1 BOISE, IDAHO, WEDNESDAY, JANUARY 19, 2000, 9:30 A. M.

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 4 COMMISSIONER SMITH: Good morning, ladies

 5 and gentlemen. This is the time and place set for

 6 hearing in Idaho Public Utilities Commission Case

 7 No. AVU-E-99-6, also identified as in the matter of the

 8 application of Avista Corporation for authority to sell

 9 its interest in the coal-fired Centralia power plant.

 10 We'll excuse temporarily Commissioner

 11 Kjellander who had to be appear before the House State

 12 Affairs Committee this morning and he will join us when

 13 they've finished with him or what's left of him will join

 14 us.

 15 We'll start this morning with the

 16 appearances of the parties. Let's begin with Avista.

 17 MR. DAHLKE: Yes, representing Avista

 18 Corporation, my name is Gary Dahlke. I'm with the law

 19 firm of Paine, Hamblen, Coffin, Brooke & Miller.

 20 COMMISSIONER SMITH: And we'll note,

 21 Mr. Dahlke, there's a motion for your admission for the

 22 purpose of this hearing by a member of the Idaho Bar,

 23 Mr. Tom DeBoer, and the Commission will grant that

 24 motion.

 25 MR. DAHLKE: Thank you very much.

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 CSB REPORTING COLLOQUY

 Wilder, Idaho 83676

 1 COMMISSIONER SMITH: For the Staff.

 2 MR. WOODBURY: Yes, Scott Woodbury, Deputy

 3 Attorney General, for Commission Staff.

 4 COMMISSIONER SMITH: And Mr. Ward.

 5 MR. WARD: Conley Ward of the firm Givens,

 6 Pursley for Potlatch.

 7 COMMISSIONER SMITH: Okay, and I believe

 8 those are all the parties to the case. Are there any

 9 preliminary matters that need to come before the

 10 Commission before we take the testimony of the

 11 witnesses? Mr. Dahlke.

 12 MR. DAHLKE: We have no preliminary

 13 matters.

 14 COMMISSIONER SMITH: All right, would you

 15 like to lead off, then?

 16 MR. DAHLKE: Our first witness is a policy

 17 witness, Mr. Gary Ely.

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 1 GARY G. ELY,

 2 produced as a witness at the instance of Avista

 3 Corporation, having been first duly sworn, was examined

 4 and testified as follows:

 5

 6 DIRECT EXAMINATION

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 8 BY MR. DAHLKE:

 9 Q Please state your name.

 10 A Gary Ely.

 11 Q And please state your employer and your

 12 position.

 13 A I'm executive vice president of Avista

 14 Corp.

 15 Q And have you caused to be prefiled in this

 16 matter direct testimony?

 17 A Yes, I have.

 18 Q And do you have that testimony before you?

 19 A Yes, I do.

 20 Q Do you have any changes or corrections to

 21 that testimony?

 22 A I do not.

 23 Q Before asking you about that testimony, I

 24 have a couple of additional questions that I would like

 25 to ask you about the Portland General Electric portion of

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 CSB REPORTING ELY (Di)

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 1 Centralia which is not included in your direct

 2 testimony. Can you tell us, Mr. Ely, what has transpired

 3 with regard to the Portland General Electric transaction

 4 with Avista Corporation concerning the Portland General

 5 Electric two-and-a-half percent share of Centralia?

 6 A Yes. Since I filed my prefiled testimony,

 7 we have closed that transaction as of December 31, 1999.

 8 Q And what will be the disposition of that

 9 two-and-a-half percent share of Centralia if the sale to,

 10 and I'll use the term TECWA, it's an acronym, T-E-C-W-A,

 11 if the sale to TECWA which is the subject of this

 12 proceeding closes?

 13 A Those properties would also be sold to

 14 TECWA.

 15 Q And would that sale result in a gain?

 16 A Yes, it would.

 17 Q Could you tell us what that gain is,

 18 approximately, on a systemwide basis?

 19 A It's approximately $4.1 million.

 20 Q And pending the closing of the sale of that

 21 two-and-a-half percent share to TECWA, is it the case

 22 that the power from that two-and-a-half percent will

 23 remain with Portland General Electric Company?

 24 A Yes, we have not integrated that into the

 25 system in any way whatsoever. Portland General continues

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 CSB REPORTING ELY (Di)

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 1 to manage that as of closing, including the coal supply

 2 and other things for that and it will remain that way

 3 until such time as either the deal with TECWA closes or

 4 it is determined that it won't.

 5 Q And can you tell us what proposal, what

 6 position rather, Avista Corporation is taking with

 7 respect to the gain on the sale of the Portland General

 8 Electric two-and-a-half percent share?

 9 A It's the corporation's position that the

 10 plant was purchased by the shareholders and would be sold

 11 by the shareholders and, therefore, in this particular

 12 proceeding, we had not previously asked for approval of

 13 that process. We would expect to keep the gain and that

 14 would go to the shareholders.

 15 Q And if the Commission were to feel that

 16 some approval of that sale was necessary, would you be

 17 requesting that that approval be given as well?

 18 A Yes, if it's in the determination of the

 19 Commission that we do need approval to make that sale, we

 20 would ask that that be given in this order.

 21 Q And has the Oregon Public Utilities

 22 Commission approved the sale from Portland General

 23 Electric to Avista Corporation prior to the closing on

 24 December 31st of last year?

 25 A Yes. Both the Oregon Commission approved

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 CSB REPORTING ELY (Di)

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 1 the sale as well as FERC approved the sale before the

 2 transaction closed.

 3 Q Thank you. Then with regard to the

 4 remainder of your direct testimony, if I were to ask you

 5 the questions that are in your direct testimony, would

 6 your answers be as contained in the prefiled testimony?

 7 A They would.

 8 MR. DAHLKE: With that, I would request

 9 that Mr. Ely's testimony be spread on the record, there

 10 are no exhibits to move for admission, and so we would

 11 offer him to be available for cross-examination.

 12 COMMISSIONER SMITH: If there's no

 13 objection, the prefiled testimony of Mr. Ely will be

 14 spread upon the record as if read.

 15 (The following prefiled testimony of

 16 Mr. Gary Ely is spread upon the record.)

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 CSB REPORTING ELY (Di)

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 1 Q Please state your name, business address

 2 and present position with Avista Corporation ("Avista").

 3 A My name is Gary G. Ely and my business

 4 address is East 1411 Mission Avenue, Spokane, Washington.

 5 I am employed by Avista as Executive Vice President.

 6 Q Would you briefly describe your educational

 7 and professional background?

 8 A I am a graduate of Brigham Young

 9 University. I have participated in several executive

 10 level courses including the Public Utility Executive

 11 Course sponsored at the University of Idaho,

 12 post-graduate courses through the Stanford Graduate

 13 School of Business, Edison Electric Institute Leadership,

 14 and Kidder Peabody School of Financial Management. I

 15 have held offices in various organizations including

 16 chairman for both the Gas Management Executive Committee

 17 and Marketing Executive Committee for the Pacific Coast

 18 Gas Association. I have served on the board of the

 19 Northwest Electric Light and Power Association and on the

 20 executive board of the Spokane Valley Chamber of

 21 Commerce. I served as president of the board of the

 22 Northwest Gas Association and was a member of the State

 23 Building Code Council which developed the State Energy

 24 Code. I am currently a board member of the Pacific Coast

 25 Gas Association and am the clearance officer for the

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 1 corporation.

 2 Q How long have you been employed by Avista

 3 and what are your present duties?

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 1 A I was first employed by Avista in 1967. As

 2 Executive Vice President I am responsible for further

 3 advancement of operations, growth and strategies in the

 4 energy and power business.

 5 Q Have you previously testified before this

 6 Commission?

 7 A Yes. I have testified before this

 8 Commission in several prior proceedings.

 9 Q What is the scope of your testimony in this

 10 proceeding?

 11 A I am the policy witness for Avista in this

 12 proceeding. My testimony provides background information

 13 related to the sale of Avista's 15% share of the

 14 Centralia Power Plant to TECWA Power, Inc. ("TECWA"), a

 15 Washington corporation and a subsidiary of TransAlta

 16 Corporation, headquartered in Calgary, Alberta, Canada.

 17 I also discuss why the sale of the Centralia Power Plant

 18 is in the public interest.

 19 Q Would you please provide a brief summary of

 20 the testimony of the other witnesses representing Avista

 21 in this proceeding?

 22 A Yes. In addition to myself, the following

 23 witnesses are presenting direct testimony on behalf of

 24 Avista:

 25 George Perks: As Superintendent, Thermal

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 1 Operations, he provides a description of the property

 2 being sold, the factors leading up to the sale and the

 3 terms of the sale.

 4 William G. Johnson: As Power Contract Analyst, he

 5 provides an economic analysis comparing the estimated

 6 cost of continued operation of the plant to the projected

 7 cost of replacement power. He also discusses replacement

 8 power options.

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 1 Thomas D. Dukich: As Manager of Rates and Tariff

 2 Administration, he explains the basis for Avista's

 3 proposal relating to the disposition of the book gain

 4 resulting from the sale of Centralia.

 5 Ronald L. McKenzie: As Senior Rate Accountant, he

 6 provides a calculation of the gain on the sale of the

 7 plant and provides proposed accounting entries related to

 8 the sale and discusses the disposition of the gain.

 9 Q Would you please describe the process that

 10 led up to the proposed sale of the Centralia Power Plant

 11 to TECWA?

 12 A Yes. Continued operation of the Centralia

 13 Power Plant requires the installation of sulfur dioxide

 14 scrubbers and low nitrogen oxide burners to meet emission

 15 standards ordered by the Southwest Washington Pollution

 16 Control Authority. Portland General Electric ("PGE"), as

 17 well as some other co-owners, did not support the

 18 installation of scrubbers at the plant. On the other

 19 hand, closure of the plant would result in mine closure

 20 costs, reclamation costs and plant dismantling costs.

 21 Given the fact that capital decisions require unanimous

 22 agreement under the applicable contract, the divergent

 23 views of the owners created a difficult situation. The

 24 co-owners of the plant agreed that a single owner could

 25 more effectively deal with issues pertaining to continued

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 Avista

 1 operation of the plant and adjacent coal mine. In

 2 October 1998 the co-owners put the plant up for sale

 3 under an auction process. TECWA was selected as the

 4 winning purchaser. Details related to the sale price and

 5 the Company's investment in the plant are provided in

 6 Mr. McKenzie's testimony.

 7 Q Are there provisions in the Centralia Plant

 8 Purchase and Sale Agreement regarding the installation of

 9 emission control equipment?

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 1 A Yes. The terms of the Agreement require

 2 the plant owners to have contracted by the end of May

 3 1999 for the installation of required emission control

 4 equipment and to continue the installation of such

 5 equipment until the sale closes.

 6 Q Did any co-owner object to the installation

 7 of the required emission control equipment?

 8 A Yes. PGE wished to avoid investment in the

 9 emission control equipment and the risk of not recovering

 10 such investment in the event that the sale to TECWA did

 11 not close. Thus, to enable the sale to TECWA to proceed,

 12 on May 5, 1999 Avista agreed to purchase PGE's 2.5%

 13 interest in the Centralia Power Plant. Avista will sell

 14 the 2.5% share purchased from PGE to TECWA. Avista also

 15 entered into an agreement with Snohomish PUD to purchase

 16 their 8% share of the plant in the event that the sale to

 17 TECWA does not close. If the sale to TECWA does not

 18 close, Avista will own a 25.5% interest in the power

 19 plant (15% original Avista + 2.5% PGE + 8% Snohomish

 20 PUD).

 21 Q Why did Avista elect to increase its

 22 ownership share of Centralia at the same time it was

 23 proposing to sell to TECWA?

 24 A As explained above, Avista purchased PGE's

 25 2.5% interest in order to facilitate the sale to TECWA.

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 Ely, Di 4

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 1 In addition, it agreed to purchase Snohomish PUD's 8%

 2 share if the sale does not close. If the sale closes,

 3 the Company and its customers will benefit through

 4 reduced exposure to mine reclamation costs and by

 5 enabling Avista to conduct resource optimization

 6 strategies more independently. If the sale does not

 7 close, Avista will have aggregated ownership shares by

 8 reducing the number of existing owners

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 1 from eight to six, and streamlining somewhat the

 2 decision-making process at the plant. Either way, Avista

 3 is better off than it was before.

 4 Q Would you please explain why the sale of

 5 the Centralia Power Plant to TECWA is in the public

 6 interest?

 7 A Yes. The sale to TECWA will eliminate

 8 uncertainties to Avista and its customers regarding mine

 9 reclamation costs, as such costs will be borne by TECWA.

 10 Moreover, the sale enables Avista to conduct resource

 11 optimization strategies more independently. The

 12 Company's analysis shows that power costs to customers,

 13 as a result of the sale, will be reduced by approximately

 14 $7.7 million on a present value basis over the next 20

 15 years.

 16 On a broader scale, the planned

 17 installation of emission control equipment will place the

 18 power plant among the cleanest coal-fired plants in the

 19 United States. TECWA will be positioned to continue to

 20 employ the majority of the some 675 employees at the

 21 plant and mine. The region will retain a valuable

 22 1340-megawatt resource, enough power for a city the size

 23 of Seattle.

 24 Q Is the sale of Centralia in the public

 25 interest from the standpoint of "no harm" to customers?

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 Ely, Di 5

 Avista

 1 A Yes. As stated earlier, the Company's

 2 analysis shows that over the 20-year study period, the

 3 costs to customers would be lower with the sale, as

 4 compared to the absence of the sale. The analysis

 5 provided by Mr. Johnson shows, on a present value basis,

 6 that customers would save approximately $7.7 million over

 7 the 20-year period.

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 1 As to service quality and reliability, the

 2 replacement resource options being evaluated by the

 3 Company would provide for service quality and reliability

 4 at a level equal to or greater than that provided by

 5 Centralia.

 6 Thus, the sale of Centralia by the Company

 7 is in the public interest from the standpoint of no harm

 8 to customers.

 9 Q What is the dollar amount of the book gain

 10 on the sale?

 11 A The after-tax gain on the sale for Avista's

 12 15% share of the project will be approximately $29.6

 13 million. As Mr. McKenzie explains in his testimony, this

 14 figure is an estimate and the final figure will be

 15 dependent upon the closing date of the sale, as well as

 16 other factors explained in his testimony. The final

 17 number, however, should not be significantly different,

 18 and, therefore, the $29.6 million represents a reasonable

 19 figure to use in discussing the disposition of the gain.

 20 Q Is it necessary to include the book gain on

 21 the sale in the analysis in order to demonstrate a

 22 no-harm condition for customers?

 23 A No. Mr. Johnson's analysis showing a

 24 present value of cost savings to customers of $7.7

 25 million excludes the book gain on the sale. Therefore,

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 Ely, Di 6

 Avista

 1 the book gain represents additional value over and above

 2 the no-harm standard. Mr. Dukich addresses the Company's

 3 proposal regarding the disposition of the gain on the

 4 sale of Centralia.

 5 Q Would you please summarize your testimony?

 6 A Yes. In this case the Company is

 7 requesting that the Commission approve the sale of its

 8 share of the Centralia Power Plant. The sale of

 9 Centralia was accomplished through a competitive bidding

 10 process with TECWA as the winning bidder. We can only

 11 assume that the winning

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 1 bid submitted by TECWA reflects the risks and rewards,

 2 both quantitative and qualitative, associated with the

 3 ownership and operation of the power plant and the coal

 4 mine.

 5 The Company's decision to sell the plant

 6 took into consideration both the quantitative and

 7 qualitative factors surrounding continued ownership of

 8 the plant, versus the sale of the plant at the price

 9 offered by the buyer, together with the projected

 10 replacement power costs. The Company's decision to sell,

 11 especially with regard to the qualitative factors, also

 12 involved business judgement.

 13 We believe that this transaction for the

 14 sale of Centralia is in the best interest of the Company

 15 and its customers, and that the sale is in the public

 16 interest. The Company requests that the Commission

 17 approve the sale of the plant, and the disposition of the

 18 gain on the sale as proposed in the testimony of Mr.

 19 Dukich.

 20 Q Does that conclude your direct testimony in

 21 this proceeding?

 22 A Yes, it does.

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 Ely, Di 7

 Avista

 1 (The following proceedings were had in

 2 open hearing.)

 3 COMMISSIONER SMITH: Mr. Ward, do you have

 4 questions?

 5 MR. WARD: No questions. Thank you.

 6 COMMISSIONER SMITH: Mr. Woodbury.

 7 MR. WOODBURY: Thank you, Madam Chair.

 8

 9 CROSS-EXAMINATION

 10

 11 BY MR. WOODBURY:

 12 Q Good morning, Mr. Ely.

 13 A Good morning, Mr. Woodbury.

 14 Q With respect to your further direct on PGE,

 15 am I to understand that that was purchased by Avista

 16 Utilities and not any of your unregulated affiliates?

 17 A It was actually purchased by Avista Corp.

 18 and it was not held in any of the unregulated

 19 subsidiaries, that is correct.

 20 Q Okay, and it would be the Company's -- it's

 21 my understanding that it's the Company's proposal that

 22 any gain with respect to the sale of PGE to TECWA should

 23 be distributed to shareholders?

 24 A That would be correct.

 25 Q Do I also understand that you would be the

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 1 witness who will stand for cross-exam on questions

 2 regarding the sale agreement as presented by Mr. Perks?

 3 A I will stand for questioning on part of

 4 that. Some of it I may refer from a technical nature to

 5 some of the other witnesses.

 6 Q Okay. The sales agreement dated May 6th of

 7 '99 which was filed with the Company's application,

 8 Exhibit 1 in the application, we had -- does this

 9 represent the agreement between the parties?

 10 A This represents the agreement between the

 11 parties and TECWA as the buyer, yes.

 12 Q Okay. Schedule 3.3(b) of that indicates

 13 sellers' government consents that were required and it

 14 envisions regulatory filings in Oregon, Washington, Utah,

 15 California, Wyoming and Idaho and also FERC. Are you

 16 familiar with the status of the regulatory proceedings?

 17 A Only those in Washington, Idaho and Oregon.

 18 Q And do you know when the FERC filing was

 19 made?

 20 A Well, the FERC filing for Portland

 21 General's share was made last year and we received

 22 approval late in December of '99, and I'm not sure on the

 23 others what the current status is.

 24 Q Section 11.3 speaks to modification of

 25 terms and indicates that --

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 1 A Which section was that, Mr. Woodbury?

 2 Q 11.3 -- and indicates that any modification

 3 would be written, must be written. Has there been any

 4 written modification to the agreement since May 6th?

 5 A No, not that I'm aware of.

 6 Q Is there any modification under present

 7 consideration by the parties?

 8 A Not that I'm aware of.

 9 Q Section 11.1 speaks of termination and

 10 indicates there will be a 180-day period from the filing

 11 after the date hereof of all applications for approval.

 12 Do you know what the date of the last regulatory filing

 13 was which would trigger that 180 days?

 14 A I don't know the exact date, but I know

 15 what the end date was. It was Puget in the State of

 16 Washington and it ended up with an end date of March 7th

 17 of 2000 and you'd have to work it backwards through the

 18 days to come up with the actual date of filing.

 19 Q Okay. Sections 8.5, 8.5 and 9.5, deal with

 20 no restraint and pertains to any filings to obtain an

 21 injunction, restraining order, restrained prohibition,

 22 action, suit, law or penalty regarding the transaction.

 23 Do you know whether there have been any restraint-type

 24 filings?

 25 A May I just review quickly?

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 1 Q I can't --

 2 A May I just review it quickly?

 3 Q Yes.

 4 A I don't believe there has been any

 5 certainly involving the parties at this point.

 6 Q Section C of that states any action by any

 7 government body that would threaten the imposition of any

 8 penalty or material economic detriment if the transaction

 9 was consummated. How are the parties defining "material

 10 economic detriment" and do any of the proposals in this

 11 case qualify as economic detriment if approved by the

 12 Commission?

 13 A I think when it says "material," I think

 14 that would have to be determined by the parties at the

 15 time that those orders were made to evaluate whether or

 16 not they were material to the ongoing operation of the

 17 business.

 18 Q Well, with respect to Avista, you're

 19 familiar with the recommendations of the parties in this

 20 case?

 21 A Yes, I am.

 22 Q And if the Commission were to approve any

 23 of those recommendations, would in the Company's mind

 24 that constitute material economic detriment?

 25 A We would have to evaluate that in light of

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 1 the Washington orders and look at the long-term

 2 consequences of the mine reclamation, the plant closure

 3 costs and other things that may fit in the overall

 4 scheme. In other words, we couldn't just look and say

 5 based on this piece that that would make a determination

 6 one way or another. It would be all the pieces together

 7 would have to be evaluated in order to make a

 8 determination.

 9 Q Okay. Section 8.8 deals with condemnation

 10 and do you know whether there's been any threatened

 11 condemnation or eminent domain proceedings with respect

 12 to Centralia?

 13 A There have been none that I'm aware of.

 14 Q And with respect to Section 3.16, Y2K

 15 readiness, I'm assuming that you survived January 1st?

 16 A Yes, everything went well under our Y2K

 17 scenarios. It's still running.

