1 BOISE, IDAHO, WEDNESDAY, JUNE 21, 2000, 9:30 A. M.

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 4 COMMISSIONER SMITH: Good morning,

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

 6 rehearing, reconsideration of Case No. AVU-E-99-6,

 7 further identified as in the matter of the application of

 8 Avista Corporation for authority to sell its interest in

 9 the coal-fired Centralia power plant.

 10 We'll begin this morning with the

 11 appearances of the parties and first we'll start with

 12 Mr. Ward.

 13 MR. WARD: Thank you. Conley Ward of the

 14 firm Givens Pursley in Boise on behalf of Potlatch

 15 Corporation. With me on my right is Dennis Peseau and on

 16 my left is Bill Nicholson of Potlatch.

 17 COMMISSIONER SMITH: Mr. Dahlke.

 18 MR. DAHLKE: Gary Dahlke of the firm of

 19 Paine, Hamblen, Coffin, Brooke and Miller, Spokane,

 20 Washington, and appearing with me is Mr. Ronald McKenzie

 21 for Avista Corporation.

 22 COMMISSIONER SMITH: Thank you and

 23 Mr. Woodbury.

 24 MR. WOODBURY: Scott Woodbury, Deputy

 25 Attorney General, for Commission Staff.

 322

 CSB REPORTING COLLOQUY

 Wilder, Idaho 83676

 1 COMMISSIONER SMITH: Thank you. Are there

 2 any preliminary matters or motions that need to be taken

 3 up at this time?

 4 MR. WARD: Yes, Madam Chairman, there's one

 5 or maybe two preliminary matters. The first is we filed

 6 this morning rebuttal testimony of Dennis Peseau in this

 7 case. I know it's probably reached the Commission only

 8 moments before we began. If the parties or the

 9 Commission has not had time to review that, I would

 10 suggest we take a short break and allow that to be done

 11 rather than reading it into the record.

 12 COMMISSIONER SMITH: Okay. Was it your

 13 intention, then, Mr. Ward, to do your direct and rebuttal

 14 at the same time?

 15 MR. WARD: Yes, if that's the pleasure of

 16 the parties and Commission.

 17 COMMISSIONER SMITH: Let's go off the

 18 record for a minute.

 19 (Off the record discussion.)

 20 COMMISSIONER SMITH: All right, we'll be

 21 back on the record. Mr. Ward.

 22 MR. WARD: Thank you. We'd call Dennis

 23 Peseau to the stand.

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 323

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 1 DENNIS E. PESEAU,

 2 produced as a witness at the instance of Potlatch

 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. WARD:

 9 Q Dr. Peseau, would you please state your

 10 name and address for the record?

 11 A Yes. My name is Dennis E. Peseau,

 12 P-e-s-e-a-u. My address is 1500 Liberty Street, S.E., in

 13 Salem, Oregon.

 14 Q And by whom are you employed and in what

 15 capacity?

 16 A I'm president of Utility Resources, Inc.

 17 Q In preparation for this proceeding today,

 18 did you prepare prefiled direct testimony consisting of

 19 some 17 pages of testimony?

 20 A Yes, I did.

 21 Q And Exhibit Nos. 205 through 209?

 22 A Yes.

 23 Q And do you have any corrections or changes

 24 to make to that testimony or exhibits?

 25 A Yes. As a result of the testimony of

 324

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 Mr. McKenzie, it became clear that our calculations of

 2 the proceeds due to Potlatch if given, if granted by the

 3 Commission to be distributed on a lump sum basis,

 4 Mr. McKenzie points out the fact that we had a carrying

 5 cost in there that would not be appropriate and I address

 6 that in my rebuttal testimony. I guess we're not sure

 7 whether that -- but at any rate, the numbers, maybe I

 8 should correct them. If I can refer everyone to my

 9 direct testimony on page 17.

 10 Q Go ahead and make your corrections,

 11 Dr. Peseau.

 12 A On line 7 of page 17, the figure of

 13 $255,000 appears. That number is -- the corrected number

 14 is $408,000 and that's the result of line 8, an incorrect

 15 reference to a five-year period. The number "5" should

 16 be replaced by "8." That results in line 13 being

 17 changed, according to Mr. McKenzie's numbers, to the

 18 figure of 332,195. That concludes my corrections.

 19 MR. WOODBURY: Dr. Peseau, at the beginning

 20 of line 8 on page 17, wouldn't that $51,000 figure

 21 change, also?

 22 THE WITNESS: No.

 23 MR. WOODBURY: You're right.

 24 Q BY MR. WARD: With those corrections -- oh,

 25 also the numbers on Exhibit 209, there would be a similar

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 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 correction to the Potlatch lump sum share on Exhibit

 2 No. 209?

 3 A That's correct and I believe the corrected

 4 exhibit actually was produced in response to a data

 5 request from Avista.

 6 Q Thank you. With those corrections, if I

 7 asked you the questions contained in your rehearing

 8 direct testimony this morning, would your answers be as

 9 given?

 10 A Yes.

 11 MR. WARD: Madam Chairman, I'd request that

 12 the direct testimony of Dr. Peseau be spread on the

 13 record as if read and Exhibit Nos. 206 through 209 be

 14 marked for identification.

