. Schoenbeck's risk  
17 adjustment, can be addressed in the Company's November filing.

18           Q. On page 14 of Mr. Thornton's testimony he recommends that Avista consider selling the  
19 Coyote Springs II Project. Has the Company considered selling the Project?

20           A. Yes. However, the Company would like to avoid selling Coyote Springs II (CSII) if at  
21 all possible. CSII was selected through the RFP process as the best project to meet the long-term

1 resource needs of the Company. At the time CSII was selected, the Project was already permitted,  
2 and the major equipment such as the gas turbine and generator, and steam turbine and generator, had  
3 already been ordered. This removed cost and scheduling uncertainty for major cost components. The  
4 Project is also located in a supportive community environment, which is a critical factor in the siting,  
5 construction and operation of a generating project such as CSII.

6 Owning and controlling the operation of CSII would allow the Company to take advantage of  
7 short-term market conditions where it may be more cost-effective at certain times to economically  
8 displace the plant. At those times the Company would sell off the natural gas and buy cheaper  
9 replacement electricity in the market. These opportunities to optimize are either not available in a fixed  
10 price electric product, or a premium price is required to get that type of flexibility. In addition,  
11 Ownership of CSII would allow Avista to "layer-in" natural gas fuel costs over time to take advantage  
12 of the changes in natural gas prices. Some of the alternatives in the RFP to Coyote Springs II were  
13 fixed price, flat delivery, electric products. In these products, however, there is no opportunity to  
14 change the fixed electric price over the ten or fifteen year term of the market contracts, unless a  
15 premium is paid to get it.

16 We believe CSII will be a valuable resource for our customers in the long-term, and the  
17 Company would like to keep the Project if possible. However, if the Company is financially unable to  
18 support the Project it would need to be sold.

19 Q. Mr. Eliassen expressed concerns that Avista's credit rating would be dropped below  
20 "investment grade" if Staff's recommendations were adopted by the Commission. Would you please  
21 explain the likely power supply related impacts if the drop in credit rating were to occur?

1           A.     Yes.  If the Company's credit rating were to drop below investment grade, it would  
2 likely place Avista in a similar position to the utilities in California (PG&E and So. Cal. Edison) with  
3 regard to its ability to purchase power from the wholesale market to serve its system load requirements.  
4 Many counterparties would refuse to sell power to Avista or grant a credit line for money that would be  
5 owed related to a transaction.  This would force Avista to prepay for power purchases, and/or post  
6 cash collateral margins, at a time when the utility would have limited cash available.  Several  
7 counterparties have already cut off transactions with Avista, or have limited transactions with Avista, as  
8 a result of the most recent downgrade that occurred.

9           Furthermore, the majority of Avista's short-term wholesale market purchases are conducted  
10 under the Western Systems Power Pool (WSPP) Agreement.  The WSPP Agreement includes a  
11 creditworthiness section, that states, in general terms, that should a party's creditworthiness become  
12 unsatisfactory to the other party, the dissatisfied party may require the counterparty to make a  
13 prepayment of cash, or use some other mutually agreeable method to satisfy the party.  Under the  
14 Agreement, a downgrade to below investment grade could result in substantial margin calls to Avista  
15 that would require Avista to make immediate cash payments or post collateral for existing transactions  
16 already entered into by Avista to serve system load requirements.  Mr. Eliassen addresses the resulting  
17 financial difficulties that would be associated with these margin calls.

18           Q.    Does that conclude your rebuttal testimony?

19           A.    Yes it does.  
20