 18 Q Related to your direct testimony, page 3,

 19 you speak of the sale of Centralia to TECWA and that it

 20 was a competitive bidding process. Were there other

 21 bidders -- were there bidders other than TECWA for

 22 Centralia?

 23 A Yes, there were.

 24 Q And how many other bids were submitted?

 25 A Under a confidentiality agreement that we

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 CSB REPORTING ELY (X)

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 1 have with the banker that put the deal together, we're

 2 not allowed to disclose the number of bids, who the bids

 3 were or what the prices were.

 4 Q Okay. Are you familiar with the 22-year

 5 history of Centralia?

 6 A Yes, I am.

 7 Q And you state that one of the reasons for

 8 the sale was, I guess, the refusal of some of the

 9 co-owners, their unwillingness to incur the debt with the

 10 capital expense and scrubbers and can you recall any

 11 other instances where capital investment was not made

 12 because of a lack of unanimous consent regarding

 13 Centralia?

 14 A That plant is required to have unanimous

 15 consent by all eight owners and over the period of the

 16 history of that plant, there had been numerous times when

 17 there have been projects delayed beyond what was, I

 18 think, a recommended or prudent time frame simply because

 19 all the owners would not agree to take and spend the

 20 capital. There has been at least three that I'm aware of

 21 where there was delays in either upgrading equipment

 22 and/or doing various other things that would have

 23 affected the plant's operation.

 24 Q The co-owner agreement, does that provide

 25 for a method of handling those instances where there's

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 1 not initial unanimous consent?

 2 A No, it does not. It says that it will be

 3 unanimous consent for capital expenditures.

 4 Q It doesn't throw it into arbitration or

 5 anything?

 6 A It does not.

 7 Q Page 5 of your direct testimony you

 8 represent that the proposed sale is in the public

 9 interest and identify -- you make some representations

 10 for the Commission to consider as satisfying that

 11 criteria and you state that it eliminates uncertainties

 12 regarding mine reclamation costs. Will it eliminate the

 13 uncertainties or, as you talk about on page 4, just

 14 reduce exposure to mine reclamation costs?

 15 A From our standpoint, it would eliminate it

 16 from our customers' responsibility. I think there is

 17 still an unclear picture of how that mine reclamation

 18 will be handled over the long term. If it's in TECWA's

 19 hands, they have the responsibility to fund that and to

 20 take care of the liabilities on it.

 21 Q Will Avista have remaining exposure once

 22 this sale closes?

 23 A No. If the sale goes to TECWA, we will

 24 have no remaining liability whatsoever. They take on

 25 full obligation.

 26

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 1 Q And do you know what the Company's present

 2 exposure is?

 3 A We know an estimate of the mine reclamation

 4 costs, an estimate of plant closure costs, and then of

 5 plant demolition costs which could be in excess of

 6 $400 million. Currently there are reserve funds that

 7 each of the owners have or reclamation funds that each of

 8 the owners have to take and fund that over a period of

 9 time, but there's only enough dollars there if the plant

 10 continues to run into the future and so that continues to

 11 be collected.

 12 Q And that $400 million figure is a figure

 13 that the Company would be looking at a percentage of

 14 should the sale not close?

 15 A That is correct. Ours would be 15 percent

 16 of that.

 17 Q You also state that one of the benefits of

 18 the sale is that the Company will have the ability to

 19 conduct resource optimization strategies more

 20 independently. Do you mean without consent of other

 21 Centralia owners?

 22 A Yes, that's correct. We would be able to

 23 follow a path independent of the other owners that would

 24 be in the best interests of our customers.

 25 Q You're not speaking of your -- are you

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 CSB REPORTING ELY (X)

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 1 speaking of your resource optimization department there?

 2 A I'm speaking of whether it's to build or

 3 buy resources that would be not tethered to the other

 4 owners as far as how they're operated or what capital

 5 requirements might be as we move forward into the future.

 6 Q You would agree with the Company witness

 7 Johnson that the sale of a dispatchable resource reduces

 8 to some degree the flexibility of the Company?

 9 A It does if you replace it only with a

 10 contract. If you decide to take and build, for instance,

 11 a gas-fired generating plant, then you will receive that

 12 flexibility back, in fact, probably additional

 13 flexibility because you have a shorter lead time as far

 14 as on and off and in fact, you can run those during heavy

 15 and light load hours and so it actually gives you more

 16 flexibility.

 17 Q The Company has made no decision to

 18 construct another generation resource at this time?

 19 A Not at this time. We will make that

 20 decision depending on what the outcome of this case is.

 21 Q One of your other stated reasons for the

 22 sale being in the public interest is that power costs to

 23 customers will be reduced by approximately $7.7 million

 24 on a present value basis over 20 years. Would you agree

 25 that that number is largely speculative?

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 CSB REPORTING ELY (X)

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 1 A I wouldn't say that it is speculative.

 2 What I would say is it's a point-in-time analysis of

 3 forward pricing curves and those vary from day to day and

 4 so it's no different than, I guess, if you would say

 5 interest rates going forward is speculative what they're

 6 going to be or cost of living increases are speculative,

 7 I would agree with that statement, but for the most part,

 8 they're studies and analyses that Mr. Johnson has done

 9 based on current, forward pricing markets at a point in

 10 time.

 11 Q But Mr. Johnson's testimony is to the

 12 extent -- well, it states that once you get out beyond

 13 ten years, it's highly speculative.

 14 A I think any time you get out beyond ten

 15 years in today's economy and environment, no matter what

 16 it is, it's highly speculative.

 17 Q On page 5 you speak of the

 18 no-harm-to-customers standard.

 19 A Yes.

 20 Q You've characterized it as a standard, and

 21 you state that service quality and reliability with

 22 replacement resource options will be at a level greater

 23 than or equal to that presently provided by Centralia.

 24 Are there any service quality and reliability

 25 deficiencies with the Centralia plant other than the

 29

 CSB REPORTING ELY (X)

 Wilder, Idaho 83676 Avista

 1 co-ownership?

 2 A Well, there has been, as I think you're

 3 aware of, over the years difficulty in mining the coal at

 4 Centralia. There's just from the standpoint of the coal

 5 field itself, there are a number of months when we can be

 6 flooded out of mining coal there, so there's an issue

 7 around a physical piece as well as long-term air quality

 8 issues that will have to be addressed.

 9 Q How much of the fuel for the Centralia mine

 10 is on site or what percentage?

 11 A Basically, all of the fuel is on site for

 12 Centralia. We have tried to bring in from Powder River

 13 Basin some blending and do some different things to meet

 14 various air quality requirements. One of the

 15 difficulties we have is with the railroads and the

 16 tariffs that are charged to move it there, it's cheaper

 17 to burn the on-site coal and actually put on the

 18 scrubbers, but one of the studies that was done when we

 19 were looking at retrofitting the plant with the current

 20 scrubbers that are being built, was it cheaper just to

 21 bring outside coal that met the requirements or to go

 22 ahead and mine and it was determined that it's cheaper to

 23 go ahead and mine.

 24 Q When you speak of pricing inventory, coal

 25 inventory, by the last 100,000 tons of coal brought in by

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 CSB REPORTING ELY (X)

 Wilder, Idaho 83676 Avista

 1 rail, are you speaking of Centralia mine coal or are you

 2 speaking of Powder River coal?

 3 A Well, that that was brought in by rail is

 4 Powder River coal, but the coal inventory itself, they

 5 actually mine it and then inventory it at the plant site

 6 because of the water problems and the flooding problems

 7 they have at the mine that certain times they can't

 8 mine. There are months, or least there's been at times

 9 months, when they could not mine the coal and, therefore,

 10 they would use out of the inventory pile.

 11 Q So the coal will be priced based on Powder

 12 River coal adjusted for some thermal?

 13 A No. The coal is actually -- and it's

 14 probably a question that goes better to either

 15 Mr. Johnson or Mr. McKenzie.

 16 Q Okay, I'll ask him.

 17 A Yes.

 18 Q You state that the Company's decision to

 19 sell took into consideration projected replacement power

 20 costs, on page 7 of your direct, but you would agree that

 21 the Company has not made a decision with respect to

 22 replacement power at this time?

 23 A Long-term replacement power, that is

 24 correct.

 25 Q And short term being one to three years you

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 CSB REPORTING ELY (X)

 Wilder, Idaho 83676 Avista

 1 would be going to the market?

 2 A Yes.

 3 Q The fuel supply agreement with the

 4 Centralia for coal, does that include some degree or

 5 element of mine reclamation costs in the pricing?

 6 A Yes, it does.

 7 Q But it was envisioned that that would not

 8 be total exposure of the parties?

 9 A Well, it was envisioned that if the plant

 10 ran through the life of the plant that, yes, it would,

 11 but the question is in today's environment, is there

 12 going to be additional requirements that would place it

 13 above what has been so far reserved and, secondly, if you

 14 close the plant today, not only do the mine reclamation

 15 costs come today and you haven't had the additional years

 16 to take and build up that reserve, but you also have a

 17 mine closure cost to PacifiCorp in addition to then the

 18 mine demolition costs of taking the plant out.

 19 MR. WOODBURY: Thank you, Mr. Ely. I have

 20 no further questions.

 21 COMMISSIONER SMITH: Commissioner Hansen.

 22 COMMISSIONER HANSEN: I have no questions.

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 CSB REPORTING ELY (X)

 Wilder, Idaho 83676 Avista

 1 EXAMINATION

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 3 BY COMMISSIONER SMITH:

 4 Q Welcome to Idaho, Mr. Ely.

 5 A Thank you, Commissioner Smith.

 6 Q It's been a long time since we've seen

 7 you.

 8 A I know, this is a whole new room. It looks

 9 very nice in here.

 10 Q Thank you. I was just curious, I guess,

 11 mostly if you know about the status of the applications

 12 that needed to be made and have been made with regard to

 13 the sale on behalf of the other partners, like PacifiCorp

 14 or Puget.

 15 A All of the applications have been made. As

 16 far as the status, we have completed our hearings in

 17 Washington and final briefings, I believe, are due the

 18 end of next week and then an order will be issued after

 19 that.

 20 Q Okay, and then for the publics like

 21 Seattle, Tacoma, Snohomish, Grays Harbor, do they do

 22 anything besides get their board of directors' approval?

 23 A No, and all they have to do is get their

 24 commissioners' or board of directors' approval and that

 25 was done a number of months ago, shortly after it was

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 CSB REPORTING ELY (Com)

 Wilder, Idaho 83676 Avista

 1 signed.

 2 Q I guess I was trying to get a sense of

 3 things that can't be known, like when they'll all be

 4 finished and if approval was likely.

 5 A That's a good question.

 6 Q Because I see that the Company also has an

 7 agreement to purchase the Snohomish County's share should

 8 the sale fail to close.

 9 A Yes, that is correct. Maybe just a little

 10 background on that. When we went into the bid opening

 11 meetings in Seattle in May, there was a lot of discussion

 12 around whether or not people wanted to continue to put

 13 money into the plant to put the scrubbers in, but that

 14 was a requirement of the bid of TECWA is that we would

 15 continue to fund the scrubber investment so that the

 16 plant would be operable when the sale closed.

 17 At that meeting there were a number of

 18 parties that were concerned about and one party that was

 19 unwilling to continue to put money in which said they

 20 would just as soon close the plant, pay whatever costs

 21 they had to pay to clean it up and reclaim it and

 22 whatever and that was Portland General, and I had made

 23 the offer to all of that group that if they wanted to

 24 step away from the table, we would for a dollar, I would

 25 pick up their liability and continue to fund the scrubber

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 CSB REPORTING ELY (Com)

 Wilder, Idaho 83676 Avista

 1 costs.

 2 Snohomish stepped forward and that night

 3 before we broke up said they wanted to see me and they

 4 said that we would like to take you up on that offer only

 5 if the deal doesn't go through because they said we do

 6 not want to continue to invest. We will invest in order

 7 to get the gain for our customers, but if the deal does

 8 not go through, then we're not going to fund any more,

 9 would you be willing to pick it up, plus what we had put

 10 in between that date and the date we find out that it

 11 either closes or not closes, so that's the deal that we

 12 wrote with Snohomish.

 13 Portland General decided that they did not

 14 want to be in it. They tried levering the other

 15 companies. We finally agreed to keep the thing on

 16 schedule was to buy their part of the plant at cost and

 17 if the deal goes through, then we pay them an additional

 18 $1.1 million. If the deal doesn't go through, then we

 19 bought the plant at cost, their two-and-a-half percent.

 20 COMMISSIONER SMITH: Thank you. That's

 21 helpful.

 22 Do you have redirect, Mr. Dahlke?

 23 MR. DAHLKE: Yes.

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 CSB REPORTING ELY (Com)

 Wilder, Idaho 83676 Avista

 1 REDIRECT EXAMINATION

 2

 3 BY MR. DAHLKE:

 4 Q Mr. Ely, you may not recall, but I thought

 5 I saw an order from FERC approving the sale to TECWA, not

 6 the EWG order now, but just the general order approving

 7 the sale. If I neglected to send that to you, I guess

 8 you wouldn't recall, but do you recall seeing that order

 9 or not?

 10 A I don't recall seeing it.

 11 MR. DAHLKE: Fine, thank you. I'll find a

 12 different way to apprise everyone.

 13 COMMISSIONER SMITH: Thank you for your

 14 help, Mr. Ely.

 15 THE WITNESS: Thank you.

 16 (The witness left the stand.)

 17 MR. DAHLKE: The next witness that Avista

 18 Corporation was going to call is Mr. George Perks and we

 19 conferred with counsel and determined that there were no

 20 cross-examination questions for Mr. Perks. He was needed

 21 at an owner's meeting of Colstrip today and so we had

 22 asked that he could be excused personally and that his

 23 testimony, his direct testimony, be spread on the record

 24 as though he were here and those questions were asked of

 25 him, so at this time I'd like to address whether that's

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 CSB REPORTING ELY (Di)

 Wilder, Idaho 83676 Avista

 1 acceptable to the parties and to the Commission.

 2 MR. WOODBURY: Well, it was my actual

 3 understanding that the Company's other witnesses,

 4 Mr. Ely, would stand for cross on Mr. Perks' testimony,

 5 not that we didn't have any questions.

 6 MR. DAHLKE: I'm sorry, we did discuss that

 7 others would respond on cross areas where Mr. Perks

 8 otherwise would have been the witness, yes.

 9 COMMISSIONER SMITH: Is there any objection

 10 to Mr. Perks not personally appearing?

 11 MR. WARD: I have no objections and have no

 12 cross.

 13 COMMISSIONER SMITH: I just had one

 14 question. It was with the 180 days and what's the

 15 drop-dead date, but I don't know if Mr. Ely's testimony

 16 is that that was March 7th because I had calculated

 17 February 6th, so if Mr. Ely's answer is March 7th, then

 18 that's it. My question is answered.

 19 MR. DAHLKE: It's March 7th.

 20 COMMISSIONER SMITH: Thank you. All right,

 21 then I will take that as a motion that Mr. Perks'

 22 prefiled direct testimony be spread upon the record as if

 23 read and so ordered.

 24 (The following prefiled testimony of

 25 Mr. George Perks is spread upon the record.)

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 CSB REPORTING COLLOQUY

 Wilder, Idaho 83676

 1 Q Please state your name, business address

 2 and present position with Avista Corporation ("Avista").

 3 A My name is George Perks and my business

 4 address is East 1411 Mission Avenue, Spokane, Washington.

 5 I am employed by Avista as Superintendent, Thermal

 6 Operations.

 7 Q Would you briefly describe your educational

 8 and professional background?

 9 A I am a graduate of the MEBA Marine

 10 Engineering School, Baltimore MD. And also have an A.S.

 11 degree in Industrial Education from Centralia College. I

 12 have participated in several utility seminars and courses

 13 including Electric Utility System Operation, General

 14 Electric Large Steam Turbine Seminar and Westinghouse

 15 Turbine Users Conferences.

 16 Q How long have you been employed by Avista

 17 and what are your present duties?

 18 A I was first employed by Avista in 1981 as

 19 Plant Superintendent of the Kettle Falls Generating

 20 Station. I am currently Superintendent, Thermal

 21 Operations and am responsible for the ownership

 22 representative duties at the Centralia and Colstrip

 23 Projects and am the purchaser representative on the

 24 Mid-Columbia Projects for Avista.

 25 Q What is the scope of your testimony in this

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 Perks, Di 1

 Avista

 1 proceeding?

 2 A I describe the Centralia Power Plant

 3 property being sold, the factors leading up to the sale

 4 and the terms of the sale.

 5 Q Would you please describe the Centralia

 6 Power Plant property being sold?

 7 A Yes. Avista owns a 15% interest in the

 8 Centralia Power Plant, a

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 Perks, Di 1a

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 1 1340-megawatt, coal-fired plant located near Centralia,

 2 Washington. The other seven co-owners and their

 3 ownership shares are: PacifiCorp 47.5%, City of Seattle

 4 8.0%, City of Tacoma 8.0%, Snohomish PUD 8.0%, Puget

 5 Sound Energy 7.0%, Grays Harbor County PUD 4.0%, and

 6 Portland General Electric 2.5%. PacifiCorp is the sole

 7 owner of the Centralia Mine which supplies coal under a

 8 fuel supply agreement to the Centralia Power Plant. Both

 9 the Centralia Power Plant and the Centralia Mine are

 10 being sold to TECWA Power Inc. ("TECWA") a subsidiary of

 11 TransAlta Corporation, headquartered in Calgary, Alberta,

 12 Canada.

 13 Q Would you please describe the factors

 14 leading up to the sale?

 15 A Management of Centralia is often difficult

 16 due to the fact that there are eight owners with

 17 different business reasons for their individual decisions

 18 on issues. In years past this was not such a

 19 significant problem, but as competition in the market has

 20 increased, these differences have become more of a

 21 problem. Since capital projects at the plant require

 22 unanimous approval of all co-owners, this can lead to

 23 difficulty in making decisions. There have been a number

 24 of different opinions among the co-owners regarding

 25 continued operation of the plant and the installation of

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 Perks, Di 2

 Avista

 1 emission control equipment. In October 1998 the

 2 co-owners put the Centralia Power Plant and the Centralia

 3 Mine up for auction. The co-owners believed that a

 4 single owner, emerging from the auction, could deal most

 5 effectively with the issues pertaining to continued

 6 operation of the plant and the mine. Mr. Ely, a previous

 7 Avista witness, addresses the selection of TECWA as the

 8 winning purchaser.

 9 Q Would you please generally describe the

 10 terms of the sale?

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 Perks, Di 2a

 Avista

 1 A Yes. TECWA has agreed to pay $454,698,000

 2 for the Centralia Power Plant. Avista's 15% share

 3 amounts to $68,204,700. The purchase price is reduced by

 4 $2,100,000 for employee benefit obligations with Avista's

 5 15% share amounting to $315,000. The purchase price is

 6 further reduced by the amount of expected reclamation

 7 accruals with Avista's share amounting to $8,610,000. In

 8 addition, TECWA will be purchasing the supplies inventory

 9 and the coal inventory. TECWA will reimburse the owners

 10 for plant additions which occur subsequent to May 31,

 11 1999. TECWA will also reimburse the owners for costs

 12 incurred for the installation of emission control

 13 equipment.

 14 Q What factors will affect the amount of

 15 proceeds Avista is to receive as a result of the sale to

 16 TECWA?

 17 A Avista's share of the proceeds is subject

 18 to an adjustment which will be determined based on what

 19 PacifiCorp's actual breakeven price of the mine turns out

 20 to be in comparison to the sales price of the mine. Coal

 21 inventory is being purchased at a price determined by the

 22 cost of the last 100,000 tons of coal delivered by rail

 23 adjusted by the heating value of the coal in inventory

 24 delivered from the mine. The closing date of the sale

 25 will also affect the gain as depreciation will continue

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 Perks, Di 3

 Avista

 1 to be accrued during the period of time Avista continues

 2 to own the plant.

 3 Q What is the termination date for closing

 4 contained in the contract with TECWA?

 5 A The termination date for closing as

 6 contained in Section 11.1(d) is twelve months from the

 7 May 6, 1999 signing of the contract or May 5, 2000.

 8 Q Is there also an option to terminate the

 9 contract in the case that timely orders are not issued

 10 approving the sale?

 11 A Yes. Section 11.1(b) of the contract

 12 allows for termination if regulatory approvals are not

 13 received within 180 days of filing. In its Application

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 Perks, Di 3a

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 1 this proceeding Avista has requested expedited treatment

 2 for approval of the sale. Avista requests that the

 3 Commission approve the sale as soon as possible.

 4 Q Does that conclude your direct testimony in

 5 this proceeding?

 6 A Yes, it does.

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 Perks, Di 4

 Avista

 1 (The following proceedings were had in

 2 open hearing.)

 3 MR. DAHLKE: The next witness that we would

 4 call is Mr. William Johnson.

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 6 WILLIAM G. JOHNSON,

 7 produced as a witness at the instance of Avista

 8 Corporation, having been first duly sworn, was examined

 9 and testified as follows:

 10

 11 DIRECT EXAMINATION

 12

 13 BY MR. DAHLKE:

 14 Q Please state your name and position.

 15 A My name is William Johnson. I'm a power

 16 contracts analyst in the resource optimization department

 17 of Avista.

 18 Q And have you caused prepared testimony to

 19 be filed in this matter?

 20 A Yes, I have.

 21 Q Do you have that testimony with you?

 22 A Yes.

 23 Q Do you have any corrections or changes to

 24 your prefiled testimony?

 25 A No, I do not.

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 CSB REPORTING COLLOQUY

 Wilder, Idaho 83676 Avista

 1 Q And you are also sponsoring two exhibits;

 2 is that correct?