 15 COMMISSIONER SMITH: Did you give up on

 16 205?

 17 MR. WARD: No. Excuse me, 205 through 209.

 18 COMMISSIONER SMITH: Is there any

 19 objection?

 20 MR. DAHLKE: No objection.

 21 COMMISSIONER SMITH: Without objection, we

 22 will spread the prefiled testimony of Dr. Peseau upon the

 23 record as if read and identify Exhibits 205 through 209.

 24 MR. WARD: Thank you.

 25 (The following prefiled direct

 326

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 testimony of Dr. Dennis Peseau is spread upon the

 2 record.)

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 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 Q PLEASE STATE YOUR NAME AND BUSINESS

 2 ADDRESS.

 3 A My name is Dennis E. Peseau. My business

 4 address is 1500 Liberty Street, S.E., Suite 250, Salem,

 5 Oregon 97302.

 6 Q BY WHOM ARE YOU EMPLOYED AND IN WHAT

 7 CAPACITY.

 8 A I am the President of Utility Resources,

 9 Inc., ("URI").

 10 Q ARE YOU THE SAME DENNIS PESEAU WHO PREFILED

 11 DIRECT TESTIMONY EARLIER IN CASE NO. AVU-E-99-6?

 12 A Yes.

 13 Q DOES THAT PREFILED TESTIMONY REMAIN TRUE

 14 AND ACCURATE TO THE BEST OF YOUR KNOWLEDGE?

 15 A Yes.

 16 Q ARE YOU AGAIN REPRESENTING POTLATCH

 17 CORPORATION IN THIS MATTER?

 18 A Yes.

 19 Q WHAT IS THE PURPOSE OF THIS TESTIMONY?

 20 A In response to a March 28, 2000 petition by

 21 Potlatch Corporation, the Commission found on April 26,

 22 2000 that it was "...reasonable on grounds of equity and

 23 fairness to provide Potlatch with additional opportunity

 24 to present its claims of entitlement to a share of the

 25 customer portion of the Centralia gain" Order 28355 at 2.

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 D. PESEAU Di 2

 Potlatch Corporation

 1 The Commission then established dates for prefiled

 2 testimony by parties, as well as a date for hearing on

 3 reconsideration. My testimony is filed in response to

 4 the Commission's order.

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 D. PESEAU Di 2a

 Potlatch Corporation

 1 Q WHAT LED POTLATCH TO REQUEST

 2 RECONSIDERATION IN THIS PROCEEDING?

 3 A The Commission's original order stated that

 4 "...the company in this case presents a persuasive

 5 argument for denying Potlatch any share of the customer

 6 portion of the Centralia gain." Order No. 28297 at 11.

 7 The argument made by Avista is summarized on page 6 of

 8 the Commission's order.

 9 Potlatch is excluded from the sharing of any gain

 because, the company contends, it is a special

 10 contract customer. The rates for Potlatch are not

 entirely based on cost of service ratemaking

 11 principles. Tr. Pp. 177, 178,191, 192. Potlatch

 is not subject to price adjustments (either

 12 increases or decreases), is exempted from PCA

 rebates and surcharges, is exempted from the

 13 WWP-E-98-11 general rate increase. Tr. P. 158.

 Price adjustments for Potlatch are identified in

 14 its contract. Tr. P. 180.

 15 As I will explain later, these assertions are not

 16 completely accurate and they lead to misleading

 17 inferences. But even if these factual assertions were

 18 correct, they do not constitute a persuasive argument for

 19 denying Potlatch a portion of the Centralia gain.

 20 Q HOW DID YOU ARRIVE AT THIS CONCLUSION?

 21 A Avista's argument essentially amounts to an

 22 assertion that Potlatch is not entitled to participate in

 23 the Centralia gain because its contract is different than

 24 a tariff and is not subject to certain types of rate

 25 adjustments. Stated in this fashion it becomes obvious

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 D. PESEAU Di 3

 Potlatch Corporation

 1 that the "argument" is simply a conclusory allegation

 2 rather than a rational analysis. Avista is basically

 3 arguing that Potlatch should be excluded from the

 4 Centralia recovery because it is a unique customer.

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 D. PESEAU Di 3a

 Potlatch Corporation

 1 no question Potlatch is unique in many respects, but this

 2 is irrelevant to the question at hand. In order to test

 3 the validity of Potlatch's claim we must discard the

 4 conclusory characterizations and instead conduct a

 5 rational analysis of the issue.

 6 Q HOW DO YOU PROPOSE TO CONDUCT SUCH AN

 7 ANALYSIS?

 8 A The logical way to approach this issue is

 9 to pose three sequential questions:

 10 1. What is the basis or rationale for allocating

 11 a portion of the Centralia gain to Avista's Idaho

 12 ratepayers?