 3 A That's correct.

 4 Q And they've been premarked as Exhibits

 5 Nos. 1 and 2?

 6 A That's correct.

 7 Q If I were to ask you the questions

 8 contained in your prefiled testimony, would your answers

 9 today be the same?

 10 A Yes.

 11 MR. DAHLKE: With that, we'd request that

 12 Mr. Johnson's testimony be spread on the record and that

 13 Exhibits numbered 1 and 2 be admitted.

 14 COMMISSIONER SMITH: If there's no

 15 objection, it is so ordered.

 16 (Avista Corporation Exhibit Nos. 1 & 2

 17 were admitted into evidence.)

 18 (The following prefiled direct

 19 testimony of Mr. William Johnson is spread upon the

 20 record.)

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 CSB REPORTING COLLOQUY

 Wilder, Idaho 83676 Avista

 1 Q Please state your name, business address,

 2 and present position with Avista Corporation ("Avista").

 3 A My name is William G. Johnson. My business

 4 address is East 1411 Mission Avenue, Spokane, Washington,

 5 and I am employed by the company as a Power Contracts

 6 Analyst in the Resource Optimization Department.

 7 Q What is your educational background?

 8 A I graduated from the University of Montana

 9 in 1981 with a Bachelor of Arts Degree in Political

 10 Science/Economics. I obtained a Master of Arts Degree in

 11 Economics from the University of Montana in 1985.

 12 Q How long have you been employed by the

 13 company and what are your duties as a Power Contracts

 14 Analyst?

 15 A I started working for Avista in April 1990

 16 as a Demand Side Resource Analyst. I joined the Resource

 17 Optimization Department as a Power Contracts Analyst in

 18 June 1996. My primary responsibilities include the

 19 evaluation of the company's long term electricity supply

 20 and wholesale opportunities.

 21 Q What is the scope of your testimony in this

 22 proceeding?

 23 A My testimony will examine the future cost

 24 of owning and operating the Centralia plant and the cost

 25 of replacement power options.

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 Johnson, Di 1

 Avista

 1 Q Are you sponsoring any exhibits to be

 2 introduced in this proceeding?

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 Johnson, Di 1a

 Avista

 1 A Yes. I am sponsoring Exhibit No(s). 1 and

 2 2, as previously marked for identification, which were

 3 prepared under my supervision and direction.

 4 Q What is the projected cost of continued

 5 operation of the Centralia plant under the current

 6 ownership arrangement?

 7 A The total cost of the Centralia plant is

 8 estimated to be $26.45/MWh in 2000 increasing to

 9 $35.50/MWh in the year 2020 as shown on page 1 of Exhibit

 10 No. 1. This cost includes fuel, operation and

 11 maintenance, and the return of and return on both

 12 existing and future capital expenditures. The cost also

 13 includes transmission expense and the expense to fund

 14 future mine reclamation costs. Current plans for the

 15 plant include the installation of scrubbers to bring the

 16 plant into compliance with the Clean Air Act, which is

 17 expected to be completed by 2003. The total plant cost

 18 shown on page 1 of Exhibit No. 1 includes the cost of

 19 scrubbers and other required capital expenditures.

 20 Q What are the replacement power options for

 21 the Centralia plant?

 22 A The company has several options available

 23 to replace power from the Centralia plant. In the

 24 short-term, 1 to 3 years, replacement power will most

 25 likely come from short-term market purchases or a 1 to 3

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 Johnson, Di 2

 Avista

 1 year purchase from the new plant owner's power marketing

 2 group, TransAlta Energy Marketing (U.S.) Inc. Any power

 3 purchase agreement with TransAlta would not begin before

 4 and would be contingent on the sale of the plant.

 5 In the long-term, replacement power could

 6 come from purchases, new generation facilities, and/or

 7 demand side options. Avista

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 1 is exploring several options for new combined cycle

 2 combustion turbine plants. Given construction lead

 3 times, a new plant would not be available until after

 4 2002.

 5 Q How does the cost of replacement power

 6 compare with the cost of continued operation of the

 7 Centralia plant?

 8 A Since no replacement power options have

 9 been finalized the actual cost is not known. Based on

 10 current estimates, short-term purchases of replacement

 11 power at the Mid Columbia would cost in the range of $25

 12 to $30/MWh for a 1 to 3 year firm energy product with a

 13 monthly shape similar to Centralia's average monthly

 14 generation. Page 2 of Exhibit No. 1 shows the estimates

 15 of replacement power costs.

 16 A new combined cycle combustion turbine

 17 plant is estimated to cost around $30/MWh in 2003 based

 18 on a projected natural gas price of $2.50/MMBtu. Future

 19 turbine costs would fluctuate depending on the cost of

 20 natural gas.

 21 Replacement power may be somewhat lower

 22 cost than the total cost of operating Centralia in the

 23 near-term, however, the incremental cost of operating the

 24 plant (fuel and O&M) will likely be lower than market

 25 rates. Also, the Centralia plant is dispatchable,

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 Johnson, Di 3

 Avista

 1 meaning it can be shut down or operated at lower output,

 2 when market prices are lower than the incremental costs

 3 of operating the plant. Market purchases are not

 4 dispatchable, making market purchases less advantageous

 5 from a resource flexibility perspective. Because

 6 Centralia's total plant cost will probably increase at a

 7 slower rate than market prices, the plant is estimated to

 8 have total costs close to market rates around the

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 Johnson, Di 3a

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 1 year 2010. Exhibit No. 2 compares total plant costs and

 2 the variable costs of the plant to projected replacement

 3 power rates.

 4 Have you calculated the benefits of

 5 replacement power versus plant cost?

 6 A Yes I have. Based on the total cost of the

 7 Centralia plant and the medium case projection of

 8 replacement power the 20 year present value benefit of

 9 replacement power is $7.7 million. For perspective, the

 10 present value of total plant cost is around $380 million

 11 over the same period.

 12 Q Would you please summarize your testimony?

 13 A Yes. The projected cost of replacement

 14 power is slightly less than the cost of continued

 15 operation of the Centralia power plant. The 20 year

 16 present value savings of replacement power is estimated

 17 to be $7.7 million.

 18 Q Does that conclude your direct testimony?

 19 A Yes.

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 Johnson, Di 4

 Avista

 1 (The following proceedings were had in

 2 open hearing.)

 3 MR. DAHLKE: I apologize, Commissioners, I

 4 forgot to ask Mr. Johnson about his rebuttal testimony.

 5 I think that we would propose that we take rebuttal and

 6 direct together.

 7 COMMISSIONER SMITH: Mr. Dahlke, that's at

 8 your pleasure if you choose to do that.

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 10 DIRECT EXAMINATION

 11

 12 BY MR. DAHLKE: (Continued)

 13 Q Mr. Johnson, did you also prepare prefiled

 14 rebuttal testimony for this proceeding?

 15 A Yes, I did.

 16 Q And if I were to ask you the questions

 17 contained in your prefiled rebuttal testimony, would your

 18 answers be the same as contained therein?

 19 A Yes.

 20 Q Were there any exhibits to your prefiled

 21 rebuttal testimony?

 22 A No, there weren't.

 23 MR. DAHLKE: Then we would request that

 24 both the direct and prefiled rebuttal testimony of

 25 Mr. Johnson be spread on the record and that Exhibits

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 CSB REPORTING JOHNSON (Di)

 Wilder, Idaho 83676 Avista

 1 numbered 1 and 2 be admitted.

 2 COMMISSIONER SMITH: Okay. Just looking at

 3 page 1 of Mr. Johnson's rebuttal on line 20, did you mean

 4 to indicate that that's an answer and not a question?

 5 MR. DAHLKE: Yes, he did.

 6 COMMISSIONER SMITH: All right, with that

 7 correction, then, we would spread the prefiled rebuttal

 8 testimony of Mr. Johnson upon the record as if read.

 9 (The following prefiled rebuttal

 10 testimony of Mr. William Johnson is spread upon the

 11 record.)

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 CSB REPORTING JOHNSON (Di)

 Wilder, Idaho 83676 Avista

 1 Q Please state your name, business address,

 2 and present position with Avista Corporation ("Avista").

 3 A My name is William G. Johnson. My business

 4 address is East 1411 Mission Avenue, Spokane, Washington.

 5 I am employed as a Power Contracts Analyst in the

 6 Resource Optimization Department.

 7 Q Have you previously provided direct

 8 testimony in this proceeding?

 9 A Yes.

 10 Q What is the scope of your rebuttal

 11 testimony in this proceeding?

 12 A My testimony will respond to issues raised

 13 by Mr. Lobb's direct testimony on behalf of Idaho Public

 14 Utilities Commission staff.

 15 Q Are you sponsoring any exhibits with your

 16 rebuttal testimony?

 17 A No.

 18 Q On page 9, line 11, Mr. Lobb answers yes to

 19 his question asking if the economic benefit of the sale

 20 demonstrated in the company's analysis is unreliable. Do

 21 you agree with his assertion and explanation of why the

 22 benefits of the economic analysis are unreliable?

 23 A No. Mr. Lobb correctly points out that

 24 changes in critical assumptions change the results of the

 25 analysis. I wholeheartedly agree that long-term

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 Johnson, Reb 1

 Avista

 1 projections of energy and fuel prices are highly

 2 uncertain. Mr. Lobb provides examples of why the

 3 benefits of the sale may be reduced, including: lower

 4 coal cost escalation, higher market prices for

 5 electricity, and higher natural gas prices that would

 6 cause combustion turbine costs and market prices to

 7 increase. These examples are all possibilities.

 8 However, it is also possible that

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 Johnson, Reb 1a

 Avista

 1 the benefits of selling the plant may be greater than

 2 anticipated. For example, the effective coal cost at

 3 Centralia could increase faster than expected due to

 4 environmental reasons related to mine reclamation costs.

 5 It is also possible that market energy prices will not

 6 increase at the rate of inflation as has been assumed in

 7 the company's analysis. History has shown that

 8 continuously increasing market electricity prices is not

 9 necessarily a valid assumption. Market energy prices

 10 actually decreased from 1985 to 1998. Currently, the

 11 forecast is for market prices to increase, but that was

 12 also the projection for energy prices in forecasts

 13 produced in the 1980s.

 14 In the past, energy price forecasts,

 15 showing continuously escalating prices, have been subject

 16 to extreme errors. For example, in 1990 BPA forecast the

 17 New Resource/Surplus Firm power rate, representing a

 18 proxy for the market price and new resources, to be

 19 $57.10/MWh in 2000 rising to $115.90/MWh in 2011. Actual

 20 market/new resource rates are less than one-half that in

 21 the year 2000. Looking back, there may be plausible

 22 explanations for why prices didn't increase, but it is

 23 very unlikely that anyone in 1985 would have predicted

 24 prices to be lower in 1998.

 25 Uncertainties in the long-term projections

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 Johnson, Reb 2

 Avista

 1 of plant costs and the cost of alternatives mean that the

 2 economic benefits of selling the plant could be either

 3 better or worse than estimated in the company's analysis.

 4 I don't believe that anyone can definitively determine

 5 that the risks of selling outweigh the risks of keeping

 6 the plant. The fact that long-term projections are

 7 subject to a high degree of uncertainty does not

 8 necessarily make the company's analysis of the economic

 9 benefits of selling the plant unreliable or the risk of

 10 selling the plant greater than the potential benefit.

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 Johnson, Reb 2a

 Avista

 1 Q On page 11, line 23, Mr. Lobb recommends

 2 that the gain on the sale be shared with ratepayers to

 3 sufficiently demonstrate that customers are not harmed by

 4 the transaction. Do you agree with that recommendation?

 5 A No I do not. We know that in the next few

 6 years the cost of the Centralia plant is going to go up

 7 related to compliance with air quality requirements.

 8 Based on market price quotes for longer-term power

 9 purchases (through 2010), Avista believes that

 10 replacement power will be less costly than projected

 11 plant costs over the next 10 years. We have more

 12 confidence in our projections of costs and prices over

 13 the next ten years then in the period beyond 10 years.

 14 So for at least the next 10 years we believe customers

 15 will either benefit or be held harmless from a sale of

 16 the plant. Beyond 10 years both the cost of the plant

 17 and the cost of replacement alternatives are speculative.

 18 Q Is there precedent for focusing on the next

 19 10 years with regard to resource planning?

 20 A Yes there is. In Avista's last Integrated

 21 Resource Plan (IRP) in 1997, the company was allowed by

 22 the Idaho Public Utilities Commission to conduct a

 23 10-year plan. The company proposed this change primarily

 24 because there is so much uncertainty beyond 10 years.

 25 Beyond 10 years there is a lot of uncertainty regarding

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 Johnson, Reb 3

 Avista

 1 the structure of the industry, what our load obligations

 2 might be, future generation technologies, fuel costs and

 3 environmental regulation. While it may not be

 4 appropriate to limit the evaluation of Centralia to 10

 5 years, it may be appropriate to put a greater emphasis on

 6 the first 10 years when some of the unknowns are more

 7 predictable.

 8 Q Would you please summarize your testimony?

 9 A Yes. Mr. Lobb recommends that the gain of

 10 the sale be shared with ratepayers to sufficiently

 11 demonstrate that customers will not be

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 Johnson, Reb 3a

 Avista

 1 harmed by the transaction. I believe that recommendation

 2 makes an implicit assumption that there is more downside

 3 risk to the sale of the plant than there is potential for

 4 even greater benefit than the company has included in its

 5 analysis. I don't believe that is necessarily the case,

 6 but is more a result of the common assumption that energy

 7 prices might increase at a faster rate than inflation.

 8 The opposite has occurred over the past 15 years. There

 9 are uncertainties regarding both the projected plant

 10 costs and the cost of alternatives and the benefits of

 11 selling the plant could turn out to be even greater than

 12 anticipated.

 13 Customers will not be harmed in the

 14 near-term from a sale of the plant. We know that in the

 15 next few years the cost of the Centralia plant is going

 16 to go up related to compliance with air quality

 17 requirements. We also believe that replacement power

 18 options will be less than projected plant costs over the

 19 next 10 years. Beyond 10 years there is a lot of

 20 uncertainty and it may be appropriate to put a greater

 21 emphasis on the first 10 years when some of the unknowns

 22 are more predictable. It is not necessary that the gain

 23 on the sale be shared with ratepayers to sufficiently

 24 demonstrate that customers will not be harmed by the

 25 transaction.

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 Johnson, Reb 4

 Avista

 1 Q Does that conclude your rebuttal testimony?

 2 A Yes.

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 Johnson, Reb 4a

 Avista

 1 (The following proceedings were had in

 2 open hearing.)

 3 COMMISSIONER SMITH: Mr. Ward, do you have

 4 questions for Mr. Johnson?

 5 MR. WARD: I do not. Thank you.

 6 COMMISSIONER SMITH: Mr. Woodbury.

 7 MR. WOODBURY: Thank you, Madam Chair.

 8

 9 CROSS-EXAMINATION

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 11 BY MR. WOODBURY:

 12 Q Mr. Johnson, you're a part of the Company's

 13 resource optimization department?

 14 A That's correct.

 15 Q And you evaluate long-term electricity

 16 supply, wholesale opportunities as part of your duties?

 17 A That's part of it, right.

 18 Q And as part of your duties, you're also

 19 responsible for making projections?

 20 A I'm one of the people who makes price

 21 projections in the Company.

 22 Q And did you -- were you the one that put

 23 together the projected costs of continued operation of

 24 Centralia?

 25 A Yes, I was.

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 Q And you indicated a $26.45 per

 2 megawatt-hour total cost estimate for year 2000. Do you

 3 know, you made this a few months ago, do you know what

 4 the present cost of operation is of Centralia? Is it

 5 higher or lower than your estimate?

 6 A I would assume it's around that, even

 7 though we don't do an estimate on a monthly basis of the

 8 cost.

 9 Q Would you agree that after the sale Avista

 10 will no longer be, if the sale is approved, be privy to

 11 information regarding Centralia operating costs?

 12 A I believe that would be correct.

 13 Q You also discuss replacement power options

 14 in your testimony, but you state that essentially no

 15 replacement power options have been finalized; is that

 16 correct?

 17 A We have made a replacement purchase, a

 18 short-term replacement purchase.

 19 Q Then so on page 3, line 6, where you say no

 20 replacement power options have been finalized, then

 21 that's not correct at this point?

 22 A At the time this was prepared that was

 23 correct, but since then we have made an arrangement.

 24 Q Okay, what type of an arrangement have you

 25 made?

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 A Well, I need to ask Mr. Dahlke because we

 2 have some confidentiality around that arrangement.

 3 MR. WOODBURY: Okay.

 4 COMMISSIONER SMITH: Do you want to be at

 5 ease for a moment or how do you want to do this? I know,

 6 let's take a five-minute break. We'll be at recess for

 7 about five minutes.

 8 (Recess.)

 9 COMMISSIONER SMITH: All right, we'll go

 10 back on the record. I believe Mr. Woodbury was asking

 11 questions.

 12 Q BY MR. WOODBURY: Mr. Johnson, it's my

 13 understanding from your prior testimony that the Company

 14 has entered into a contract for replacement power.

 15 A That's correct.

 16 Q And it's also my understanding that the

 17 terms of that contract, including pricing and length, are

 18 confidential.

 19 A That's true.

 20 Q And should the Commission or other party

 21 desire to view that, I don't believe there's a

 22 proprietary confidentiality agreement in this case, but

 23 one could be executed and the Company would provide that?

 24 A That's my understanding.

 25 Q And your familiarity with the terms of the

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 agreement, would your testimony be changed in any way?

 2 A No, it would not.

 3 Q Okay. Looking to your rebuttal testimony,

 4 you take issue with Mr. Lobb's, Staff's, statement that

 5 the economic benefit analysis of the Company is

 6 unreliable, and yet you go on to state that he correctly

 7 points out that changes in the critical assumptions

 8 change the results of the analysis and that you would

 9 agree that long-term projections are highly uncertain

 10 with respect to energy and fuel prices and that the

 11 economic benefits of selling the plant could be either

 12 better or worse than estimated; is that right?

 13 A That's his statement, yes.

 14 Q Can you push the microphone up? If the

 15 estimated benefits can be better or worse than projected,

 16 doesn't that say something about the reliability of the

 17 analysis?

 18 A I believe there is uncertainty in the

 19 analysis. There's uncertainty of what the plant will

 20 cost in the future, there's uncertainty of what

 21 replacement power purchases will be, but I think there's

 22 a symmetry to the uncertainty on both sides.

 23 Q To the extent that the benefits could be

 24 either better or worse, isn't it just as reasonable to

 25 project a $7.7 million loss over 20 years?

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 A My base case analysis is there will be a

 2 gain, but it's certainly possible there could be a

 3 $7.7 million loss.

 4 COMMISSIONER KJELLANDER: Mr. Johnson, I'm

 5 sorry to interrupt, could you please move closer to your

 6 microphone? Thank you.

 7 Q BY MR. WOODBURY: You state with some

 8 certainty that Centralia plant costs will increase in the

 9 next few years. Are you referring there to the cost of

 10 scrubbers and emission control equipment?

 11 A Primarily the addition of the scrubbers,

 12 generation rewinds, some other large capital expenditures

 13 that need to be made at the plant, plus escalation in

 14 fuel costs and O&M.

 15 Q Any offsetting decrease in costs that

 16 you're aware of that are on the horizon?

 17 A Not that I'm aware of.

 18 Q I did have a question that I asked Mr. Ely

 19 regarding the coal, but I was told that Mr. McKenzie

 20 would be the better person to ask regarding that.

 21 A I guess it would be what the question is

 22 about the coal. If it's about the coal supply issues, I

 23 might know more about it than Mr. McKenzie.

 24 Q I think it was regarding the pricing of the

 25 coal inventory.

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 A I'm not aware of the accounting procedures

 2 to price the coal inventory.

 3 Q All right. At page 3 of your rebuttal

 4 testimony, you state that the -- you're speaking of the

 5 Company's 1997 integrated resource plan and the

 6 Commission authorizing a change from 20 years to 10 years

 7 as far as the forecast period.

 8 A That's correct.

 9 Q And you state that the Company proposed a

 10 change because of uncertainty beyond 10 years and then

 11 you identified some areas of that uncertainty, one being

 12 structure of the industry. Can you indicate with some

 13 certainty what changes will occur in the industry in the

 14 next three years or ten years?

 15 A I don't know any specific examples of what

 16 might occur, but --

 17 Q Do you know what Avista's load obligations

 18 will be three years from now?

 19 A I don't know for certain, but I suspect

 20 they would be similar to what they are now.

 21 Q You suspect what?

 22 A They'd be similar to what they are now with

 23 some slight growth.

 24 Q Do you know what new technologies we'll see

 25 in the next ten years?

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 A I don't know which ones will be

 2 commercially available and applicable, no.

 3 Q And do you know what changes in

 4 environmental regulation you would probably see in the

 5 next ten years?

 6 A I know what some of the possibilities are,

 7 but I don't know what will be applied, necessarily.

 8 MR. WOODBURY: Thank you, Mr. Johnson.

 9 Madam Chair, Staff has no further questions

 10 of Mr. Johnson.

 11 COMMISSIONER SMITH: Do the Commissioners

 12 have questions of Mr. Johnson?

 13 Redirect, Mr. Dahlke?

 14 MR. DAHLKE: No, thank you.

 15 COMMISSIONER SMITH: Thank you for your

 16 help, Mr. Johnson.