 13 2. Does this rationale apply with equal force to

 14 Potlatch?

 15 3. If the rationale does apply, does the Potlatch

 16 contract waive this entitlement or otherwise bar

 17 Potlatch's participation?

 18 Q ALRIGHT, LETS BEGIN WITH THE FIRST

 19 QUESTION. WHAT WAS THE BASIS FOR THE COMMISSION'S

 20 DETERMINATION THAT IDAHO RATEPAYERS ARE ENTITLED TO A

 21 PORTION OF THE CENTRALIA GAIN?

 22 A The Commission's Order accepted the

 23 argument that "the ratepayers' payment of depreciation

 24 expense on property other than real property establishes

 25 a right to [a portion of] the gain on the sale of an

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 D. PESEAU Di 4

 Potlatch Corporation

 1 asset." Order No. 28297 at 8. I summarized the

 2 conceptual basis for this "depreciation reserve

 3 methodology" in pages 3-4 of my original prefiled

 4 testimony in this proceeding, which I attach here as

 5 Exhibit No. 205. Virtually identical arguments were also

 6 advanced by the Commission staff.

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 D. PESEAU Di 4a

 Potlatch Corporation

 1 The essential principle underlying the

 2 Commission's decision is that customers of Avista,

 3 through paying for depreciation in rates, "return" the

 4 original shareholder investment in Centralia. To the

 5 extent that investment has been returned, customers

 6 become "equitable owners" who are entitled to a pro rata

 7 share of the gain roughly equal to the percentage of the

 8 original investment cost that has been repaid through

 9 depreciation. In short, prior depreciation payments

 10 provide both the rationale for ratepayer participation

 11 and the method of quantifying the customers' entitlement.

 12 Q HOW CAN YOU BE POSITIVE THIS WAS THE

 13 COMMISSION'S RATIONALE FOR ITS ORDER?

 14 A First, the Order expressly says so.

 15 Secondly, no other argument was advanced for customer

 16 sharing at any time during the proceedings, nor is any

 17 other basis referenced in the Commission's Order.

 18 Q VERY WELL. TURNING TO YOUR SECOND

 19 QUESTION, DOES THIS RATIONALE APPLY WITH EQUAL FORCE TO

 20 POTLATCH?

 21 A Unquestionably it does. In fact, I will go

 22 farther and state that taking a contrary position on this

 23 point seems to me beyond the limits of good faith debate.

 24 Q HOW CAN YOU BE SO SURE ON THIS POINT?

 25 A Fortunately we have a long and detailed

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 D. PESEAU Di 5

 Potlatch Corporation

 1 Commission record that has been accumulated over the

 2 years regarding the Potlatch contract. This record

 3 conclusively establishes the following facts:

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 D. PESEAU Di 5a

 Potlatch Corporation

 1 1. At the inception of the Potlatch contract in

 2 1991, its rates were approximately 8% above the

 3 applicable tariff rate that Potlatch was otherwise

 4 entitled to, and well above its cost of service.

 5 2. Thereafter, Potlatch was subject to floor and

 6 ceiling rates that escalated every year, while the

 7 rest of Avista's customers saw no increases until

 8 the Commission approved a 7.58% general rate

 9 increase effective August 1, 1999.

 10 3. By late 1999 when the Commission authorized a

 11 general rate increase, the Potlatch contract was

 12 generating a return that all three cost of service

 13 studies conceded to be between 31% and 101% above

 14 its cost of service!

 15 Q HOW DO YOU KNOW THE POTLATCH RATE WAS WELL

 16 ABOVE COST OF SERVICE AT ITS INCEPTION?

 17 A Because the Commission held extensive

 18 hearings on the contract in Case No. WWP-E-91-5, and all

 19 parties, including the Commission staff in the person of

 20 Keith Hessing, endorsed this view. In fact, the other

 21 staff witness in that case, Thomas Faull, expressed

 22 concern that the Potlatch rates might be sufficiently

 23 above cost of service to warrant an undue discrimination

 24 claim.

 25 Given the steady contractual price escalations at

 336

 D. PESEAU Di 6

 Potlatch Corporation

 1 a time when electric utility costs were generally flat or

 2 decreasing, and given the 1999 cost of service results,

 3 we can say with virtual certainty that Potlatch has paid

 4 rates far in excess of its cost of service during the

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 D. PESEAU Di 6a

 Potlatch Corporation

 1 entire duration of the contract, and it will almost

 2 certainly continue to do so until the contract terminates

 3 on December 31, 2001.

 4 Q HOW DOES THIS RELATE TO THE ISSUE IN THIS

 5 CASE?

 6 A This record conclusively demonstrates that

 7 Potlatch has paid its full share of depreciation on the

 8 Centralia plant and more.

 9 Q HOW DO YOU KNOW THIS?

 10 A All cost of service studies, by definition,

 11 include a component for depreciation. Since Potlatch has

 12 clearly been paying more than its full cost of service,

 13 we know that it has also paid its share of depreciation

 14 for Centralia as well as other assets. This is not

 15 simply a theoretical assertion. Examining the cost of

 16 service studies prepared by Avista, the Staff, and

 17 Potlatch in the 1999 rate case enables us to isolate the

 18 depreciation expense as an identifiable component of cost

 19 of service, per the following table:

 20 Annual

 Study Overall Rate of Rate of Return Depreciation

 21 Sponsor Return From All From Potlatch Paid by

 Rates Rates Potlatch

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 Staff 7.27% 12.65% $416,680

 23 Potlatch 6.94% 13.93% $416,564

 Avista 9.45% 12.36% $434.872

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 D. PESEAU Di 7

 Potlatch Corporation

 1 Q WHAT CONCLUSIONS DO YOU DRAW FROM THIS

 2 EVIDENCE?

 3 A These facts conclusively establish that the

 4 Commission's rationale for authorizing customer

 5 participation in the Centralia gain, which I have

 6 referred to as the "depreciation reserve methodology",

 7 applies with equal force to Potlatch during the term of

 8 its existing contract

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 D. PESEAU Di 7a

 Potlatch Corporation

 1 Q WHAT ABOUT THE PERIOD OF TIME PRIOR TO THE

 2 EFFECTIVE DATE OF THE EXISTING CONTRACT?

 3 A The Centralia plant has been in service

 4 since 1971. During the first twenty years of the plant's

 5 life, Potlatch paid tariff rates in the same manner as

 6 other customers, and is therefore equally entitled to

 7 share in the gain attributable to that period as well.

 8 Q HOW DOES THIS EVIDENCE SQUARE WITH THE

 9 AVISTA ARGUMENT THAT "THE RATES FOR POTLATCH ARE NOT

 10 ENTIRELY BASED ON COST OF SERVICE RATEMAKING PRINCIPLES"?

 11 A The statement is literally true, but very

 12 misleading. This Commission, as well as most others with

 13 which I am familiar, has for many years used cost of

 14 service studies to guide it in establishing rates, but

 15 never has it relied exclusively on cost of service. The

 16 Potlatch contract, with rates well above cost of service,

 17 illustrates this point.

 18 The statement is nevertheless misleading because

 19 it is clearly designed to suggest that Potlatch's rates

 20 are below cost of service. As I have just demonstrated,

 21 this implication is patently erroneous. This error was

 22 greatly compounded on cross examination when Avista's

 23 witness Mr. McKenzie insisted that the contract may have

 24 been designed to recover little more than variable costs

 25 and some small contribution to fixed costs. This

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 D. PESEAU Di 8

 Potlatch Corporation

 1 misstatement was wildly wrong, but I don't think

 2 Mr. McKenzie was being intentionally deceptive. I fear,

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 D. PESEAU Di 8a

 Potlatch Corporation

 1 however, the Commission may have given some credence to

 2 his assertions.

 3 Q THIS IS SOMEWHAT BESIDE THE POINT, BUT WHY

 4 DO YOU CONCLUDE THAT MR. MCKENZIE WAS NOT INTENTIONALLY

 5 DECEIVING THE COMMISSION?

 6 A If you had a background in the natural gas

 7 industry of the 1990s, as Mr. McKenzie obviously does,

 8 and if you were not familiar with the nomenclature used

 9 by the electric industry in the 1980s, you could easily

 10 make the same mistake. In the natural gas industry,

 11 customers have the legal right to "bypass" the local

 12 distribution company and take service directly from an

 13 interstate pipeline. Since most large industrial

 14 customers are located on or near a pipeline, the bypass

 15 option gives them a great deal of negotiating leverage.

 16 Consequently, it is not unusual for distribution

 17 companies to negotiate industrial contracts that are far

 18 below embedded cost of service. The rationale is that it

 19 is better for the utility to recover its variable costs

 20 (primarily the cost of gas) and some incremental

 21 contribution to embedded cost, rather than lose the

 22 customer completely.

 23 I have attached an excerpt from the transcript as

 24 Exhibit No. 206 that shows that Mr. McKenzie is clearly

 25 under the impression that electric customers have the

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 D. PESEAU Di 9

 Potlatch Corporation

 1 same option to bypass the local distribution system.

 2 But this simply isn't so. In Idaho, customers have no

 3 electric supply options other than the certificated

 4 utility. Under these circumstances, utilities have no

 5 incentive to negotiate a contract that

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 D. PESEAU Di 9a

 Potlatch Corporation

 1 does not recover the full embedded cost of service, and

 2 even if they did the Commission would be unlikely to

 3 approve a below cost contract.

 4 In addition to his mistake of law, I suspect

 5 Mr. McKenzie was further confused by references in the

 6 1991 proceeding to the inclusion of some incremental

 7 costs in the Potlatch rates. But in 1991, the term

 8 incremental costs had a much different meaning in the

 9 electric industry than its current usage in the natural

 10 gas field. At the time, electric utilities had just

 11 experienced nearly two decades of wildly escalating

 12 generation costs. New power supplies were typically two

 13 to three times embedded costs, and many Commission's,

 14 including Idaho's, were experimenting with "marginal cost

 15 pricing" by charging certain loads or customer groups

 16 prices above embedded cost in order to reflect the higher

 17 cost of incremental power supplies. It is in this sense

 18 that the parties in the 1991 case characterized the

 19 Potlatch contract as recovering some incremental costs.

 20 This is quite clear if the transcript is read with an

 21 understanding of the historical context. In other words,

 22 the parties were discussing the fact that Potlatch's

 23 rates were in excess of its fully allocated cost of

 24 service rather than, as Mr. McKenzie apparently assumes,

 25 priced at a level that recovered little more than

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 D. PESEAU Di 10

 Potlatch Corporation

 1 variable costs.