 17 (The witness left the stand.)

 18 MR. DAHLKE: Our next witness is Mr. Thomas

 19 Dukich.

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 CSB REPORTING JOHNSON (X)

 Wilder, Idaho 83676 Avista

 1 THOMAS D. DUKICH,

 2 produced as a witness at the instance of Avista

 3 Corporation, having been first duly sworn, was examined

 4 and testified as follows:

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 6 DIRECT EXAMINATION

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 8 BY MR. DAHLKE:

 9 Q Mr. Dukich, you might try to lean forward

 10 to the mike. With the blower, it was a little hard to

 11 hear Mr. Johnson, but it's much more comfortable with the

 12 blower.

 13 A How is that?

 14 Q Better, magic. Would you please state your

 15 name and position?

 16 A My name is Tom Dukich. I'm the rates

 17 director at Avista.

 18 Q And, Mr. Dukich, have you prepared and

 19 filed prefiled direct testimony in this matter and

 20 prefiled rebuttal testimony?

 21 A I have.

 22 Q And do you have any corrections or changes

 23 to either your prefiled direct testimony or your prefiled

 24 rebuttal testimony?

 25 A I do not.

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 CSB REPORTING DUKICH (Di)

 Wilder, Idaho 83676 Avista

 1 Q If I were to ask you the questions

 2 contained in your prefiled direct testimony and your

 3 prefiled rebuttal testimony, would your answers be the

 4 same as contained therein?

 5 A They would.

 6 Q And are you also sponsoring some exhibits

 7 for us today?

 8 A Yes.

 9 Q Can you tell us what exhibits those are?

 10 A The exhibits, I believe, are all in the

 11 direct testimony.

 12 Q Exhibits 3, 4, 5 and 6?

 13 A Yes.

 14 MR. DAHLKE: I'd request that Mr. Dukich's

 15 testimony be spread on the record and that the exhibits

 16 that he's sponsoring, Exhibits 3, 4, 5 and 6, be admitted

 17 into evidence.

 18 COMMISSIONER SMITH: If there is no

 19 objection, we will spread the prefiled testimony of

 20 Mr. Dukich upon the record as if read and admit

 21 Exhibits 3 through 6.

 22 (Avista Corporation Exhibit Nos. 3 - 6

 23 were admitted into evidence.)

 24 (The following prefiled direct and

 25 rebuttal testimony of Mr. Thomas Dukich is spread upon

 the record.)

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 CSB REPORTING DUKICH (Di)

 Wilder, Idaho 83676 Avista

 1 I. INTRODUCTION

 2 Q. Please state your name, business address

 3 and present position with the Company?

 4 A. My name is Thomas D. Dukich. My business

 5 address is East 1411 Mission Avenue, Spokane, Washington.

 6 I am the Manager of Rates and Tariff Administration. I

 7 joined the Company in 1978 after having been previously

 8 employed as an Associate Professor at Gonzaga University.

 9 Q. Would you briefly describe your duties?

 10 A. My responsibilities as Rates Manager

 11 include the formulation and management of the Company's

 12 plans and activities related to the regulation of gas and

 13 electric services in the states of Washington, Idaho,

 14 Oregon, and California.

 15 Q. Would you describe your educational

 16 background?

 17 A. I graduated from the University of

 18 Minnesota in 1967 with a B.A. in Psychology and Business,

 19 and from the University of Montana in 1972 with M.A. and

 20 Ph.D. degrees in Experimental Psychology, Statistics and

 21 Research Design. During my 20 years of employment at

 22 Avista I have completed courses and seminars on strategic

 23 planning, forecasting, finance, accounting, rate design

 24 and pricing.

 25 Q. What is the scope of your testimony?

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 Dukich, Di 1

 Avista

 1 A. I discuss the basis for Avista's proposal

 2 relating to the disposition of the book gain resulting

 3 from the sale of Centralia ("the sale"). In my testimony

 4 I attempt to provide a general framework of issues for

 5 the Commission to consider rather than focusing on a

 6 specific methodology regarding the disposition of the

 7 gain. I also briefly discuss the Company's position

 8 regarding the depreciation-based proposal put forth by

 9 PacifiCorp.

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 Dukich, Di 1a

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 1 Q. Are you sponsoring any exhibits in this

 2 proceeding?

 3 A. Yes, I am sponsoring Exhibit Nos. 3, 4, 5

 4 and 6, as marked for identification. I will introduce

 5 and describe these exhibits, as appropriate, later in my

 6 testimony.

 7 II. GAIN ON THE SALE

 8 Q. Has the Company concluded that it is in the

 9 public interest to sell Avista's share of Centralia?

 10 A. Yes, for the various reasons summarized in

 11 Mr. Ely's testimony.

 12 Q. Is there a gain on the sale of the

 13 Company's share of Centralia?

 14 A. Yes. The after-tax gain related to the

 15 sale of the Company's 15% ownership share is

 16 approximately $29.6 million. Mr. McKenzie testifies to

 17 the calculation of this book gain.

 18 Q. Is it necessary to include the book gain in

 19 the economic analysis in order to satisfy a "no-harm" to

 20 customers standard as a result of the sale?

 21 A. No. Mr. Johnson's analysis shows a present

 22 value of cost savings to customers of $7.7 million over

 23 the 20-year study period. His analysis excludes the book

 24 gain on the sale. Therefore, the book gain represents

 25 additional value over and above the no-harm to customers

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 Dukich, Di 2

 Avista

 1 standard.

 2 Q. What should the Commission take into

 3 consideration in its decision related to the disposition

 4 of the gain?

 5 A. The Commission should consider various

 6 alternatives and, most importantly, should consider the

 7 soundness of the rationale underlying these alternatives.

 8 In addition, the Commission may want to consider how

 9 these alternatives relate to the unique

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 Dukich, Di 2a

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 1 circumstances of each of the companies involved in the

 2 sale, i.e., the disposition of the gain for Avista may

 3 appropriately be different than that for PacifiCorp.

 4 III. PROPOSAL

 5 Q. Turning now to the Company's proposal for

 6 the disposition of the gain on the sale of Centralia,

 7 what are you recommending?

 8 A. I am asking the Commission to consider

 9 allowing Avista to retain all of the book gain relating

 10 to the sale. Admittedly, this may be viewed by some as

 11 an "aggressive" position for the Company to take. But I

 12 believe there are circumstances that warrant giving this

 13 proposal serious consideration. Should the Commission

 14 decide that 100% is not appropriate, the Company believes

 15 there is still a rational and reasonable basis that would

 16 support a shareholder retention level above the

 17 depreciation based approach proposed by PacifiCorp. I

 18 also recommend that the Commission consider the gain in

 19 its historical context. I believe that a discussion that

 20 puts the gain in an historical context unique to Avista

 21 will provide useful information for the Commission to

 22 consider, regardless of the methodology the Commission

 23 ultimately adopts.

 24 Q. What principle do you believe the

 25 Commission should consider in determining how to treat

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 Dukich, Di 3

 Avista

 1 the gain on the sale of the Centralia Power Plant?

 2 A. I believe the Commission should consider

 3 whether the transaction strikes a balance between the

 4 interests of ratepayers and shareholders that is fair,

 5 and that preserves affordable service. So, the first

 6 element I suggest the Commission consider is the

 7 historical balance that has evolved over the years

 8 between Avista customers and

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 Dukich, Di 3a

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 1 Avista shareholders, and take this balance into account

 2 in its determination of a fair and equitable disposition

 3 of the gain.

 4 Q. What is the other element?

 5 A. The second element is related to fairness.

 6 It is the notion that the benefit of a gain should follow

 7 the risk of possible loss. It would seem to be equitable

 8 that if shareholders take risk, that risk should result

 9 in occasional gains, not just exclusively losses. Stated

 10 another way, a policy that awards all or most of the

 11 gains to customers, and occasional losses to shareholders

 12 would seem to be inequitable.

 13 Q. Please explain further the first element

 14 related to the balance that has evolved over the years

 15 between Avista customers and Avista shareholders.

 16 A. Exhibit No. 3 shows Avista's overall

 17 electric rate of return since 1973, the first full year

 18 Centralia was placed in utility service. It is clear

 19 from Exhibit No. 3 that, more often than not, Avista's

 20 rate of return has been below that considered fair and

 21 reasonable and authorized by the Commission. Certainly,

 22 it is clear that Avista's rate of return has not been

 23 guaranteed during these years. And, I think it is fair

 24 to say, Avista shareholders have not been unduly enriched

 25 during this time.

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 Dukich, Di 4

 Avista

 1 Exhibit No. 4 shows how Avista's Residential rates

 2 have compared with over 200 other investor owned

 3 utilities for the last 20 years (1978 to 1999). Rates

 4 for residential customers have consistently been among

 5 the very lowest in the United States, most often ranking

 6 third lowest or better. A typical bill for an Avista

 7 electric customer has averaged about one-half the U.S.

 8 average.

 9 Q. What do you conclude from these two

 10 exhibits?

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 Avista

 1 A. Customers seem to have been exceptionally

 2 well served over the past 20 years in terms of rate

 3 levels, and it appears that shareholders have not been

 4 unduly enriched during this time.

 5 Furthermore, the Company has consistently received

 6 high marks for its customer service. For example,

 7 Theodore Barry & Associates, in an independent survey of

 8 electric utilities in 1998, ranked the Company number one

 9 in overall customer service performance. The Company

 10 surpassed 33 other energy providers for the lowest annual

 11 customer service expense, while receiving one of the

 12 highest customer satisfaction ratings in the survey

 13 group. In 1999, Avista's customer service call center

 14 was selected as the Best Call Center of the Year by Call

 15 Center Magazine.

 16 Q. Did shareholders suffer any losses during

 17 the time periods covered by Exhibit Nos. 307 and 308?

 18 A. Yes, and this leads to the notion that the

 19 benefit of a gain should follow the risk of possible

 20 loss.

 21 Exhibit No. 5 shows the major write-offs booked by

 22 Avista since 1985. The after-tax total for the electric

 23 utility system is $58.7 million; pre-tax write-offs were

 24 in excess of $96 million. These include write-offs

 25 associated with Skagit, WNP-3, Kettle Falls, Creston and

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 Dukich, Di 5

 Avista

 1 the sale of Meyers Falls.

 2 Exhibit No. 6 helps put these write-offs in the

 3 context of the Company's net utility plant investment

 4 since 1985. Between 1985 and 1998, electric net utility

 5 plant has increased by $52.2 million. Gross plant

 6 investment has increased by $601.6 million. A comparison

 7 of Exhibit Nos. 5 and 6 shows that after tax write-offs

 8 have exceeded the change in net plant investment since

 9 1985. In terms of incremental gross plant investment

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 1 since 1985, approximately 10% has been written off, after

 2 tax. On a before tax basis, 16% of incremental gross

 3 plant investment has been written off.

 4 Q. Are you claiming that the Company was

 5 treated unfairly by having to incur such significant

 6 write-offs?

 7 A. Fairness in past Commission decisions is

 8 not really the issue here. This is not a matter of

 9 second guessing the Commission with regard to prudence

 10 and I am not contending that the Commission should ignore

 11 the "used and useful" standard or any other rule or law.

 12 What is relevant is that the shareholders took risk in

 13 making these investments in order to discharge the

 14 utility's public service obligations. The net result is

 15 that shareholders did not realize a return on their

 16 investment, or did not recover all of their investment,

 17 or both. In other words, they took a risk and lost.

 18 In the specific case of Kettle Falls and WNP-3,

 19 shareholders took a risk in building a resource and in

 20 subsequent regulatory proceedings were not allowed to

 21 recover all of the costs. Again, the exact reason for

 22 taking the write-offs is not the most important point.

 23 The important point is that significant after tax

 24 write-offs have occurred approximately 10% of gross plant

 25 investment since 1985. Shareholders are exposed to

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 Dukich, Di 6

 Avista

 1 unexpected losses. There is no guaranteed return on the

 2 investments, or guaranteed return of the investments.

 3 Unexpected shareholder losses are not recovered.

 4 The question then becomes: If there is an

 5 unexpected gain, who should get it, shareholders or

 6 customers?

 7 Q. Are you familiar with any situation where

 8 shareholders took a risk and won? For example, are you

 9 familiar with any situation where shareholders took a

 10 risk in

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 Dukich, Di 6a

 Avista

 1 building a resource, or making a purchase, and in a

 2 subsequent regulatory proceeding were allowed by this

 3 Commission to retain all or even a part of the "gain" or

 4 savings?

 5 A. No. I can't recall a single instance.

 6 Usually the opposite is true. For example, the Company

 7 purchases over 100 average megawatts of power under

 8 long-term contracts from the Mid-Columbia public utility

 9 districts at an average cost below a penny per kWh. The

 10 prices for these contracts are well below market and have

 11 been for many years, which has provided the Company's

 12 retail customers with significant benefits. But because

 13 there is no rate base treatment or other provision for

 14 shareholders to benefit from these very favorable

 15 contracts, 100% of the benefits are being flowed through

 16 to customers.

 17 Q. What do you conclude from this discussion?

 18 A. Customers have enjoyed rates among the very

 19 lowest in the United States and high levels of customer

 20 service. Shareholders, on the other hand, have

 21 frequently achieved returns below those authorized by the

 22 Commission and have incurred substantial write-offs.

 23 Shareholders have not shared in efficiency gains achieved

 24 by Avista management nor have they shared in savings

 25 achieved by the purchase or construction of below market

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 Dukich, Di 7

 Avista

 1 resources.1 As stated earlier, its seems inequitable for

 2 shareholders to receive none of the benefits from "good

 3 decisions," or opportunity sales that do no harm to the

 4 customer, and yet absorb losses associated with

 5 investments that were deemed to be above-market or

 6 imprudent.

 7 Q. How does this relate to your recommendation

 8 on the gain associated with

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 23 1. However, for natural gas service, the Commission has

 recently allowed Company shareholders the opportunity to

 24 retain certain purchase and gas management efficiencies

 through the Gas Benchmark Mechanism.

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 Dukich, Di 7a

 Avista

 1 the sale of Centralia?

 2 A. The Company requests that the Commission

 3 carefully consider the balance of equities between

 4 shareholders and customers in deciding on the disposition

 5 of the gain from the sale of Centralia. Given the

 6 write-offs Avista has taken, and given the historically

 7 low rates and high quality service enjoyed by customers,

 8 it would be reasonable and equitable in this particular

 9 instance to allow the Company to retain 100% of the gain

 10 associated with the sale.

 11 IV. PACIFICORP PROPOSAL

 12 Q. Does the Company have a view with regard to

 13 PacifiCorp's proposal, should the Commission not find the

 14 above arguments persuasive?

 15 A. Yes. At a minimum, Avista shareholders

 16 should be no worse off than under the depreciation-based

 17 proposal put forth by PacifiCorp. As the Company

 18 understands this proposal, shareholders are allowed to

 19 retain a portion of the gain that is proportional to the

 20 un-depreciated amount of the Centralia investment. The

 21 remaining portion of the gain would go to ratepayers in

 22 the form of an offset that will provide a direct benefit

 23 to customers. Mr. McKenzie discusses how the

 24 depreciation-based methodology would apply to Avista. He

 25 also discusses the Company's proposal for the disposition

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 Dukich, Di 8

 Avista

 1 of the customers share of the gain under such an

 2 approach. Although this approach is considerably less

 3 desirable to the Company, the disposition of the gain

 4 discussed by Mr. McKenzie does address, albeit to a

 5 lesser degree, the equity issues previously addressed in

 6 my testimony.

 7 Q. Does this conclude your direct testimony?

 8 A. Yes.

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 Avista

 1 Q. Please state your name, business address

 2 and present position with the Company?

 3 A. My name is Thomas D. Dukich. My business

 4 address is East 1411 Mission Avenue, Spokane, Washington.

 5 I am the Director of Rates and Tariff Administration.

 6 Q. Have you previously filed testimony in this

 7 proceeding?

 8 A. Yes.

 9 Q. What is the scope of your rebuttal

 10 testimony?

 11 A. In my rebuttal testimony I respond to the

 12 testimony of staff and intervenor witnesses related to

 13 the disposition of the gain on the sale of Centralia.

 14 Q. Are you sponsoring any exhibits with your

 15 rebuttal testimony?

 16 A. No.

 17 Q. Do you have any opening comments before

 18 turning to the specific issues raised by other witnesses

 19 in the case?

 20 A. Yes. First of all I would like to clarify

 21 and summarize my testimony since there may be some

 22 confusion regarding the rationale for Avista's proposal

 23 regarding the disposition of the gain on the sale of

 24 Centralia. Our proposal is premised upon balancing the

 25 interests of customers and shareholders. In my direct

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 Dukich, Reb 1

 Avista

 1 testimony I outlined what I believe to be the current

 2 status of this balance as the Commission faces the

 3 decision regarding the gain on the sale:

 4 Previous Investment Write-offs by Avista - The

 Company's shareholders have not been shielded from

 5 significant write-offs: since 1985 before tax

 write-offs have totaled over $96 million. The

 6 purpose of presenting this historical fact in this

 portion of my testimony was not to complain,

 7 contest, revisit, or call into question the

 fairness of the prior decisions of the Commission.

 8 The purpose was to simply show that past

 Commission decisions and Company actions have

 9 resulted in significant write-offs (losses) to

 shareholders, and that a balance of interests for

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 1 customers and shareholders would seem to

 necessitate occasional gains going to shareholders

 2 along with the losses.

 3 Customer Service and Retail Rates - Several

 independent studies have rated Avista's customer

 4 service and business operations as outstanding.

 In addition, retail rates for the Company's

 5 customers have varied between the lowest and the

 fifth lowest in the United States over the last 20

 6 years. The purpose of this testimony was to

 simply show that customers have been well served

 7 by Avista, and that the Company's customer service

 and retail rates should not be factors that would

 8 preclude the Commission in any way from assigning

 the gain to shareholders.

 9

 Historical Rates of Return - In Exhibit No. 3 of

 10 my direct testimony I provided a comparison of

 Avista's actual and "Commission Basis" rates of

 11 return to those authorized by the Commission for

 the period 1973 to 1998. The purpose of this

 12 testimony was not to claim an entitlement to the

 gain from Centralia simply and only because the

 13 Company's earned rate of return was sometimes

 below the authorized return. The purpose was to

 14 point out that the regulated rates of return since

 1973 have not unduly enriched shareholders, as I

 15 concluded on Page 5 of my direct testimony.

 16 Both my direct testimony and rebuttal testimony

 17 speak to the balance of interests between customers and

 18 shareholders, and request that the Commission consider

 19 this balance in its decision. The Company's book value

 20 has been significantly decreased in the past for the

 21 investments that were disallowed for recovery by the

 22 Commission related to WNP-3, Skagit, and Kettle Falls

 23 (Exhibit No. 5). If there is to be symmetry (fairness),

 24 it is also necessary for there to be an increase in book

 25 value from time to time. Therefore, we believe it would

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 Dukich, Reb 2

 Avista

 1 be reasonable and appropriate for all, or a major

 2 portion, of the gain on Centralia to be assigned to

 3 shareholders. It is our position that this would balance

 4 the interests involved without diminishing future

 5 customer service or increasing customers' rates.

 6 Q. Turning now to rebuttal of specific issues,

 7 on Page 10 of his testimony Dr. Peseau discusses a

 8 "capitalist economic system" that "governs every publicly

 9 traded corporation, including Avista and other members of

 10 the utility industry." Do you have any comments on this

 11 testimony?

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 1 A. Yes. One theory of regulation is that the

 2 Commission serves as a substitute or surrogate for

 3 competition in our "capitalist economic system" to ensure

 4 that pricing to customers is fair, just and reasonable,

 5 and that service is safe and reliable.1 Commission

 6 regulation is primarily economic in the sense that prices

 7 are regulated through an analysis of various costs,

 8 including capital return.

 9 It is the Company's decision, in the first

 10 instance, to determine whether to acquire or dispose of

 11 assets. These decisions, however, are subject to the

 12 specific approval of the Commission, including the

 13 financial impact on customers from those decisions.

 14 In the competitive world, both the gains and

 15 losses from investment decisions accrue to the business

 16 owners. Monopoly status, in and of itself, does not

 17 preclude the assignment of both gains and losses to

 18 shareholders. As the surrogate for competition, it is

 19 the Commission's decision as to how gains and losses are

 20 shared between customers and shareholders.

 21 Q. Beginning on Page 13, Line 2 of his

 22 testimony, Dr. Peseau states that the Skagit, Creston and

 23 Meyers Falls write-offs "cannot be attributed to

 24 regulatory actions?" Is this testimony correct?

 25 A. No. In Order No. 19411 in Case No.

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 Dukich, Reb 3

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 1 U-1008-219, dated January 30, 1985, the Commission

 2 disallowed recovery of 50% of the Company's investment in

 3 the Skagit Project. The Commission allowed a 15-year

 4 amortization of the remaining 50%, without a

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 18 1The Company is also subject to other sources of

 competition in the form of alternate fuel sources,

 19 neighboring public utilities and Bonneville Power

 Administration (BPA). BPA serves as wholesale provider

 20 of preference power to public agencies within a

 statutorily defined region in the Northwest that includes

 21 all of Avista's service territories. While Avista's

 service territory in Idaho does have the protection of

 22 the Idaho Antipiracy Statute, some competition can occur

 on the fringes. In addition, certain customers, such as

 23 federal agencies, have direct rights to purchase from

 BPA. In 1990 Avista lost the housing load of Fairchild

 24 Air Force Base to BPA. All of this competition

 places pressure on Avista to keep its rates low to meet

 25 competition.