 2 Q OK, WHERE DOES ALL THIS LEAVE US?

 3 A We have answered the first two questions I

 4 posed earlier. The Commission properly held that the

 5 Idaho customers right to participate in the Centralia

 6 gain arises as a result of their return of

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 D. PESEAU Di 10a

 Potlatch Corporation

 1 Avista's capital in the form of depreciation payments for

 2 the plant. Secondly, it is quite clear that Potlatch

 3 paid its full share of this depreciation expense, both

 4 before and after the 1991 contract was executed, and

 5 therefore has the same entitlement to participate in the

 6 gain as other ratepayers. As I stated earlier, the

 7 evidence on this question is so overwhelming that I don't

 8 see how a contrary position can be fairly argued.

 9 Q ALRIGHT, LET'S TURN TO THE THIRD QUESTION

 10 YOU POSED EARLIER. IS THERE ANYTHING IN THE POTLATCH

 11 CONTRACT THAT WAIVES POTLATCH'S RIGHTS OR OTHERWISE BARS

 12 ITS RIGHT TO PARTICIPATE IN THE CENTRALIA GAIN.

 13 A No.

 14 Q DO YOU HAVE TO "INTERPRET" THE CONTRACT TO

 15 REACH THIS CONCLUSION?

 16 A Not in the sense you are suggesting. My

 17 conclusion is based on a straightforward reading of the

 18 contract with some knowledge of its historical context

 19 and prior Commission proceedings.

 20 Q STARTING WITH THE HISTORICAL CONTEXT, HOW

 21 DID THE POTLATCH CONTRACT ARISE?

 22 A I will try to make a very long and tortuous

 23 story relatively succinct. In the late 1970s and early

 24 1980s, Potlatch installed a series of cogeneration

 25 facilities at its Lewiston mill. At the time it was

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 D. PESEAU Di 11

 Potlatch Corporation

 1 taking service from Washington Water Power ("WWP")

 2 pursuant to a contract that incorporated Schedule 25

 3 rates. After extended negotiations,

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 D. PESEAU Di 11a

 Potlatch Corporation

 1 WWP agreed to purchase the output of Potlatch's

 2 cogeneration facilities as required by the Public

 3 Utilities Regulatory Policy Act ("PURPA"). The Idaho

 4 Commission approved this PURPA contract, but it was

 5 subsequently rejected by the Washington Utilities and

 6 Transportation Commission. The parties then negotiated a

 7 second agreement, which was approved by Washington but

 8 rejected in Idaho.

 9 Toward the end of this decade-long struggle, WWP

 10 filed an amendment to its tariff that required loads in

 11 excess of 25 megawatts to be served under a special

 12 contract. Potlatch intervened in protest in the

 13 Commission proceedings on this proposal. This

 14 intervention was ultimately mooted when the 1991

 15 agreement was approved.

 16 Q COULD YOU BRIEFLY SUMMARIZE THE NATURE OF

 17 THE 1991 CONTRACT?

 18 A In essence, it is a two pronged agreement

 19 that provides for the simultaneous sale of cogenerated

 20 power to WWP and the purchase of both firm and

 21 interruptible power by Potlatch.

 22 Q DO YOU AGREE THAT "POTLATCH IS NOT SUBJECT

 23 TO PRICE ADJUSTMENTS (EITHER INCREASES OR DECREASES)"?

 24 A This statement is inaccurate and misleading

 25 on two grounds. First, both the purchase and sale rates

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 D. PESEAU Di 12

 Potlatch Corporation

 1 have been subject to increases in each and every year

 2 since 1992. These increases are summarized in the

 3 contract exhibits attached to my testimony as Potlatch

 4 Exhibit No. 207.

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 D. PESEAU Di 12a

 Potlatch Corporation

 1 But even more to the point is the fact that the

 2 contract does not expressly bar Commission ordered price

 3 adjustments, nor could it have legally done so even if

 4 the parties had so desired. A utility and its customer

 5 cannot lawfully contract away the Commission's continuing

 6 regulatory jurisdiction, nor can the Commission surrender

 7 that jurisdiction by approving a contract. It is true

 8 that a contract that establishes prices for a specified

 9 term cannot, in the absence of a savings clause, be

 10 adjusted as a matter of course in general rate

 11 proceedings. But both the contract terms and prices are

 12 always subject to revision by the Commission if it

 13 becomes adverse to the public interest or otherwise works

 14 a manifest injustice. Keith Hessing's testimony in the

 15 1991 contract approval case, Case No. WWP-E-91-5, nicely

 16 summarizes the distinction between the so-called "tariff"