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 Dukich, Reb 3a

 Avista

 1 return on the unamortized balance. The rate making

 2 treatment approved by the Commission required the Company

 3 to write off approximately 75% of its investment in the

 4 Project (the absence of a return on the remaining balance

 5 resulted in an additional write-off above the initial

 6 50%).

 7 The Company wrote off its $11.2 million investment

 8 in the Creston Project without receiving or requesting a

 9 change in retail rates, as well as the $200,000

 10 associated with Meyers Falls.

 11 Q. Beginning at Page 13, Line 20 of his

 12 testimony, Dr. Peseau addresses the Company's testimony

 13 regarding gains associated with building or purchasing

 14 resources. Do you have any comments on this testimony?

 15 A. Yes. The Company's testimony that

 16 Dr. Peseau refers to includes the following question

 17 beginning on Page 6, Line 22 of my direct testimony:

 18 "For example, are you familiar with any situation

 where shareholders took a risk in building a

 19 resource, or making a purchase, and in a

 subsequent regulatory proceeding were allowed by

 20 this Commission to retain all or even a part of

 the "gain" or savings?"

 21

 22 In my response to this question I stated, "I can't

 23 recall a single instance."

 24 In his testimony addressing this question and

 25 answer, Dr. Peseau points to the Company's recent rate

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 Dukich, Reb 4

 Avista

 1 case (Case No. WWP-E-98-11) where the Commission assigned

 2 all gains and losses from commercial trading activity to

 3 shareholders as an instance where gains are assigned to

 4 shareholders, contrary to my assertion.

 5 What Dr. Peseau fails to recognize, however, is

 6 that these speculative commercial trading transactions

 7 are unrelated to the resources that are built or

 8 purchased to serve

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 Dukich, Reb 4a

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 1 customers' loads. The Company clearly explained this

 2 fact in its testimony in the case, and the Commission

 3 recognized it on Page 16 of its Order No. 28097:

 4 "Recognizing that the Resource Optimization

 department of the Company does engage in some

 5 level of speculative transactions not otherwise

 associated with the operation of Company resources

 6 or serving retail load,..." (underscore added)

 7 Furthermore, on Page 16, Line 5 of Dr. Peseau's

 8 testimony, with regard to the Company's subsidiary

 9 operations, he states, "Avista's shareholders have

 10 therefore borne the entire risk and are entitled to all

 11 the profits from the gain." Similarly, with commercial

 12 trading activities, the Company places its own capital at

 13 risk, bears the entire risk, and receives all gains and

 14 losses. Thus, Dr. Peseau's testimony actually supports

 15 the Company's position.

 16 Q. At Page 4, Line 1 of his testimony,

 17 Dr. Peseau states that, "In this sense, Avista customers

 18 have been co-investing in Centralia," and later

 19 references an "equitable ownership interest" in Centralia

 20 by customers. Do you have any comments on this

 21 testimony?

 22 A. Yes. The legal and operational ownership

 23 of utility assets resides with, and is the responsibility

 24 of, the utility. The presumed monopoly status of the

 25 utility and the corresponding regulation by the

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 Dukich, Reb 5

 Avista

 1 Commission does not result in customers owning the

 2 utility's assets. Simple use of a product, even if the

 3 price is regulated and based on cost, does not result in

 4 ownership of the means of producing that product.

 5 Customers no more

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 Dukich, Reb 5a

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 1 own the generating assets than I own some of McDonalds

 2 because I have purchased their Big Macs2.

 3 As the surrogate for competition, it is the

 4 Commission's decision as to how gains and losses are

 5 shared between customers and shareholders.

 6 Q. On Page 11, Line 24 of Ms. Stockton's

 7 testimony, regarding the disposition of the gain, she

 8 states that, "The depreciation approach is the proper

 9 approach according to the Supreme Court of Idaho."

 10 Ms. Stockton also states that, "The Supreme Court of

 11 Idaho, in Boise Water Corporation v. Idaho Public

 12 Utilities Commission, 99 Idaho 158, 578 P.2d 1089 (1978),

 13 found that the ratepayers' payment of depreciation

 14 expense (on property other than real property)

 15 establishes a right to the gain on the sale of an asset."

 16 Do you have any comments on this portion of

 17 Ms. Stockton's testimony?

 18 A. Yes. For a number of reasons, we believe

 19 that this ruling does not bind the Commission to a

 20 similar decision in this case. First, the Idaho Supreme

 21 Court ruling in Boise Water Corporation v. Idaho Public

 22 Utilities Commission, 99 Idaho 158, 578 P.2d 1089 (1978)

 23 (Boise Water case), is a decision made for a company in

 24 different utility business with a different regulatory

 25 history.

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 Dukich, Reb 6

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 10 2One approach to allocating gain on the sale of an asset

 was outlined in Democratic Central Committee v.

 11 Washington Metro. Area Transit Comm. 485 F.2d 786

 (D.C. Cir. 1973). On pages 805-806 the court framed the

 12 task as follows:

 "Investors, we have concluded, are not automatically

 13 entitled to gains in value of operating utility

 properties simply as an incident of the ownership

 14 conferred by their investments. And it goes without

 saying that consumers do not succeed to such gains simply

 15 because they are users of the service furnished by the

 utility. Neither capital investment nor service

 16 consumption contributes in any special way to

 value-growth in utility assets. Rather, the values with

 17 which we are concerned have grown simply because of a

 rising market.

 18 Investors and consumers thus start off on an equal

 footing, and the disposition of the growth must depend on

 19 other factors. We thus reach the dual critical inquiry;

 identification of the principles which must guide the

 20 allocation, as between investors and consumer groups, of

 appreciation in value of utility assets while in

 21 operating status; and application of those principles to

 transit's situation."

 22 Over 25 years have passed since this decision. There

 have been significant changes in the electric utility

 23 industry during this time and this case may not be

 entirely on point. Nevertheless, it can provide a useful

 24 framework for debate and discussion and I have used it

 for this purpose.

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 Dukich, Reb 6a

 Avista

 1 Second, the sale of Centralia involves the sale of

 2 depreciable property. The Boise Water case involved a

 3 transfer of real property to an affiliate, and thus the

 4 sale of depreciable property was not even at issue in the

 5 Boise Water case, nor did the case involve an outright

 6 sale of property.

 7 Third, in addressing gains to ratepayers related

 8 to sales of property on Page 1092, on two different

 9 occasions the ruling includes statements with

 10 introductory qualifiers. One sentence begins with, "One

 11 way of looking at", and another begins with, "In one

 12 sense." Thus, we believe the ruling does not dictate a

 13 "one size fits all" method for viewing or handling all

 14 gains from the sale of property.

 15 Fourth, the Boise Water case involves property

 16 with a book value of $12,295.000. In Avista's current

 17 filing, the gain is related to the sale of a major

 18 base-load generating resource. The Company's investments

 19 in generating resources have been subjected to rigorous

 20 reviews that have resulted in substantial write-offs for

 21 the Company. A decision related to the disposition of

 22 the gain on the sale of Centralia is clearly in a

 23 different category than that of the relatively minor real

 24 property transaction.

 25 Fifth, although the ruling on Page 1089 includes a

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 Dukich, Reb 7

 Avista

 1 reference to both "rewards" and "losses," there is no

 2 meaningful discussion of balancing gains and losses for

 3 customers and shareholders in the case.

 4 Lastly, I can not find in the court's ruling an

 5 exact reference to Ms. Stockston's statement that, "The

 6 Supreme Court of Idaho. . .found that the ratepayers'

 7 payment of depreciation expense (on property other than

 8 real property) establishes a right to the gain on the

 9 sale of an asset." Our reading of the Court's ruling is

 10 that customers have an equitable interest and can not, by

 11 law, be excluded from the potential of receiving a

 12 portion of the

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 Dukich, Reb 7a

 Avista

 1 gain. However, the exact method or the exact amount of

 2 the sharing must be justified by the facts of the case in

 3 question. Customers have the right to have place at the

 4 table, as do shareholders, but neither has a legal right,

 5 a priori, to any specific portion of the gain.

 6 With regard to the disposition of the gain on

 7 Centralia, symmetry and fairness for the Company's

 8 customers and shareholders should be based on the unique

 9 circumstances for Avista. I have outlined Avista's

 10 unique circumstances in my direct testimony.

 11 Historically, Avista's customers have not paid all of the

 12 investment costs associated with generating projects, as

 13 evidenced by the write-offs experienced by the Company,

 14 e.g., WNP-3 and Kettle Falls. Consequently, for this and

 15 the other reasons outlined, we believe that it would be

 16 reasonable and appropriate for all, or a major portion,

 17 of the Centralia gain be assigned to Avista's

 18 shareholders.

 19 The gain on the sale of Centralia represents

 20 economic value over and above the book value of the asset

 21 and the amount rate based. Customers have not been

 22 charged a return on this economic value (the gain), nor

 23 have they paid depreciation based on this economic value.

 24 The assignment of all or a major portion of the gain to

 25 shareholders, therefore, would not take away from

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 Dukich, Reb 8

 Avista

 1 customers any value that they have or are currently

 2 receiving.

 3 Q. On Page 3, Line 17 of his testimony

 4 Dr. Peseau states that, "Once an asset is placed in rate

 5 base, regulation in Idaho provides for both the return on

 6 (rate of return) and return of (depreciation) shareholder

 7 investment in a plant such as Centralia." Do you have

 8 any comments on this testimony?

 9 A. Yes. It is very important to note that in

 10 this testimony Dr. Peseau has repeatedly used the

 11 qualifier: "Once an asset is placed in rate base,..."

 12 (underscores added).

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 Dukich, Reb 8a

 Avista

 1 In his discussion on Page 11 regarding compensation to

 2 the Company for its investment risk, he again uses the

 3 qualifier: "As soon as a utility asset is placed in rate

 4 base." And once more on Page 12, Line 9, "Once the plant

 5 is in rate base,..."

 6 "Rate base" includes the value of any investments

 7 for which the Commission has granted recovery through

 8 retail rates. In general, an investment which has been

 9 disallowed for rate making purposes must be written off

 10 by the Company, which results in a reduction to both rate

 11 base and the Company's book value. The Company receives

 12 neither a return on, nor a return of this investment.

 13 Therefore, the allowed rate of return to compensate the

 14 Company for its investment risk is earned only on the

 15 investment that the Commission has approved for recovery

 16 in rates.

 17 The rate of return established by the Commission

 18 for the Company does not in any way preclude a decision

 19 by the Commission to assign all, or a major portion, of

 20 the gain on Centralia to shareholders. The Company's

 21 investments in generating resources have been subjected

 22 to rigorous reviews that have resulted in substantial

 23 write-offs for the Company. Sales of assets such as

 24 Centralia are also subject to a specific decision of the

 25 Commission granting approval of the sale, and the

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 Dukich, Reb 9

 Avista

 1 disposition of any related gains and losses. In both

 2 instances, either a disallowance of investment recovery

 3 or an assignment of a gain to shareholders, the decision

 4 of the Commission has a direct financial impact on

 5 financial statements and shareholders, irrespective of

 6 the rate of return authorized by the Commission for the

 7 Company.

 8 Q. Beginning on Page 24, Line 15 Dr. Peseau

 9 discusses potential future policy decisions by the

 10 Commission related to utility mergers and acquisitions,

 11 and electric restructuring, and recommends that the

 12 Commission "set a policy in this proceeding"

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 Dukich, Reb 9a

 Avista

 1 regarding the future sharing of gains and losses. Do you

 2 agree with Dr. Peseau's recommendation?

 3 A. No. Electric industry restructuring on a

 4 broad scale has not yet occurred in the State of Idaho,

 5 nor does it seem imminent. It would be premature to make

 6 decisions, or adopt policies, related to electric

 7 restructuring now, before all the factors that would need

 8 to be taken into consideration are known, including any

 9 possible legislation. It is also not necessary or

 10 prudent to make specific stranded cost or benefit

 11 decisions now, in dealing with the proposed sale of

 12 Centralia. Furthermore, any decisions related to utility

 13 mergers and acquisitions should be based on the specific

 14 circumstances of the transaction, and the information

 15 available at the time.

 16 Q. Do you have any further comments related to

 17 the testimony of staff and intervenor witnesses in the

 18 proceeding?

 19 A. Yes. The Company has not responded to each

 20 and every statement of each witness or to certain

 21 off-handed remarks of Dr. Peseau. To the extent that a

 22 witness has made a statement not rebutted by the Company,

 23 our silence does not indicate agreement.

 24 The Company's position regarding the sale of

 25 Centralia and the disposition of the gain on the sale

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 Dukich, Reb 10

 Avista

 1 stands as filed by the Company in its direct and rebuttal

 2 testimony in this case.

 3 Q. Does this conclude your rebuttal testimony?

 4 A. Yes.

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 Dukich, Reb 10a

 Avista

 1 (The following proceedings were had in

 2 open hearing.)

 3 MR. DAHLKE: And Mr. Dukich is available

 4 for cross-examination.

 5 COMMISSIONER SMITH: Mr. Ward, do you have

 6 questions for Mr. Dukich?

 7 MR. WARD: No questions.

 8 COMMISSIONER SMITH: Mr. Woodbury.

 9 MR. WOODBURY: Thank you, Madam Chair.

 10

 11 CROSS-EXAMINATION

 12

 13 BY MR. WOODBURY:

 14 Q Good morning, Mr. Dukich.

 15 A Good morning.

 16 Q Referring first to your direct testimony on

 17 page 2, you speak of a no-harm-to-customers standard. Is

 18 that, to your knowledge, a statutory standard or is it a

 19 standard that was developed by this Commission in its

 20 orders?

 21 A You know, I can't recall, Mr. Woodbury.

 22 I'll try not to guess.

 23 Q When you use the term "no-harm-to-customers

 24 standard," are you speaking of immediate harm or future

 25 harm?

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 A I think that would include all for the

 2 foreseeable.

 3 Q Short term and long term?

 4 A Right. Probably more long term. I mean,

 5 there could be some small perturbations but long term.

 6 Q The Company's primary proposal in this case

 7 is to retain all of the book gain related to the sale and

 8 you state that that may be viewed by some as an

 9 aggressive position.

 10 A Correct.

 11 Q Is it viewed by the Company as an

 12 aggressive position?

 13 A No, I think my testimony outlines why we

 14 took that position in terms of balancing equities over

 15 time and taking a look at the fact that it's not very

 16 often that there are gains compared to the number of

 17 times that there are unexpected losses and to balance

 18 that out, it might be reasonable to take a look at

 19 allowing 100 percent of the gain given the history of

 20 what's happened.

 21 Q Would you agree that it could reasonably be

 22 viewed by some of your customers as an aggressive

 23 position?

 24 A I'm not sure how to answer that. I don't

 25 know. I probably --

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 Q Then I wonder if you feel that nobody

 2 really would view it as an aggressive position why you

 3 would put that in your testimony.

 4 A Oh, because I believe that if you look at

 5 maybe some of the positions that the parties have taken

 6 in this proceeding across the states and contrast it to

 7 PacifiCorp's depreciation approach or maybe the Staff's

 8 review of what's happened in the state before, it may be

 9 more aggressive than what you would normally see a

 10 company propose, but I think the intent was to engage a

 11 debate or, I mean, at least an examination of the reasons

 12 or the basis for prior decisions, and our impression was

 13 that sometimes not necessarily -- well, if you look at

 14 all the jurisdictions together, there hasn't been a real

 15 thorough discussion, it doesn't seem, of the reasons why

 16 the depreciation methodology is, I guess you might say,

 17 convenient or provides a nice quantitative tool, but

 18 there isn't a lot of discussion, extensive discussion,

 19 about the reasons behind it or the philosophy that has

 20 gone to how the gains are distributed.

 21 Q Okay, your direct testimony was filed

 22 before other party positions were developed, wasn't it?

 23 A Yes.

 24 Q You also state that the Commission should

 25 consider the Company's proposal in an historical

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 context.

 2 A Right.

 3 Q And can you define what you mean by

 4 "historical context"? Are you talking about your

 5 representations as far as whether or not the Company

 6 achieved what you perceived to be a reasonable return in

 7 the last 13, 20 years, is that what you're speaking of?

 8 A I think when we put this together, there

 9 was no firm definition of historical, but one definition

 10 was from the time that Centralia went into rate base,

 11 which I think is 1972, so basically, the plant has been

 12 in, I think, for about 28 years. I think earlier we

 13 talked in the hearing about 22, but it's been about 28,

 14 so that was one benchmark.

 15 I think the other benchmark was probably

 16 the benchmark of the heavy construction era in the '70s

 17 and '80s when the -- basically what happened in the

 18 utility industry kind of changed, I think. Interest

 19 rates were high, there was the nuclear power issue, I

 20 guess, and what had happened all around the United

 21 States. There was a lot more write-offs. I think prior

 22 to that the utility industry was a lot more, you might

 23 say, sedate or certain, but from the '70s on, I think

 24 there's a lot more uncertainty, a lot more write-offs.

 25 If you throw in deregulation on top of that, you've got,

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 I guess, in the modern history from 1970 on, it's kind of

 2 a different era, so that was the time frame where I was

 3 talking about, not going back to 1920 or something, but

 4 more from 1970.

 5 Q Should we consider Avista's proposal to

 6 retain all the gain in the context of your most recent

 7 general rate case where the Company requested a 25 basis

 8 point adder and equity return for good management?

 9 A I think that was part of the balancing and

 10 I think I used -- in my rebuttal testimony, I have a

 11 footnote for the Democratic Central Committee decision

 12 and how that basically frames many of the issues and

 13 basically, that decision talked about are there ways

 14 that, say, the Company should not get the gain and one of

 15 the ways might be to say if the Company had earned

 16 excessively, then they shouldn't get the gain the

 17 equities would say. If the Company had exceptionally

 18 poor customer service, they shouldn't get the gain, or

 19 the Company had really high rates, they shouldn't get the

 20 gain, so the way I outlined my testimony was to say that

 21 none of those appear to be true of Avista, maybe the

 22 opposite is true; the rates have been low, our customer

 23 service has been very good and there hasn't been

 24 excessive earnings from our point of view, so it was more

 25 of, I guess you might say, from an exclusionary point of

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 view because that's the tactic that some of the courts

 2 seem to have taken. The equities didn't indicate that

 3 there was anything negative against the Company.

 4 Q Would you agree with Dr. Peseau's testimony

 5 that in the 13 years between '86 and '99 when the Company

 6 did not have a general rate case that the Company took

 7 that opportunity to refinance its debt at a lower

 8 interest rate, thereby decreasing its cost of capital and

 9 initiated programs that resulted in operational savings?

 10 A Correct. Well, the operational savings, as

 11 a matter of fact, costs increased, but they were offset

 12 by, partially offset by, things that were done on

 13 refinancing debt, so I wouldn't agree with that statement

 14 broadly that all costs decreased. As a matter of fact,

 15 they didn't. I think the ability, part of the ability,

 16 to stay out was due to refinancing and lower interest

 17 rates compared to what they were set in 1986.

 18 Q Would you agree with Dr. Peseau's

 19 observation that one of the primary reasons your rates

 20 along with Idaho Power's are among the lowest in the

 21 country is because you're hydro-based utilities?

 22 A Certainly, that's partially true, but there

 23 are other hydro-based utilities or utilities that had a

 24 chance to be hydro-based, whether that be Portland

 25 General or Puget, as evidenced by the fact that they

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 probably have had upwards of 4-$500 million worth of

 2 residential exchange benefits that Avista never did get,

 3 so their costs were actually higher than Bonneville's,

 4 the way the exchange was calculated, ours were lower, so

 5 if you compare us to the primary hydro utility in the

 6 region, which is Bonneville, our costs were actually

 7 lower and evidenced by the fact that we didn't qualify

 8 for the exchange, and if you look at non-hydro costs, the

 9 national studies show that our other costs are also among

 10 the lowest in the U.S., as well as our customer service,

 11 so I don't think that that is the only reason.

 12 Certainly, the foresight that we had to

 13 build those plants, which, by the way, are not in the

 14 middle of our service territory, they're in Montana, and

 15 up until recently our two major facilities were on the

 16 very edge of our service territory, Cabinet and Noxon are

 17 outside, a river does not run through our service

 18 territory in that sense, we went outside of our territory

 19 to build those projects.

 20 Q Okay.

 21 A I might add, also, that about -- I think

 22 the Company's owned hydro, if I'm not mistaken, is

 23 approximately about 40 percent of our resources. If you

 24 include purchased, I think it's maybe around 60, so we

 25 have a substantial portion of thermal as well as hydro.

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 Q On page 6 of your direct testimony, you

 2 frame a question to yourself and then you avoid the

 3 answer.

 4 A I do? What page?

 5 Q Page 6. Your question was, "Are you

 6 claiming that the Company was treated unfairly by having

 7 to incur such significant write-offs?"

 8 And your answer was, "Fairness in past

 9 Commission decisions is not really the issue here."

 10 You framed the question and avoided the

 11 answer. Do you want to answer it directly, the question,

 12 yes or no?

 13 COMMISSIONER SMITH: He asked if you wanted

 14 to.