 17 and "contract" standards of ratemaking, and I have

 18 attached the relevant section of his testimony as Exhibit

 19 No. 208.

 20 Q IS IT CLEAR THAT THE CONTRACT STANDARD

 21 GOVERNS THE POTLATCH CONTRACT?

 22 A The Staff clearly assumed so in the 1991

 23 proceedings. It is likewise clear that the contracting

 24 parties regarded Potlatch's acceptance of scheduled

 25 annual rate increases in lieu of general rate adjustments

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 D. PESEAU Di 13

 Potlatch Corporation

 1 as an integral part of their "deal." But the contract

 2 did not attempt to bind the Commission to this deal. The

 3 relevant contractual provision is unique in my

 4 experience, and it incorporates a subtle, but crucial,

 5 departure from the contract standard discussed by

 6 Mr. Hessing:

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 D. PESEAU Di 13a

 Potlatch Corporation

 1 COMPLIANCE WITH LAWS. Both parties shall comply

 with all applicable laws and regulations of

 2 governmental agencies having jurisdiction over the

 Facility and the operations of the Parties. In

 3 the event that any regulatory commission or agency

 having jurisdiction over the operation of the

 4 Facility, imposes new or changed regulations or

 policies which affect the rates contained in this

 5 Agreement, or if the payments by WWP to Potlatch

 under this Agreement are partially or totally

 6 disallowed as recoverable costs in the retail

 rates of WWP in Idaho or Washington, either Party

 7 shall have the right, for a period of one hundred

 twenty (120) days from the effective date of such

 8 new or changed regulations, to terminate this

 Agreement.

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 10 Q WHY DO YOU SAY THIS PROVISION IS UNIQUE?

 11 A Because it does not specify either a

 12 contract or tariff standard for changing rates. Instead

 13 it simply provides that, if the Commission alters the

 14 pricing arrangement, either party can terminate the

 15 contract within 120 days. Potlatch's witness, Bill

 16 Nicholson, aptly summarized this situation in his

 17 testimony in Case No. WWP-E-91-5:

 18 [T]he Commission is left with a choice to which,

 in this case, the parties to the agreement have a

 19 choice. Very candidly, if there is a significant

 disturbance of this contract... the parties to it

 20 would take probably a very serious look at whether

 or not they wish to exercise their rights under

 21 the contract.

 22 Case No. WWP-E-91-5 Tr. At 155.

 23 Q SO WHAT IS THE ANSWER TO YOUR THIRD

 24 QUESTION? DID POTLATCH WAIVE ITS RIGHT TO PARTICIPATE IN

 25 THE CENTRALIA GAIN?

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 D. PESEAU Di 14

 Potlatch Corporation

 1 A It did not. The agreement between Potlatch

 2 and WWP contemplated that the scheduled prices would not

 3 be altered in general rate cases. If

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 D. PESEAU Di 14a

 Potlatch Corporation

 1 the Commission intervenes to alter this deal, either

 2 party can terminate the agreement. I see nothing in this

 3 arrangement that affects the issue in this case.

 4 Q WOULD YOU PLEASE EXPLAIN?

 5 A Obviously neither of the parties to the

 6 contract foresaw in 1991 the possibility that electric

 7 generation would be partially deregulated or that WWP

 8 would sell a generating plant to an Exempt Wholesale

 9 Generator. I have confirmed this conclusion with

 10 Potlatch's representatives, but it is obvious on the face

 11 of the document. If the parties had anticipated this

 12 situation, they likely would have addressed it in the

 13 agreement, probably by a mutual reservation of rights.

 14 Since the parties did not explicitly address this

 15 situation, the only remaining question is whether

 16 Potlatch's entitlement is extinguished by the agreement

 17 to exchange scheduled price changes for rate case

 18 protection. In my view, this arrangement clearly has no

 19 bearing on the case at hand.

 20 Q WHY NOT?

 21 A Because this case has nothing to do with

 22 changes to rates. The predicate on which the

 23 Commission's decision rests is that ratepayers in effect

 24 "bought" a portion of the Centralia plant from Avista by

 25 paying depreciation costs. When the plant is sold, the

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 D. PESEAU Di 15

 Potlatch Corporation

 1 ratepayers are therefore entitled to a return of their

 2 investment plus a pro rata share of the profits from the

 3 sale. As it happens, the Commission chose

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 D. PESEAU Di 15a

 Potlatch Corporation

 1 (wrongly in my view) to implement this payment by

 2 reducing customers' rates over a period of years. But it

 3 could just as easily have ordered the utility to issue

 4 each ratepayer a check or billing credit for its share of

 5 the proceeds. If it had chosen this course, it would be

 6 much clearer that the ratemaking provisions of the

 7 contract are irrelevant.

 8 This point is so crucial it bears reemphasis.

 9 Avista's rates did not change because of any change in

 10 underlying costs or ratemaking methodology. They changed

 11 only because Avista sold property that belonged in part

 12 to its customers, and it was therefore obliged to pay the

 13 customers in accordance with their ownership interests.

 14 The Commission's incorporation of the payment in rates

 15 does not alter the fact it is nothing more nor less than

 16 a distribution of proceeds from the sale of the

 17 customers' property. Potlatch's rates, however

 18 established, therefore have absolutely no bearing on its

 19 right to recover the sum attributable to the sale of

 20 "its" property.

 21 Q ARE THERE ANY OTHER MATTERS THE COMMISSION

 22 SHOULD CONSIDER IN THIS CASE?

 23 A Yes. Basic standards of justice and equity

 24 are also at issue here. The Commission calculated the

 25 size of the customer credit by summing the total

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 D. PESEAU Di 16

 Potlatch Corporation

 1 Centralia depreciation paid by all Idaho customers,

 2 including Potlatch. It then distributes the proceeds by

 3 allocating the total, including Potlatch's payments,

 4 among all customers other than Potlatch. If the

 5 Commission stands by the original decision, it is

 6 basically confiscating property that Potlatch "bought"

 7 and distributing

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 D. PESEAU Di 16a

 Potlatch Corporation

 1 it to parties who have no legitimate claim to the

 2 resulting windfall. This is not only irrational, it is

 3 also inequitable and unjust.

 4 Q WHAT IS THE APPROXIMATE ALLOCATION OF THE

 5 $6,811,624 IDAHO CUSTOMERS GAIN THAT POTLATCH WOULD

 6 RECEIVE IF THE COMMISSION INCLUDES IT IN THE PRO RATE

 7 GAIN DISTRIBUTION?

 8 A I estimate Potlatch's share of the gain to

 9 be approximately $408,000, or $51,000 per year for the 8

 10 year period, as shown on my Exhibit No. 209.

 11 Q HOW SHOULD THIS AMOUNT BE PAID TO POTLATCH?

 12 A There is really no defensible reason to

 13 allow Avista to retain proceeds to which it is not

 14 entitled. Consequently, I recommend that the entire sum

 15 of $332,195 be paid to Potlatch when the sale closes,

 16 either by a check or in the form of a billing credit. If

 17 for some reason the Commission feels that payment should

 18 match the 5 year payout to other customers, then the

 19 simplest distribution method would be an annual payment

 20 or billing credit in the amount of $51,000 plus interest.

 21 Q DOES THIS CONCLUDE YOUR TESTIMONY?

 22 A Yes.

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 D. PESEAU Di 17

 Potlatch Corporation

 1 (The following proceedings were had in

 2 open hearing.)

 3

 4 DIRECT EXAMINATION

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 6 BY MR. WARD: (Continued)

 7 Q Now, Dr. Peseau, did you also file rebuttal

 8 testimony in this proceeding?

 9 A Yes, I did.

 10 Q And were there any exhibits to the rebuttal

 11 testimony?

 12 A No.

 13 Q And do you have any corrections or changes

 14 to make to that rebuttal testimony?

 15 A No, I don't.

 16 Q And if I asked you the questions contained

 17 therein this morning, would your answers be as given?

 18 A Yes, they would.

 19 MR. WARD: With that I'd request that

 20 Dr. Peseau's rebuttal testimony be spread on the record

 21 as if read.

 22 MR. DAHLKE: And we would enter an

 23 objection on behalf of Avista to the rebuttal testimony

 24 as not called for in the noticed proceeding. We just

 25 received it this morning and believe that the arguments

 359

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 that Potlatch intended to present should have been

 2 presented in the direct testimony.

 3 COMMISSIONER SMITH: Mr. Woodbury, do you

 4 have any opinion on this or objection?

 5 MR. WOODBURY: Mr. Ward had contacted me

 6 earlier and I said that I didn't have any objection with

 7 respect to rebuttal testimony on Staff's.

 8 COMMISSIONER SMITH: Any reply, Mr. Ward?

 9 MR. WARD: Yes, Madam Chair. I think it's

 10 correct to characterize the procedural rules, which I

 11 recognize don't entirely apply here, can be summarized as

 12 follows: that surrebuttal may be a matter of grace

 13 granted by the tribunal, but rebuttal, I believe, is

 14 generally thought of as a matter of right. I do

 15 apologize for the late filing, but I'd like to point out

 16 that we were in something of a time bind.

 17 The Commission's notice provided for

 18 service on us of Staff and Company testimony on the 15th

 19 of June. I received Mr. Lobb's testimony on the 14th,

 20 which was last Wednesday. I received Avista's testimony

 21 at the close of business on Thursday the 15th and

 22 Mr. Dahlke was -- apparently, we had a failure of

 23 overnight service and Mr. Dahlke was kind enough to

 24 scurry around and get me a copy, but that meant we had

 25 only three working days by the Commission's timetable to

 360

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 Wilder, Idaho 83676 Potlatch Corporation

 1 prepare rebuttal after we saw the testimony and since

 2 Dr. Peseau was out of town that week, effectively it was

 3 two days, Monday and Tuesday of this week, so we did it

 4 as quickly as we could. I faxed Mr. Dahlke a rough draft

 5 of the testimony last night, but I don't see how we could

 6 legitimately be required to act more expeditiously.

 7 COMMISSIONER SMITH: The Commission will go

 8 at ease for a few minutes and take the objection under

 9 consideration and then we'll return.

 10 (Pause in proceedings.)

 11 COMMISSIONER SMITH: We'll be back on the

 12 record. The Commission has taken Mr. Dahlke's objection

 13 under consideration and denies it at this time, believing

 14 that Potlatch has the burden of proof in this case, this

 15 is their reconsideration, and they would have the

 16 opportunity for live rebuttal at the conclusion, so the

 17 fact that they did it in writing and are going to put it

 18 on first is okay and, Mr. Dahlke, if you need more time,

 19 we'd be happy to recess further to allow you additional

 20 opportunity to review it and prepare cross.