 15 THE WITNESS: No, I don't want to. I think

 16 the issue here is for the sake of discussion is that our

 17 intent was not to revisit past decisions and whether we

 18 considered them fair or not. We may have considered them

 19 unfair in some sense, but what's done is done. I guess

 20 maybe that would be a better answer and my point wasn't

 21 that we were treated unfairly. My point was that the end

 22 result was we had some write-offs, a lot of write-offs,

 23 $96 million pre-tax and no gains basically, so it's been

 24 during that time a no gains game with the symmetry being

 25 all write-offs and not many gains and in that sense, the

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 CSB REPORTING DUKICH (X)

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 1 balance of equities is not -- it's not that balanced if

 2 you want to take that approach.

 3 Q BY MR. WOODBURY: You would agree that the

 4 standards that the Commission applied in those cases with

 5 respect to prudence and used and useful the Commission

 6 was fair in doing so?

 7 A Yes, I think that they could do that and

 8 that was certainly within their -- that's the point of my

 9 testimony. This is not a matter of law in that sense.

 10 It's a matter of Commission discretion and I think I talk

 11 about the Commission being a surrogate for competition

 12 and so to that extent, maybe these are extraordinary

 13 losses, whether you call -- prudency basically is a

 14 surrogate for price, I think, by and large and that maybe

 15 the price came in too high so the plants were not allowed

 16 and if the price comes in too low or there's an

 17 extraordinarily good decision made, even if that's for

 18 whatever the reason, like maybe the gain on Centralia,

 19 maybe the Company ought to get to retain that.

 20 Q At page 6 of your testimony you ask

 21 yourself, "Are you familiar with any situation where

 22 shareholders took a risk and won?" And the answer is

 23 "No." Was that your answer alone or did that represent

 24 the institutional memory of the Company?

 25 A I thought it represented both and I do mean

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 CSB REPORTING DUKICH (X)

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 1 to clarify that from the basis of a regulated -- from the

 2 regulated business, on the regulated side. There may be

 3 some smaller gains in the 50-100,000 range, but nothing

 4 major that I'm aware of on the regulated side of the

 5 business. If you have another example, I'd be interested

 6 to hear that if I was wrong. If you look through our

 7 10-K's --

 8 Q I don't have another thing that I would

 9 like to bring up about that.

 10 A Okay.

 11 Q In your rebuttal testimony, you address

 12 Staff raised a Boise Water case, a Supreme Court case,

 13 Idaho Supreme Court, in its testimony and you state on

 14 page 6 that the court found that the ratepayers' payment

 15 of depreciation expense on property other than real

 16 property establishes a right to the gain on the sale of

 17 an asset. You wouldn't -- you agree that that's what the

 18 court found in that case?

 19 A Could you refer me to the line again,

 20 Mr. Woodbury? I'm sorry.

 21 Q It's probably between line 5 and line 12 on

 22 page 6.

 23 A This is what Ms. Stockton said.

 24 Q Okay. Well, do you disagree that that's

 25 what the court found?

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 A I can't find that exact statement in the

 2 court case, no.

 3 Q Then on page 7, you say your reading of the

 4 court's ruling is that customers have an equitable

 5 interest and cannot, by law, be excluded from the

 6 potential of receiving a portion of the gain and that

 7 customers have the right to have a place at the table, as

 8 do shareholders, but neither have a legal right, a

 9 priori, to any specific portion of the gain.

 10 A Right.

 11 Q And that's the Company's reading of that

 12 case?

 13 A Yes.

 14 Q You tried to distinguish that case in

 15 saying that that decision was made for a company in a

 16 different utility business with a different regulatory

 17 history.

 18 A Correct. I think we distinguish about five

 19 or six different -- not only --

 20 Q Are you saying that the court's decision in

 21 Boise Water establishes no precedent for cases involving

 22 electric utilities?

 23 A I'm saying that that's one of the things

 24 you'd want to look at. If you look at equities, you'd

 25 look at the history, the embedded history, of what's

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 happening and it wasn't my impression that the Boise

 2 Water case established some firm precedent, no.

 3 Q You cite the --

 4 A In fact, I think if you read the last

 5 paragraph in that case, it says that there needs to be a

 6 basis in fact for how the gain is distributed and the

 7 facts of the case have to support the decision the

 8 Commission makes.

 9 Q You then go on to cite the Democratic

 10 Central Committee case involving Washington Metro Area

 11 Transit and is it your understanding that the -- that

 12 that's a transit company?

 13 A Yes.

 14 Q That's a different utility business?

 15 A It is a different utility business, yes. I

 16 might add, though, that I didn't cite that in terms of

 17 any precedent.

 18 Q The court cited it in its opinion, too,

 19 didn't it?

 20 A Pardon?

 21 Q The court cited that case in its opinion?

 22 A Yes, and the footnote in that basically

 23 says that the preamble in that case, the discussion in

 24 that case, I think, frames the issue very well and I

 25 didn't cite the outcome of the case as being precedent

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 CSB REPORTING DUKICH (X)

 Wilder, Idaho 83676 Avista

 1 for anything, but I think the discussion talking about

 2 gains following risks and benefits following burdens,

 3 that frames the issue very well that we're facing today.

 4 Q Page 10 of your rebuttal testimony you

 5 state, "To the extent that a witness has made a statement

 6 not rebutted by the Company, our silence does not

 7 indicate agreement."

 8 A Correct.

 9 Q Does your silence indicate disagreement?

 10 A No.

 11 Q You understand the purpose of rebuttal

 12 testimony?

 13 A Yes.

 14 Q And was the Company not provided with

 15 adequate time to prepare rebuttal in this case?

 16 A Well, the Company chose for the sake of

 17 expedience and brevity and focusing on the major issue

 18 not to address each and every issue, particularly in

 19 Dr. Peseau's testimony regarding what we consider

 20 offhanded remarks, that it wasn't worth going through and

 21 rebutting that item by item. We chose to ignore that

 22 rather than rebut it, but it didn't mean we agreed with

 23 it.

 24 Q You understand that the Commission can only

 25 consider the record in this case?

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 Wilder, Idaho 83676 Avista

 1 A Yes.

 2 Q So if you've foregone some argument, then

 3 essentially that's waived?

 4 A I would defer to Mr. Dahlke and let him

 5 make a legal judgment on that.

 6 MR. WOODBURY: Fine. Madam Chair, Staff

 7 has no further questions of Mr. Dukich.

 8 COMMISSIONER SMITH: Thank you,

 9 Mr. Woodbury.

 10 Do we have questions from the

 11 Commissioners? Commissioner Hansen.

 12

 13 EXAMINATION

 14

 15 BY COMMISSIONER HANSEN:

 16 Q I just would kind of like to clarify, on

 17 your direct testimony on page 5, lines 1 through 3, you

 18 talk about, you say, "Customers seem to have been

 19 exceptionally well served over the past 20 years...," and

 20 from your previous discussions in this matter, is that

 21 based on the service quality they've received as well as

 22 the low rates that they've been assessed mainly due to

 23 hydropower, is that where you get that they were

 24 exceptionally served?

 25 A Yes, I think if you look at -- I think my

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 1 exhibit shows that the customers have been either the

 2 lowest -- among the four lowest in the United States over

 3 the last 20 years, as well as the studies that have been

 4 done, like Call Center of the Year, customer service.

 5 Also, I think in the testimony, I think Ms. Maxwell's

 6 testimony in the rate case, our just concluded rate case,

 7 showed that Avista had the lowest complaint rate of any

 8 of the Idaho utilities, electric utilities, so I think

 9 it's both rates and customer service.

 10 Q Okay, going on, then you talk or you have

 11 reference to the shareholder and you say, "...it appears

 12 that shareholders have not been unduly enriched." What

 13 do you mean by "unduly"?

 14 A Well, to be honest with you, that statement

 15 was in there as -- I cited the Democratic Central as what

 16 I consider a framework for the debate, kind of, and in

 17 the Democratic Central decision, they talk about the

 18 Metro Authority one year earned real high rates of return

 19 and that was part of the balancing of equities to say

 20 that the customers have earned -- I mean the company

 21 earned very high rates of return. I didn't find anything

 22 comparable to that in our history.

 23 Our rates of return have been around the

 24 allowed, up or down, and you can argue about whether they

 25 were exact or whatever, but there were no windfall

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 1 returns of the 20 to 30 percent range or anything even

 2 close to that. They were all around the allowed, within

 3 a couple of percent, and that really was the intent of

 4 the statement. You couldn't look back and say, well, you

 5 didn't get any gains, but one year you earned 28

 6 percent. There's nothing in the recent history that

 7 shows that.

 8 Q So really, then, you kind of based that on

 9 rate of return?

 10 A Yes, even though that's not really an

 11 adequate measure, because the rate of return

 12 automatically factors out any write-offs, so even absent

 13 write-offs and you know what I mean, then the rate of

 14 return looks forward and when the rate base is

 15 calculated, rate of return is excluded, so I did base it

 16 on a rate of return, yeah.

 17 Q By doing so, I guess the question I've got

 18 in my mind is, is it really, I guess I'd ask, is it the

 19 ratepayers' fault that the stockholders have not received

 20 the rate of return that you think is just and fair to

 21 them?

 22 A No. In fact, I think that goes to maybe

 23 the question Mr. Woodbury asked me about avoiding my own

 24 question. The intent wasn't to say it was anybody's

 25 fault or anyone was to blame or anyone was treated

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 1 unfairly, including the customers, and if that came

 2 across in my testimony, I'm sorry about that. I really

 3 didn't mean to talk about who's at fault in that sense.

 4 What I meant to say is that whatever the reason, here's

 5 how it came out and if you look historically at the

 6 balance of the equities or fairness that there are more

 7 things on the negative side than the positive side.

 8 There are a lot of losses dollar-wise but

 9 no gains, no material gains. No matter who's to credit

 10 or to blame, that's just the way it's turned out and that

 11 maybe is one thing the Commission may want to look at in

 12 terms of looking at a balancing over the years, so again,

 13 I don't want to phrase it in terms of anyone's fault or

 14 blame.

 15 Q I guess just one last question.

 16 A Sure.

 17 Q I guess I'm just kind of surprised, under

 18 this kind of condition, why did the Company wait 13 years

 19 to come in for a rate case? I mean, didn't you feel the

 20 pressure then or in the past that you should be coming

 21 forth and trying to better the rate of return for your

 22 stockholders?

 23 A I think Mr. Redmond made a commitment at

 24 one time actually in this Hearing Room or the one before

 25 it was remodeled that we would try to have a rate freeze

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 1 for 10 years and I think that was part of what we looked

 2 at. The way the events unfolded in terms of the interest

 3 rates decreasing, what the Company did to keep out of a

 4 rate case, I think all that did factor into not coming

 5 in, but this case in particular, the gain on the

 6 Centralia case, is in a way independent of an increase

 7 for -- a request for a rate case and, again, the reason

 8 to cite the rate of return was only to show that there

 9 hadn't been any undue enrichment in the past. It wasn't

 10 cited to show that we were unfairly treated. It was to

 11 show that there wasn't any windfall profits in there that

 12 would have offset the $96 million worth of write-offs

 13 that we had, so I don't consider this in the same, I

 14 guess, framework as a general rate case filing.

 15 COMMISSIONER HANSEN: That's all I have.

 16 COMMISSIONER SMITH: Do we have redirect,

 17 Mr. Dahlke?

 18 MR. DAHLKE: No redirect.

 19 COMMISSIONER SMITH: Thank you,

 20 Mr. Dukich.

 21 (The witness left the stand.)

 22 MR. DAHLKE: The next witness is Mr. Ronald

 23 McKenzie.

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 1 RONALD L. McKENZIE,

 2 produced as a witness at the instance of Avista

 3 Corporation, having been first duly sworn, was examined

 4 and testified as follows:

 5

 6 DIRECT EXAMINATION

 7

 8 BY MR. DAHLKE:

 9 Q Mr. McKenzie, would you please state your

 10 full name and position?

 11 A My name is Ronald L. McKenzie. I'm a

 12 senior rate accountant with Avista Corporation.

 13 Q And, Mr. McKenzie, have you prepared

 14 prefiled direct testimony and prefiled rebuttal testimony

 15 for this proceeding?

 16 A Yes, I have.

 17 Q Do you have that testimony with you?

 18 A Yes.

 19 Q Do you have any corrections or changes to

 20 your prefiled testimony?

 21 A No, I do not.

 22 Q If I were to ask you the questions

 23 contained in that testimony, would your answers be the

 24 same?

 25 A Yes.

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 CSB REPORTING McKENZIE (Di)

 Wilder, Idaho 83676 Avista

 1 Q And are you also sponsoring Exhibits 7 and

 2 8 with your direct testimony?

 3 A Yes, I am.

 4 Q Do you have any additional comments that

 5 you need to make with regard to the changes in the

 6 prefiled testimony of Kathleen Stockton that is referred

 7 to in your rebuttal testimony but was delivered to you

 8 subsequent to the filing of your rebuttal testimony?

 9 A I've made no changes to my rebuttal

 10 testimony based on the changes of Ms. Stockton. My

 11 rebuttal testimony is based on her original testimony

 12 before the revisions and some of the revisions that she

 13 made were a result of reviewing my rebuttal testimony.

 14 MR. DAHLKE: With that, I'd move that

 15 Mr. McKenzie's direct testimony and rebuttal testimony be

 16 spread on the record and that Exhibits 7 and 8 be

 17 admitted into evidence.

 18 COMMISSIONER SMITH: If there's no

 19 objection, it is so ordered.

 20 (Avista Corporation Exhibit Nos. 7 & 8

 21 were admitted into evidence.)

 22 (The following prefiled direct and

 23 rebuttal testimony of Mr. Ronald McKenzie is spread upon

 24 the record.)

 25

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 CSB REPORTING McKENZIE (Di)

 Wilder, Idaho 83676 Avista

 1 Q Please state your name, business address

 2 and present position with Avista Corporation ("Avista").

 3 A My name is Ronald L. McKenzie and my

 4 business address is East 1411 Mission Avenue, Spokane,

 5 Washington. I am employed by Avista as a Senior Rate

 6 Accountant.

 7 Q Would you briefly describe your educational

 8 background?

 9 A I was graduated from Eastern Washington

 10 University in 1973 with a Bachelor of Arts degree in

 11 Business Administration majoring in accounting. I

 12 obtained a Master of Business Administration Degree from

 13 Eastern Washington University in 1989. I have attended

 14 several utility accounting and ratemaking courses and

 15 workshops.

 16 Q How long have you been employed by Avista

 17 and what are your present duties?

 18 A I was first employed by Avista in September

 19 1974. My present duties include preparing data related

 20 to regulatory matters and presenting testimony before

 21 regulatory commissions.

 22 Q Have you previously testified before this

 23 Commission?

 24 A Yes. I have testified before this

 25 Commission in several prior proceedings.

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 McKenzie, Di 1

 Avista

 1 Q What is the scope of your testimony in this

 2 proceeding?

 3 A My testimony in this proceeding addresses

 4 the calculation of the gain associated with the sale of

 5 Avista's 15% share of the Centralia Power Plant to TECWA

 6 Power, Inc. ("TECWA"). I also set forth proposed

 7 accounting entries to record the sales transaction. I

 8 discuss the Company's proposed ratemaking treatment in

 9 the event that the Commission allocates a

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 McKenzie, Di 1a

 Avista

 1 portion of the gain to customers.

 2 Q How did Avista originally plan to treat the

 3 gain resulting from the sale?

 4 A In its application Avista originally

 5 proposed to defer the gain on the sale and to decide the

 6 issue of allocation of the gain between shareholders and

 7 customers in a future proceeding.

 8 Q Are you sponsoring any exhibits?

 9 A Yes. I am sponsoring Exhibit No. 7 which

 10 consists of three pages and Exhibit No. 8 which consists

 11 of two pages.

 12 Q Will you please explain page 1 of Exhibit

 13 No. 7?

 14 A Yes. Page 1 shows the estimated cash

 15 proceeds from the plant sale, the estimated income tax

 16 calculation and the estimated after tax gain. The plant

 17 sale price that Avista expects to receive is 15% of

 18 $454,698,000, or $68,204,700. Avista's share is subject

 19 to an adjustment which will be determined based on what

 20 PacifiCorp's actual breakeven price of the mine turns out

 21 to be in comparison to the sales price of the mine.

 22 Avista's share of the sale of the 230KV transmission

 23 system amounts to $18,000. The purchase price is reduced

 24 by $2,100,000 for employee benefit obligations with

 25 Avista's 15% share amounting to $315,000. The purchase

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 McKenzie, Di 2

 Avista

 1 price is further reduced by the amount of expected

 2 reclamation accruals with Avista's share amounting to

 3 $8,610,000. Projected closing costs amount to $625,000.

 4 TECWA is reimbursing plant additions and RACT (Reasonably

 5 Available Control Technology) compliance expenditures.

 6 Coal inventory is being purchased at a price determined

 7 by the cost of the last 100,000 tons of coal delivered by

 8 rail adjusted by the heating value of the coal in

 9 inventory delivered from the

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 Avista

 1 mine. TECWA is purchasing supplies at original cost.

 2 The total projected cash proceeds amounts to

 3 approximately $67,800,000. The estimated income tax

 4 expense amounts to approximately $19,100,000 and the

 5 after tax gain is projected to be approximately

 6 $29,600,000.

 7 Q Would you please explain pages 2 and 3 of

 8 Exhibit No. 7?

 9 A Yes. Page 2 of Exhibit No. 7 shows the

 10 projected accounting entries for Avista. Page 3 consists

 11 of notes that relate to the proposed accounting entries

 12 on page 2.

 13 Q Is the gain subject to change as well as

 14 the accounting entries?

 15 A Yes. There are a number of factors that

 16 will affect the amount of the gain as well as the

 17 accounting entries. Such factors include the closing

 18 date of the sale, the difference between PacifiCorp's

 19 actual breakeven price of the mine and the sales price of

 20 the mine, the valuation of coal inventory, and the true

 21 up of estimates to actuals once actual information is

 22 available.

 23 Q Will Avista provide the Commission with

 24 final accounting entries?

 25 A Yes. Avista will provide the Commission

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 McKenzie, Di 3

 Avista

 1 with final accounting entries that will include a final

 2 calculation of the gain.

 3 Q Turning now to the gain on the sale of

 4 Centralia, what is the Company's position on the

 5 disposition of the gain?

 6 A As indicated in Mr. Dukich's testimony, the

 7 Company is proposing that all the gain should be assigned

 8 to shareholders.

 9 Q In the event the Commission allocates a

 10 portion of the gain to customers, such as the

 11 depreciation method proposed by PacifiCorp, does the

 12 Company have a specific proposal on the ratemaking

 13 treatment for the

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 McKenzie, Di 3a

 Avista

 1 customers' share of the gain?

 2 A Yes. If the Commission were to allocate a

 3 portion of the gain to customers based on the

 4 depreciation method proposed by PacifiCorp, it would

 5 result in a sharing of the gain between customers and

 6 shareholders as shown on page 1 of Exhibit No. 8. Line 4

 7 shows the customer percentage of the gain being 69.70%

 8 based on the ratio of accumulated depreciation to gross

 9 plant. Line 8 shows the dollar amount of the customer

 10 portion of the estimated gain amounting to approximately

 11 $20,635,000. Line 10 shows the allocation of the

 12 customer portion of the gain to jurisdictions based on

 13 the production/transmission allocation formula with the

 14 Idaho portion of the customer share of the gain amounting

 15 to approximately $6,800,000.

 16 Q Is the method of allocating the gain

 17 between shareholders and customers in Exhibit No. 8 the

 18 same method being proposed by PacifiCorp?

 19 A Yes. This method allocates the gain

 20 between shareholders and customers on the ratio of

 21 undepreciated plant (gross plant less accumulated

 22 depreciation) to gross plant for the shareholder share of

 23 the gain, and on the ratio of depreciated plant to gross

 24 plant for the customer share of the gain. This is the

 25 same methodology being proposed by PacifiCorp for

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 McKenzie, Di 4

 Avista

 1 allocating their gain on sale of the Centralia Power

 2 Plant.

 3 Q How does the Company propose to handle the

 4 customer portion of the gain for ratemaking purposes, if

 5 a portion of the gain is allocated to customers?

 6 A Page 2 of Exhibit No. 8 shows that the

 7 Company proposes to use the customer portion of the gain

 8 to: 1) offset costs related to storm damage repair costs

 9 in Idaho resulting from Ice Storm 1996, 2) offset the

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 McKenzie, Di 4a

 Avista

 1 Idaho electric portion of the remaining transition

 2 obligation for postretirement health care and life

 3 insurance benefits, 3) offset the costs associated by the

 4 buy-out of a PURPA contract, and 4) offset a portion of

 5 the cost of the initial payment to settle the Nez Perce

 6 lawsuit.

 7 Q How does the Company propose that the

 8 customer portion of the gain be treated for ratemaking

 9 purposes in the event that the Commission allocates a

 10 smaller percentage of the gain to customers than that

 11 allocated under the depreciation method?

 12 A In that event, the Company proposes that

 13 the customers' share of the gain be used in the order

 14 listed on page 2 of Exhibit No. 8. The gain should first

 15 be used to offset all or a portion of the costs related

 16 to storm damages in Idaho resulting from Ice Storm 1996.

 17 Then, if any customer gain remains, the remaining gain be

 18 used to offset all or a portion of the transition

 19 obligation for postretirement health care and life

 20 insurance benefits. Any remaining customer gain would

 21 then be used to offset all or a portion of PURPA contract

 22 buy-out. And finally, any remaining customer gain would

 23 be used to offset a portion of the initial payment to

 24 settle the Nez Perce lawsuit.

 25 Q Will the Company's revenue requirement in

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 McKenzie, Di 5

 Avista

 1 its next general electric rate case be impacted by the

 2 Company's proposal on how to handle the customer portion

 3 of the gain?

 4 A Yes. All of the items identified above

 5 with the exception of Ice Storm will have the effect of

 6 reducing the revenue requirement in the Company's next

 7 general electric rate case.

 8 Q Is there a rationale for using the four

 9 items identified above to

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 1 offset any customer portion of the gain?

 2 A Yes. The gain on the sale of the Centralia

 3 Power Plant is the type of event that does not occur on a

 4 regular basis. Likewise, the storm damage costs from Ice

 5 Storm 1996 relate to an unusual event. The

 6 postretirement benefit transition costs resulted from a

 7 one-time, accounting change. The PURPA contract buy-out

 8 and the Nez Perce lawsuit payment are also one-time

 9 events. The combined amount of the four offset items

 10 equal the customer portion of the gain under the

 11 depreciation method of allocating the gain, and three of

 12 the four offset items will benefit customers by reducing

 13 revenue requirements in future electric general rate

 14 cases.

 15 Q Did the Commission disallow recovery of Ice

 16 Storm in Avista's last electric rate case?

 17 A Yes. The Commission in its Order No. 28097

 18 in Case No. WWP-E-98-11 at page 11 did disallow recovery

 19 of Ice Storm costs.

 20 Q Considering the prior disallowance, why do

 21 you believe that a portion of the any customer share of

 22 the Centralia gain be first used to offset Ice Storm

 23 costs?

 24 A The Commission's Order dealt with not

 25 allowing recovery of Ice Storm costs through rates. The

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 McKenzie, Di 6

 Avista

 1 Commission used the rationale that Ice Storm was an

 2 extraordinary, non-recurring expense. Certainly, the

 3 sale of the Centralia Power Plant falls into the same

 4 category as Ice Storm of being an extraordinary and

 5 non-recurring type of event. The Company's proposal does

 6 not violate Order 28097 as no recovery of Ice Storm is

 7 being sought through rates. Rather, a portion of the

 8 extraordinary, non-recurring gain from the sale of

 9 Centralia is being proposed to offset the extraordinary,

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 1 recurring cost of Ice Storm.

 2 Q Does that conclude your direct testimony in

 3 this proceeding?

 4 A Yes, it does.

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 McKenzie, Di 7

 Avista

 1 Q Please state your name, business address

 2 and present position with Avista Corporation ("Avista").

 3 A My name is Ronald L. McKenzie and my

 4 business address is East 1411 Mission Avenue, Spokane,

 5 Washington. I am employed by Avista as a Senior Rate

 6 Accountant.

 7 Q Have you previously submitted direct

 8 testimony in this proceeding?

 9 A Yes.

 10 Q What is the scope of your rebuttal

 11 testimony in this proceeding?

 12 A My rebuttal testimony responds to the

 13 direct testimony of Commission Staff witness, Kathleen L.

 14 Stockton, and Potlatch Corporation witness, Dennis E.

 15 Peseau. I explain why Avista's proposal on how to

 16 utilize the customer share of the gain for ratemaking

 17 purposes is appropriate and will not result in a double

 18 recovery of costs. I explain several corrections to

 19 Ms. Stockton's revenue requirement calculation and

 20 explain why her proposal is not appropriate. My rebuttal

 21 testimony explains why Dr. Peseau's calculation of the

 22 customer share of the gain is incorrect. I also explain

 23 why the Potlatch contract should receive absolutely no

 24 share of any customer portion of the gain and that any

 25 revenue adjustments should be spread on a uniform

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 McKenzie, Reb 1

 Avista

 1 percentage basis.

 2 Q Would you please restate Avista's position

 3 on the disposition of the gain on the sale of the

 4 Centralia Power Plant?

 5 A Yes. As indicated in Mr. Dukich's

 6 testimony, Avista is proposing that all the gain should

 7 be assigned to shareholders. In the event

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 McKenzie, Reb 1a

 Avista

 1 the Commission allocates a portion of the gain to

 2 customers, such as the depreciation method proposed by

 3 PacifiCorp, Avista is proposing that any customer portion

 4 of the gain by used to offset the specific items

 5 identified in my direct testimony. The first offset item

 6 that I identify is Ice Storm 1996.

 7 Q Would you please respond to Ms. Stockton's

 8 position that it is not appropriate to use the gain on

 9 the sale of Centralia to offset the unrecovered costs of

 10 the Ice Storm 1996?

 11 A Yes. Beginning at page 13, line 19,

 12 Ms. Stockton argues that since the Commission did not

 13 allow recovery of Ice Storm costs through present rates

 14 in Avista's recently concluded general rate case, it is

 15 not appropriate to request recovery of those costs now.

 16 Avista is not requesting recovery of Ice Storm costs

 17 through rates. Avista is requesting that a portion of

 18 any customer portion of the gain be first used to offset

 19 Ice Storm costs.

 20 At page 13, beginning at line 6, of her testimony

 21 Ms. Stockton argues that, "It is clear that the

 22 Commission did not allow recovery of the Ice Storm costs

 23 through present rates, and did not intend for the Company

 24 to request relief at an even later time." It is clear is

 25 that the Commission did not allow recovery of Ice Storm

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 McKenzie, Reb 2

 Avista

 1 costs through present rates. It is certainly not clear

 2 that the Commission precluded offsetting a portion of any

 3 customer share of the Centralia gain against Ice Storm

 4 costs.

 5 Q Would you please respond to Ms. Stockton's

 6 testimony that the sale of the Centralia Plant is a

 7 "usual" event and is therefore not in the same "unusual"

 8 event category as an ice storm?

 9 A Yes. In its over 110-year history, this is

 10 the first major generating resource ever sold by the

 11 Company. The sale of the Centralia

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 McKenzie, Reb 2a

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 1 Power Plant is an unusual event. At page 14, beginning

 2 at line 23, of her testimony Ms. Stockton attempts to put

 3 the sale of Centralia into the "normal course of

 4 business" category. This is simply not the case. It is

 5 not Avista's normal course of business to sell its

 6 generating assets. Avista's normal course of its

 7 electric utility business is to generate, transmit and

 8 distribute power to its customers. The sale of Centralia

 9 is an extraordinary, non-recurring type of event.

 10 Q Would you please respond to Ms. Stockton's

 11 testimony pertaining to the other three offset items

 12 Avista is proposing?

 13 A Yes. At page 15, beginning at line 8, of

 14 her testimony Ms. Stockton disagrees with using any

 15 customer portion of the gain to offset postretirement

 16 benefit transition costs, a PURPA contract buyout, and a

 17 portion of the Nez Perce initial lawsuit settlement

 18 payment. She argues that since customers are currently

 19 paying the yearly amortization of these costs through

 20 rates, that approving an offset for these costs would

 21 allow over-recovery.

 22 Avista is proposing to offset any customer portion

 23 of the gain by first offsetting the costs associated with

 24 Ice Storm and then by writing off all or a portion of the

 25 unamortized balances related to the three items listed

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 McKenzie, Reb 3

 Avista

 1 above. It was not Avista's intent to over-recover costs

 2 associated with the proposed write-off items. Avista

 3 originally proposed to wait until its next general rate

 4 case to adjust the revenue requirement to recognize the

 5 elimination or reduction in the amortization expenses

 6 related to these items. Between rate cases Avista may

 7 experience reductions in some costs, but the majority of

 8 its costs increase. Hence, Avista did not believe that

 9 there would

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 McKenzie, Reb 3a

 Avista

 1 be an over-recovery of costs associated with the proposed

 2 write-off amounts between rate cases.

 3 If the Commission were to allocate a portion of

 4 the gain to customers using the depreciation method and

 5 determine that a rate adjustment is appropriate for the

 6 offsets shown on page 2 of Exhibit No. 8, the reduction

 7 in the Idaho electric annual revenue requirement would be

 8 $816,000. Worksheets showing the calculation of this

 9 amount have been provided to the Staff.

 10 Q Is there an inconsistency in Staff's

 11 testimony regarding the adjustment of revenues for

 12 changes occurring since the recently approved rate case?

 13 A Yes. While Ms. Stockton claims that unless

 14 rates are adjusted, there will be an over-recovery of

 15 costs; another Staff witness, Mr. Lobb, at page 13,

 16 beginning at line 1, recognizes that replacement power

 17 costs are expected to increase the revenue requirement

 18 above the level associated with Centralia in the recent

 19 general rate case, but argues that the revenue

 20 requirement not be changed until a future rate case.

 21 Q Does Ms. Stockton's testimony contain

 22 inconsistencies regarding the treatment of gains and

 23 losses?

 24 A Yes. At page 9 of her testimony, beginning

 25 at line 6, she cites Case No. IPC-E-93-20, an Idaho Power

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 McKenzie, Reb 4

 Avista

 1 Company case dealing with a loss on the sale of

 2 distribution facilities. In that case Idaho Power

 3 Company requested that the loss be absorbed in the

 4 accumulated reserve for depreciation account. Under that

 5 proposed treatment the reserve balance would be depleted

 6 which would cause an increase in Idaho Power

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 McKenzie, Reb 4a

 Avista

 1 Company's rate base. In the future, depreciation rates

 2 would also increase due to the loss. The Commission

 3 Staff recommended that the loss from the sale be placed

 4 into a regulatory asset account to be amortized over a

 5 period of ten years. The unamortized balance of the loss

 6 would be excluded from rate base and the annual

 7 amortization expense would be included in the revenue

 8 requirement. The Commission rejected Idaho Power

 9 Company's proposal and accepted the Staff's proposal of

 10 an amortization with no return on the unamortized

 11 balance.

 12 In the current case, Ms. Stockton is recommending

 13 a treatment of the gain on the sale of Centralia that the

 14 Staff opposed and the Commission rejected in the Idaho

 15 Power Company case. Ms. Stockton proposes, beginning on

 16 page 16 at line 10 of her direct testimony, that the gain

 17 be credited to accumulated depreciation, that rate base

 18 be lowered and that depreciation expense be reduced. In

 19 the Idaho Power Company case Staff proposed an

 20 amortization with no return on the unamortized balance

 21 and in this case Staff is proposing an amortization with

 22 a return on the unamortized balance.

 23 Q Do you have any problem with Ms. Stockton's

 24 calculation of her proposed reduction in revenue

 25 requirement shown on Exhitbit No. 104?

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 McKenzie, Reb 5

 Avista

 1 A Yes. The Staff proposed reduction in rate

 2 base should be an average that takes into account the

 3 first year of amortization of the gain. In addition,

 4 preferred trust securities have tax deductible interest.

 5 Hence, the weighted cost of preferred trust securities

 6 should be excluded from the preferred equity return and

 7 included with the debt return. A corrected calculation

 8 has been provided in the workpapers submitted to the

 9 Staff. It

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 McKenzie, Reb 5a

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 1 should be noted that based on an amortization rate of

 2 3.38%, the effective amortization period used by

 3 Ms. Stockton is 29.6 years.

 4 Q Turning now to Potlatch's testimony, does

 5 Dr. Peseau modify Avista's calculation of the customers'

 6 share of the gain under the depreciation method?

 7 A Yes. Avista's calculation of the

 8 customers' share of the gain under the depreciation

 9 method is shown on my Exhibit No. 8, page 1 of 2. The

 10 69.70% customer share is calculated by dividing

 11 accumulated depreciation by gross plant. Dr. Peseau

 12 changes the calculation on his Exhibit No. 203 by adding

 13 $4,000,000 of deferred income taxes to accumulated

 14 depreciation and then divides that sum by gross plant to

 15 produce a customer share of 76.63%.

 16 Q Is Dr. Peseau's adjustment appropriate?

 17 A Absolutely not. The Commission should

 18 reject Dr. Peseau's adjustment of directly assigning

 19 deferred income taxes to the customer share. The

 20 depreciation method of allocating the gain is an approach

 21 that, if adopted, should not include components other

 22 than gross plant and accumulated depreciation. Specific

 23 components such as income taxes should not be singled out

 24 for assignment to either customers or shareholders.

 25 While Avista is not proposing to directly assign

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 McKenzie, Reb 6

 Avista

 1 components of the net of tax gain, one such direct

 2 assignment that would drastically reduce the benefit to

 3 customers is a direct assignment of federal income tax

 4 associated with the sale. Federal income tax associated

 5 with the sale will be computed on the difference between

 6 the sales price and the net depreciated tax basis of the

 7 plant. Hence, a portion of the taxable gain relates to

 8 the cumulative

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 McKenzie, Reb 6a

 Avista

 1 amount of depreciation taken for tax purposes. It is

 2 estimated that accumulated tax depreciation at December

 3 31, 1999 will be $44,767,210 and the associated federal

 4 income tax on that portion of the gain will be

 5 $15,668,523 ($44,767,210 x 35%). Since tax benefits

 6 relating to approximately $42,029,393 or 93.88% of the

 7 total amount of tax depreciation of $44,767,210 will

 8 cumulatively have been passed on to customers at December

 9 31, 1999, 93.88% of the $15,668,523 tax on the gain or

 10 $14,709,609 could be directly assigned to customers with

 11 $958,914 being assigned to shareholders.

 12 While Dr. Peseau's inappropriate adjustment would

 13 result in an increase in the customer portion of the gain

 14 of $2,051,661 ($22,686,697-$20,635,036), he fails to

 15 recognize other adjustments that would reduce the

 16 customer portion of the gain. Rather than $10,920,960

 17 (69.70% x $15,668,523) of federal income tax associated

 18 with tax depreciation being allocated to customers under

 19 the depreciation method, $14,709,609 could be directly

 20 assigned to customers. Such a direct assignment would

 21 reduce the amount of gain to customers by $3,788,649

 22 ($14, 709,609-$10,920,960).

 23 Q In addition to Dr. Peseau's method being

 24 theoretically flawed, does Dr. Peseau use an incorrect

 25 amount of deferred federal income taxes under his

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 McKenzie, Reb 7

 Avista

 1 approach?

 2 A Yes. Dr. Peseau argues that deferred taxes

 3 related to tax benefits associated with tax depreciation

 4 in excess of book depreciation that have not been flowed

 5 through to customers should be added to accumulated

 6 depreciation. He uses a $4,000,000 amount. The correct

 7 amount would be $993,236 from Exhibit No. 7, page 2 of 3,

 8 entry number 7. The $4,000,000 of deferred federal

 9 income taxes incorrectly used by Dr. Peseau relates to

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 McKenzie, Reb 7a

 Avista

 1 109. Among other timing differences, FAS-109 deferred

 2 tax liabilities reflect tax benefits associated with tax

 3 depreciation in excess of book depreciation that have

 4 previously been flowed through to customers.

 5 Q Would you please summarize your objections

 6 to Dr. Peseau's proposed modification to the calculation

 7 of the customer share of the gain under the depreciation

 8 approach?

 9 A Yes. The depreciation approach to

 10 allocating the gain to customers is determined by

 11 dividing accumulated depreciation by gross plant.

 12 Modifying the calculation to include deferred income

 13 taxes as Dr. Peseau proposes is not appropriate.

 14 Dr. Peseau uses an incorrect amount in his calculation.

 15 If the depreciation approach were to be modified to

 16 include deferred income taxes, a direct assignment of

 17 federal income tax associated with the sale would

 18 drastically reduce the benefit to customers.

 19 Q Would you please comment on Dr. Peseau's

 20 proposal on how to distribute the customer share of the

 21 gain to retail customers?

 22 A Yes. At page 24, beginning at line 1, of

 23 Dr. Peseau's testimony he claims that the customer share

 24 of the gain should be allocated to retail customers based

 25 on annual energy consumption. He further states that

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 McKenzie, Reb 8

 Avista

 1 large industrial customers and contract customers should

 2 receive a single billing credit or a check with other

 3 customers receiving a credit over the course of a year.

 4 The Commission should not adopt Dr. Peseau's

 5 proposal. Any rate reduction should be spread to

 6 customer classes, excluding the Potlatch special

 7 contract, on a uniform percentage basis as proposed by

 8 Mr. Lobb at page 12 of his direct testimony, beginning at

 9 line 16. The Potlatch special contract is

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 McKenzie, Reb 8a

 Avista

 1 not subject to price adjustments, either increases or

 2 decreases. The Potlatch special contract has been

 3 exempted from Power Cost Adjustment (PCA) rebates and

 4 surcharges, from the Demand Side Management (DSM) tariff

 5 rider and from the recent general rate increase effective

 6 August 1, 1999. The Potlatch special contract should get

 7 no share of any price reduction associated with gain on

 8 sale of the Centralia Power Plant. A uniform percentage

 9 basis of spreading a rate reduction is more appropriate

 10 than a uniform cents-per-kilowatt-hour basis since a

 11 uniform percentage basis more closely resembles the

 12 spread of general rate changes in the past and since PCA

 13 rebates and surcharges as well as the DSM tariff rider

 14 are spread to rate schedules on a uniform percentage

 15 basis.

 16 Q Does that conclude your rebuttal testimony

 17 in this proceeding?

 18 A Yes, it does.

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 McKenzie, Reb 9

 Avista

 1 (The following proceedings were had in

 2 open hearing.)

 3 MR. DAHLKE: Mr. McKenzie is available for

 4 cross-examination.

 5 COMMISSIONER SMITH: Mr. Ward, do you have

 6 questions for Mr. McKenzie?

 7 MR. WARD: I do.

 8

 9 CROSS-EXAMINATION

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 11 BY MR. WARD:

 12 Q Mr. McKenzie, my questions will fall into

 13 two broad categories. The first ones have to do not with

 14 the question of how to allocate the gain on the sale but

 15 with the manner of accounting for the disposition of

 16 Centralia itself, so I just want you to know that's where

 17 I'm directed in case I'm unclear.

 18 With regard to Centralia and the sale and

 19 the accounting for it, as I understand it, the Company's

 20 position is, first of all, Mr. Johnson conducted an

 21 analysis that finds at least under one scenario that the

 22 present value of the sale versus continued operations

 23 produce roughly a $7.7 million 20-year net present value

 24 benefit associated with the sale; correct?

 25 A I'd state it a little bit differently.

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 Mr. Johnson's analysis looks at the continued operation

 2 of the mine versus replacement power options and that

 3 comparison results in his present value benefit to

 4 customers.

 5 Q Fine, I'll accept that, and would it be

 6 fair for me to assume that insofar as the actual

 7 accounting on the Company's books as opposed from

 8 regulatory accounting, the accounting on the Company's

 9 books for the sale will in fact remove the Centralia

 10 asset and accumulated depreciation from the Company's

 11 books?

 12 A Yes.

 13 Q But on the regulatory side, it seems to me,

 14 and certainly if you disagree with my paraphrase, feel

 15 free to do so, it seems to me that -- well, first of all,

 16 on the regulatory side, the Company has not proposed, has

 17 it, to delete Centralia from rate base and adjust rates

 18 accordingly?

 19 A Not in this proceeding, no, but that would

 20 be a result in a future proceeding, a future general rate

 21 case.

 22 Q If in fact -- you were a witness in the

 23 prior rate case, were you not?

 24 A No, I was not.

 25 Q Were you in attendance?

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 A Yes.

 2 Q And would it be fair to say that in

 3 response to a motion and argument by Potlatch that

 4 regarding the then pending Centralia sale that the

 5 Company took the position that that sale was not a known

 6 and measurable and reliable adjustment to rates at that

 7 point?

 8 A I would agree with that characterization,

 9 yes.

 10 Q And the Commission accepted that argument,

 11 did it not?

 12 A Yes.

 13 Q Had the Commission not accepted that

 14 argument and determined that the sale was a known and

 15 measurable adjustment, would not the appropriate

 16 accounting treatment, regulatory accounting treatment,

 17 been the same as the book treatment; that is, the removal

 18 of a plant from rate base, both with respect to the asset

 19 value and the accumulated depreciation?

 20 A That would be one of the adjustments, but

 21 you'd also have to factor in replacement power.

 22 Q And if you know, I recognize this isn't

 23 your field, doesn't the power cost adjustment provision

 24 for Avista capture power purchases and changes in power

 25 supply costs?

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 A The power cost adjustment only captures

 2 changes in power supply costs due to changes in

 3 streamflow conditions, actual conditions compared to the

 4 average that's built into its rates.

 5 Q The costs, however, are themselves, the

 6 base costs are themselves, calculated not only using

 7 streamflows but other fuel sources, are they not?

 8 A Not other fuel sources. The costs of

 9 short-term purchases and sales are determined to evaluate

 10 the difference in power costs due to the change in

 11 streamflows, but these questions are more properly

 12 addressed to Mr. Johnson.

 13 Q Okay. Let me leave that, then, and go back

 14 to my basic question. Why didn't the Company in this

 15 case account for the sale of Centralia in the same manner

 16 that it would if we were looking at an ordinary rate

 17 proceeding; that is, the removal of the plant from rate

 18 base and associated adjustments?

 19 A First off, the sale has not occurred yet,

 20 so there's uncertainty at this point in time of making

 21 that adjustment. The other point is, and Mr. Johnson

 22 would be the witness that would respond to this question,

 23 what the replacement power cost is in comparison to the

 24 cost of Centralia power.

 25 Q Well, I don't want to cross you on

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 Mr. Johnson's testimony, but you are aware, are you not,

 2 that he postulates a most likely scenario of decreased

 3 costs?

 4 A Over his time horizon. I'm not sure

 5 exactly in the short term, one- to three-year period,

 6 what the comparison is, but over the long term, he's

 7 demonstrating a benefit to customers.

 8 Q Do you happen to have Mr. Johnson's

 9 testimony and exhibits with you?

 10 A Yes, I do.

 11 Q If you'd turn to page 2 of Exhibit No. 1,

 12 do you have that?

 13 A Yes.

 14 Q Those -- let's look at the, since we're in

 15 this year now, the three postulated scenarios for

 16 replacement power costs and do you see those three

 17 numbers there beginning with 25.21?

 18 A Yes.

 19 Q If you go back a page to the 2000

 20 calculation of Centralia costs, scan over to the far

 21 right-hand side and you'll see that cost listed as $26.45

 22 per megawatt-hour, do you see that?

 23 A Yes.

 24 Q Doesn't that suggest to you that even in

 25 the short term Mr. Johnson projects that there will be

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 immediate savings from the substitution of purchased

 2 power for the Centralia plant?

 3 A Comparing those two numbers, that is the

 4 result, but I'm not sure that that is what actually is

 5 occurring or has occurred. Mr. Johnson talked about a

 6 replacement purchase that's already been made, the terms

 7 of which are confidential, and you should address

 8 questions regarding Mr. Johnson's exhibits and cost to

 9 Mr. Johnson.

 10 Q All right, but given the way that the

 11 Company has treated this application, if there are cost

 12 savings, those will not result in any rate reductions,

 13 will they?

 14 A Well, the Company is proposing some offsets

 15 that would result in future rate reductions under its

 16 proposal.

 17 Q But only after a rate hearing sometime in

 18 the future, if ever?

 19 A No. My testimony leaves the option up to

 20 the Commission. They could adjust rates after they

 21 approve the sale currently and I identify an amount of

 22 that adjustment in my rebuttal testimony.

 23 Q Let's leave the subject and go now to the

 24 treatment of the gain. Starting with your direct

 25 testimony, if you'd turn to that, now, beginning on about

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 page 4 of your testimony, you discuss the use of any

 2 customer portion of the gain to reduce certain items on

 3 the books, that are currently on the books, you obviously

 4 recall that testimony?

 5 A Yes.

 6 Q I'm going to leave aside the ice storm

 7 which I think is pretty well covered and let's focus on

 8 the other three items, if you would, and you list those

 9 at the bottom of page 4 and page 5. Now, would you agree

 10 with me that the existing rates of the Company have a

 11 component designed to recover the amortization of those

 12 three costs?

 13 A Yes, they do.

 14 Q And going back to the rate case, if this

 15 proceeding had occurred as part of the rate case and the

 16 Commission were to accept your proposal, that is, the

 17 assignment or the use of some of the proceeds to write

 18 down these accounts, that would have decreased rates,

 19 would it not?

 20 A It would have made the revenue requirement

 21 smaller, yes.

 22 Q Okay. Now, in this case if the Commission

 23 accepts your proposal as is, will rates decrease?

 24 A Again, as I previously stated, my rebuttal

 25 testimony identifies a rate decrease associated with

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 these three offset items and leaves the option up to the

 2 Commission of whether or not rates should be adjusted.

 3 We bring up the fact that the majority of our costs

 4 increase over time and we don't feel that we would be

 5 over-collecting on these offset items, but, again, the

 6 Commission has the option of changing the Company's

 7 rates.

 8 Q Okay.

 9 A The amount is identified on page 4 of my

 10 rebuttal testimony, line 7, $816,000.

 11 Q Well, I wanted to come back to that in a

 12 bit, but are you then withdrawing your original proposal

 13 that's contained in your direct testimony?

 14 A No.

 15 Q All right, let me ask you one further

 16 question about the original proposal. I don't know what

 17 the life, the amortization life, of those accounts were,

 18 but let's assume it was three years. Do you have that

 19 hypothesis in front of you?

 20 A I have the hypothesis, but the amortization

 21 periods were much longer than that. In the case of the

 22 Nez Perce settlement, it was 45 years.

 23 Q If in fact -- well, maybe there's an easier

 24 way to ask it. If the Company were not to come in for

 25 another general rate case for another 13 years, can you

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 accept that happy hypothesis?

 2 A Okay.

 3 Q Isn't it true that to the extent the

 4 Company recovers some or all of these items up front

 5 without a rate adjustment that at any time that the

 6 combination of the amortization process and the

 7 contribution from the gain zeros out the account

 8 thereafter the Company will overrecover in rates?

 9 A I don't agree with that statement. You

 10 have to look at the Company's overall costs to determine

 11 whether its earnings have been excessive or not and over

 12 time costs generally tend to increase, so there are

 13 offsets to any reductions that might occur in specific

 14 cost items.

 15 Q That's fair enough. Would my hypothesis be

 16 true if you assume all other things are equal?

 17 A If all of the other Company's costs

 18 remained the same, yes, your hypothesis would be true.

 19 Q Okay. Turning to the rebuttal testimony,

 20 if you would, we have on pages -- beginning at the bottom

 21 of page 6 and through page 7, there's a discussion that

 22 took me a very long time to wade through and understand,

 23 but I think I have it now, so let me see if that's in

 24 fact the case. Here you are responding to Dr. Peseau's

 25 proposal regarding deferred taxes and one of your

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 observations is that a certain portion of the gain,

 2 $40 million plus, comes from the reduction of asset value

 3 because of depreciation. That's your first hypothesis;

 4 correct?

 5 A Yes.

 6 Q And then you say because the customers

 7 furnished those funds to reduce the asset value, we could

 8 attribute the income tax consequences to the customers;

 9 isn't that the next step in the syllogism?

 10 A No. The point I'm making is because of

 11 flow-through treatment of tax benefits for plant

 12 additions made prior to 1981, customers have received

 13 reductions in rates for the flow-through of those tax

 14 benefits amounting to about 93.9 percent of the total tax

 15 depreciation, so they've received a benefit, so you could

 16 directly assign the tax on that piece of the gain to the

 17 customers because they've previously received the

 18 benefit.

 19 Q Are you saying they received a benefit

 20 because the Company was able to take a deduction for

 21 depreciation?

 22 A Yes. They received the amount of reduction

 23 in tax expense from the tax depreciation that was taken

 24 and that was a benefit to customers.

 25 Q Isn't it the normal assumption that the

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 owner of the Company receives the benefit of depreciation

 2 in that sense; in other words, his return is his cash

 3 flow minus depreciation and, of course, other non-cash

 4 items?

 5 A Well, revenues reflected the pass-through

 6 of the benefits, so there was no net income effect to the

 7 Company.

 8 Q Let me try one more time, Mr. McKenzie. If

 9 I'm the customer and you're the owner of Avista and you

 10 have a $10.00 revenue requirement, part of that revenue

 11 requirement -- and let's say that part of that revenue

 12 requirement consists of $1.00 for depreciation. Okay, in

 13 my rates, I give you $3.00 or whatever, including the

 14 $1.00 for depreciation and that's what happens in

 15 ratemaking, isn't it?

 16 A In that simple example, yes, but there's

 17 also tax depreciation than may be different than book

 18 depreciation and that's exactly what happened here. Tax

 19 depreciation exceeded book depreciation and the tax

 20 effect of that was flowed through, the benefit was flowed

 21 through, to customers and resulted in revenues being

 22 lower than what they would have been if the tax deduction

 23 was based on book depreciation.

 24 Q I understand that, Mr. McKenzie, but I'm

 25 trying to divorce the idea right at the moment of tax

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 timing differences from the first -- from the larger

 2 portion of your testimony in which you suggest that the

 3 ratepayers would become responsible for 93.88 percent of

 4 the tax on the gain because they paid depreciation.

 5 That's a separate allegation, okay?

 6 Let me try to cut to the chase and get at

 7 it another way. How could the ratepayers become

 8 responsible for the tax on a gain that in effect -- when

 9 in effect they don't receive all the gain?

 10 A I think what I'm trying to explain in my

 11 testimony is that if you want to make direct assignments,

 12 like Dr. Peseau is suggesting making a tweak to the

 13 accumulated depreciation method, that if you decide to

 14 make that tweak, which is incorrect because he uses an

 15 incorrect number, then you need to also look at other

 16 things that could be directly assigned that would

 17 influence the allocation of the gain and the tax on the

 18 tax depreciation recapture could be almost entirely

 19 directly assigned to customers because they've received

 20 those tax benefits over time.

 21 Q Well, I can't speak for the other

 22 customers, Mr. McKenzie, but I can speak for Potlatch,

 23 we'd cheerfully pay it if we get the full recapture of

 24 the depreciation amount.

 25 Let me approach the witness, if I may.

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista

 1 (Mr. Ward distributing documents.)

 2 MR. WARD: This won't need to be marked.

 3 These are already exhibits in the proceeding. Now,

 4 Madam Chair, I've passed out two separate pages. The

 5 first, as you can see, is a copy of Mr. McKenzie's

 6 rebuttal, page 7, and the second is Exhibit No. 7, page 2

 7 of 3.

 8 Q BY MR. WARD: I did give you both pages,

 9 didn't I, Mr. McKenzie?

 10 A You didn't give me anything, but I do have

 11 it.

 12 Q You're the one I wanted to have access to

 13 it at the same time. I apologize.

 14 (Mr. Ward approached the witness.)

 15 Q BY MR. WARD: Now, then, nobody would

 16 characterize me as an accounting expert, Mr. McKenzie, so

 17 correct my terms if I wander off of the straight and

 18 narrow, but I'd like to ask you some general questions

 19 first and then we'll get to these two pages. In general,

 20 over many years there have been a variety of differences

 21 in booking of taxes for regulatory books on the one hand

 22 and tax books on the other; is not that true?

 23 A I'm not sure I entirely agree with that.

 24 Q Well, let's take deferred taxes. Way back

 25 in -- I can almost remember to my youth in this business

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 1 the treatment of deferred taxes was originally left to

 2 state commissions. They could flow through tax timing

 3 differences or they could normalize. Do you recall that

 4 long ago?

 5 A I recall long ago that the flow-through

 6 method was adopted for Avista for ratemaking purposes,

 7 yes.

 8 Q And in fact, some jurisdictions, and I'd

 9 suggest to you this is one, you can verify that some

 10 other time, alternated between normalization and

 11 flow-through; that is, they went from normalization to

 12 flow-through and then later on back to normalization

 13 again. Now, in the latter instance, the conversion back

 14 to normalization was mandated by federal law, was it not?

 15 A In 1981, yes, the Tax Reduction Act

 16 mandated deferred accounting for federal income taxes for

 17 property additions beginning in 1981 and beyond. The

 18 plant that existed prior to 1981 was under the old

 19 flow-through method and continued to be under the

 20 flow-through method even after 1981.

 21 Q Okay; so with respect to -- well, let's

 22 focus now for the moment on any normalized differences.

 23 If you have deferred taxes because of normalization --

 24 and that happens, does it not?

 25 A Yes.

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 1 Q -- isn't it a fact that what happens in the

 2 regulatory process is the customers, ratepayers, pay the

 3 Company for a calculated tax liability that in fact is

 4 more, typically, than the Company's actual taxes?

 5 A Yes.

 6 Q And those differences are booked as

 7 deferred taxes?

 8 A Correct.

 9 Q Now, and isn't it true that in general,

 10 those deferrals are due to different service lives and

 11 depreciation lives between regulatory books and tax

 12 books?

 13 A Yes. Normally, tax lives are shorter than

 14 book lives and also the tax rules allow for accelerated

 15 depreciation methods where the book method is a straight

 16 line method, normally.

 17 Q Now, and isn't it also true that assuming

 18 the Company keeps an asset over the entire period of its

 19 life, in theory, at least, the customers who have prepaid

 20 somewhat more than the actual income taxes due on

 21 revenues generated by a particular asset will in the end

 22 recover after some cross-over point those excess payments

 23 as the -- well, let me just ask it like that. At some

 24 cross-over point they start to recover back, do they not?

 25 A Yes. The revenue requirement is based on

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 1 the straight line book calculation and deferred taxes are

 2 just the balancing to account for the difference between

 3 the tax and the book depreciation, but deferred taxes

 4 will equal zero at some point in time.

 5 Q Okay. Now, after taking issue with

 6 Dr. Peseau's theory, you take issue with the number that

 7 he calculates for deferred tax of $4 million; correct?

 8 A Correct.

 9 Q Now, we may have inadvertently contributed

 10 to some confusion here by citing a round figure of

 11 $4 million that should have said, probably, roughly

 12 $4 million, but if you would look at -- I don't see lines

 13 on Exhibit 7. Do you see the -- oh, number 2, plant in

 14 service, below that do you see the second number 2,

 15 accumulated depreciation?

 16 A Yes.

 17 Q And that figure is 40,196,000 and change;

 18 correct?

 19 A Correct.

 20 Q Now, I want you to look over to page 7 of

 21 your testimony and on line 5 -- do you see that?

 22 A Yes.

 23 Q -- you have the total amount of tax

 24 depreciation of $44,767,210, do you see that?

 25 A Yes.

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 1 Q Isn't that difference roughly $4 million?

 2 A Yes, it is, but like I state in my

 3 testimony, my rebuttal testimony, the flow-through method

 4 of accounting flowed those tax benefits through to

 5 customers and you're comparing a tax depreciation number

 6 that includes both normalization and flow-through with

 7 the majority being flow-through.

 8 Q And you say that some portion of -- and now

 9 we have to look to your Exhibit No. 7 again, down at the

 10 bottom, just before the first line across the exhibit,

 11 there's a $4 million figure?

 12 A Under note 8?

 13 Q Yes, thank you.

 14 A Yes.

 15 Q And your testimony says some portion of

 16 that is due to -- is flowed-through items?

 17 A Correct.

 18 Q But wouldn't the correct calculation of the

 19 total deferred tax difference be note 7, 993,236, plus

 20 note 8, 4 million less whatever flowed-through items are

 21 in the account and not otherwise accounted on the

 22 Company's books?

 23 A Well, if you did that calculation, you'd

 24 add 4 million to the 993,236 and then subtract 4 million

 25 because that basically represents tax amounts that were

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 1 flowed through to customers. Note 7 there represents

 2 what you previously asked me about, under normalization,

 3 what are the deferred taxes and that's the 993,236. The

 4 reason for the 4 million under FAS-109 is basically the

 5 fact that there were flow-through tax benefits that have

 6 already been given to customers.

 7 Q Let me suggest this: Mr. McKenzie, since

 8 we have different estimates of what the deferred tax

 9 balance is, isn't that something that could be relatively

 10 easily audited and accounted for when the books are

 11 closed?

 12 A Yes, and it could be audited and accounted

 13 for now. Basically, my exhibit shows deferred taxes at

 14 the end of 1999 under note 7 and then note 8 is the

 15 FAS-109 deferred tax amounts. These amounts will change

 16 a little bit as we proceed past the end of 1999 into 2000

 17 until the sale closes and in that sense, they could be

 18 audited, but they could be audited now as well.

 19 Q But are you contending that all the items

 20 in FAS-109 are flow-through items?

 21 A No, I'm not.

 22 MR. WARD: Okay, I'll leave it at that. I

 23 have one final matter. Again, if I may approach the

 24 witness.

 25 COMMISSIONER SMITH: Yes, you may.

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 1 MR. WARD: And, Madam Chair, this might be

 2 easiest if we take a five-minute break because I'm going

 3 to walk him through this exhibit to save a little time.

 4 COMMISSIONER SMITH: All right, we'll take

 5 a five-minute break.

 6 (Recess.)

 7 COMMISSIONER SMITH: All right, it looks

 8 like everybody is ready. We'll go back on the record.

 9 Q BY MR. WARD: Now, if you would turn to

 10 your rebuttal testimony, bottom of page 8 --

 11 COMMISSIONER SMITH: Mr. Ward, is your mike

 12 on?

 13 MR. WARD: I'm sorry.

 14 Q BY MR. WARD: Referring to your rebuttal

 15 testimony at the bottom of page 8 and the top of page 9,

 16 beginning with the last partial sentence there, you're

 17 explaining why you do not agree that the Potlatch

 18 contract should participate in any portion of the gain,

 19 of the customers' share of the gain, from the sale of

 20 Centralia; correct?

 21 A Correct.

 22 Q And you say at the bottom of page 8, the

 23 last partial sentence, "The Potlatch special contract is

 24 not subject to price adjustments, either increases or

 25 decreases." Do you see that testimony?

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 1 A Yes.

 2 Q Now, first of all, let me ask you, is it

 3 fair to assume that when the Company and Potlatch entered

 4 into their contract that the rate was established at a

 5 point in which the parties agreed, among other things, to

 6 cover not only depreciation on the Company's assets but a

 7 return on those assets; isn't that fair to assume?

 8 A I don't know that to be the case. I wasn't

 9 party to the negotiations or any of the studies that went

 10 into the negotiations. I would be of the opinion that to

 11 the extent that variable costs are covered and fixed

 12 costs are partially recovered that would otherwise be

 13 spread to other customers that there would be a benefit

 14 to the Company having the Potlatch contract and that was

 15 probably the basis for the negotiations.

 16 Q Well, let me ask it another way. Attached

 17 to the contract, let me represent to you that attached to

 18 the contract, is the application the two parties filed

 19 with the Commission and among other things in that

 20 application, they contended that the contract was just

 21 and reasonable. Generally speaking, just and reasonable

 22 rates provide for a return on and a return of capital to

 23 the Company, do they not?

 24 A In a normal ratemaking context I would

 25 agree with that, but this was a special contract where

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 1 the determined rates I don't believe were entirely set

 2 based on cost of service ratemaking principles.

 3 Q I understand that caveat, but let me try

 4 one more time. Would the Company knowingly have entered

 5 into a contract with Potlatch that didn't cover their

 6 depreciation and some return on their assets? Do you

 7 think that likely?

 8 A It's possible. As I stated, as long as

 9 there was some fixed cost recovery that without Potlatch

 10 as a customer would be spread to other customers, there

 11 would be a benefit of having the Potlatch contract.

 12 Q Would the Commission normally approve an

 13 agreement that provided nothing more than an incremental

 14 benefit from a system customer?

 15 A I believe it would and I think that's what

 16 happens like in the case of bypass customers. If you

 17 allow a lower rate and you can demonstrate some fixed

 18 cost recovery, that's better keeping that customer than

 19 losing the customer and having your other customers pick

 20 up costs that would have been otherwise allocated to the

 21 bypass customer.

 22 Q Well, in 1992, or for that matter now, does

 23 Potlatch have the ability to bypass Avista?

 24 A Well, now it's under special contract, but

 25 at the end of that contract, yes, it could go to the open

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 1 market and purchase power.

 2 Q Is that your understanding of the current

 3 law?

 4 A Yes.

 5 Q Okay. Let me refer you to the -- turning

 6 back to -- I'd like you to turn to Exhibit B which is

 7 marked with a second post-it that we put on your

 8 document. Now, with regard to your testimony that the

 9 Potlatch special contract is not subject to price

 10 adjustments, either increases or decreases, isn't it true

 11 that this exhibit, at least for the floor rate and the

 12 ceiling rate, provides for what I'll characterize as

 13 relatively steady escalation in both?

 14 A I haven't calculated the escalation rates.

 15 It appears they escalate at a pretty much steady rate,

 16 but there are years when the rate doesn't go up, but my

 17 testimony wasn't addressing price adjustments that are

 18 identified in the contract. My testimony was addressing

 19 price adjustments outside the contract, like a general

 20 rate increase or a power cost adjustment or a demand side

 21 energy tariff rider.

 22 Q Well, let's go to rate adjustments outside

 23 the ratemaking process. If you'd turn to the first

 24 sticky I put on your document, under paragraph X is a

 25 definition of system avoided energy rate. Do you see

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 1 that?

 2 A Yes.

 3 Q And that definition ties the system avoided

 4 energy rate to the incremental cost, determined hourly,

 5 in cents per kilowatt-hour, for the last resource

 6 operated or obtained by WWP, now Avista; correct?

 7 A Correct.

 8 Q Now, during the break you had an

 9 opportunity to look over the rest of the document and

 10 without going into detail or asking everybody to read an

 11 incredibly complicated sequence, that system avoided

 12 energy rate has many, I'll call them, caveats,

 13 limitations, modifications in the rest of the

 14 definitions, but basically, isn't it true that that

 15 definition drives Potlatch's rates?

 16 A I think I'd generally agree with that. I

 17 think, also, I might add that it's kind of a

 18 market-driven rate.

 19 Q It can be if the incremental cost is the

 20 market price of energy; correct?

 21 A Right.

 22 Q Now, would you also agree with me, and I

 23 know this is not your area of expertise, power supply,

 24 but isn't it true that just intuitively we can see that

 25 any time you change the resource stack there is likely to

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 1 be impacts on the incremental cost?

 2 A There could be, yes.

 3 Q And if that's true, there would be impacts

 4 on the system avoided energy rate and ultimately on

 5 Potlatch's rates?

 6 A There could be, yes.

 7 MR. WARD: That's all I have. Thank you.

 8 COMMISSIONER SMITH: Okay, thank you,

 9 Mr. Ward.

 10 Mr. Woodbury, I assume you have cross.

 11 MR. WOODBURY: Yes.

 12 COMMISSIONER SMITH: Well, why don't we

 13 take our lunch break now and come back at 1:15.

 14 (Noon recess.)

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