 21 MR. DAHLKE: Thank you.

 22 COMMISSIONER SMITH: Mr. Ward? Oh, then,

 23 we will then spread the prefiled rebuttal testimony of

 24 Dr. Peseau on the record as if read.

 25 (The following prefiled rebuttal

 361

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 testimony of Dr. Dennis Peseau is spread upon the

 2 record.)

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 362

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 Q Please state your name and business

 2 address.

 3 A My name is Dennis E. Peseau. My business

 4 address is 1500 Liberty Street, S.E., Suite 250, Salem,

 5 Oregon 97302.

 6 Q By whom are you employed and in what

 7 capacity?

 8 A I am the President of Utility Resources,

 9 Inc., ("URI").

 10 Q Are you the same Dennis Peseau who prefiled

 11 rehearing testimony earlier in Case No. AVU-E-99-6?

 12 A Yes.

 13 Q What is the purpose of this testimony?

 14 A I am providing brief rebuttal to Staff's

 15 and Avista's rehearing testimony.

 16 Q On page 3 of his rehearing testimony,

 17 Mr. McKenzie states that Potlatch's is not entitled to

 18 participate in the Centralia gain because its "rates have

 19 nothing to do with the recovery of Centralia

 20 depreciation." Do you agree?

 21 A No. Potlatch's contract has a demand

 22 component that recovers all fixed costs, including

 23 capacity costs with depreciation, as well as an energy

 24 component. Both demand and energy rates include some

 25 marginal or incremental costs and are therefore priced

 363

 D. PESEAU Di 2

 Potlatch Corporation

 1 above Avista's embedded costs to serve Potlatch.

 2 Q Mr. McKenzie also characterizes the

 3 contract's energy rates as "market based energy rates"

 4 (P.3, L.17). Is this correct?

 5 A No. As the contract clearly states, the

 6 energy rate is equal to Avista's incremental variable

 7 cost. On occasion this will equal the variable cost

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 D. PESEAU Di 2a

 Potlatch Corporation

 1 component of market rates, but it is clearly wrong to

 2 mischaracterize these energy rates as "market based".

 3 Q Leaving aside the mischaracterization,

 4 Mr. McKenzie suggests that prior cost of service studies

 5 underestimated Potlatch's costs because they should have

 6 assigned market based energy costs to Potlatch. Is this

 7 correct?

 8 A No. Mr. McKenzie is confusing prices and

 9 revenues with costs. A cost of service study has to

 10 compare revenues to embedded costs to be meaningful. If

 11 we assigned to each customer a cost equivalent to the

 12 prices actually paid as Mr. McKenzie suggests, the result

 13 is gibberish. In that event, revenues would always equal

 14 costs regardless of the utility's real underlying cost of

 15 service. All customers would be exactly at cost in every

 16 instance, with no deviation possible.

 17 Q Can you provide an example that illustrates

 18 the difference between prices and costs for cost of

 19 service purposes?

 20 A Yes. Fortunately, there is a perfect

 21 example from the Commission's recent history. The pre

 22 1997 FMC contract priced its interruptible block of power

 23 based on the Valmy plant's incremental costs. But no one

 24 suggested that these incremental costs should actually be

 25 assigned as FMC's costs in cost of service studies.

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 D. PESEAU Di 3

 Potlatch Corporation

 1 Instead, the cost studies all used fully allocated

 2 embedded costs to determine FMC's share of the utility's

 3 total cost of service.

 4 Q What does all this have to do with the

 5 recovery of depreciation costs?

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 D. PESEAU Di 3a

 Potlatch Corporation

 1 A Virtually nothing. I am just correcting

 2 Mr. McKenzie's errors lest they cause confusion. What

 3 Mr. McKenzie fails to grasp is that we can set pricing

 4 components with embedded costs, incremental costs, or a

 5 ouiji board, but the ultimate question is whether the

 6 price components cover fully allocated costs including

 7 depreciation. In the present case, Potlatch's payment

 8 clearly exceeded its cost of service throughout the

 9 contract, and it is therefore obvious that it paid its

 10 fair share of depreciation costs including Centralia's.

 11 It is worth noting that Mr. Lobb concurs.

 12 Q Mr. McKenzie also suggests that Potlatch

 13 has recovered any Centralia depreciation payments in

 14 revenues from energy sales to Avista. Do you agree?

 15 A No, the suggestion is ridiculous. Avista

 16 has an obligation to purchase Potlatch's cogeneration

 17 under federal law. That obligation has no relevance to

 18 Potlatch's entitlement to a recapture of its Centralia

 19 investment.

 20 Q Is Mr. McKenzie's calculation of Potlatch's

 21 share of the gain correct?

 22 A If the Commission allows Potlatch to recoup

 23 its share of the gain as a lump sum, I agree with

 24 Mr. McKenzie's calculation.

 25 Q Have you also read Mr. Lobb's rehearing

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 D. PESEAU Di 4

 Potlatch Corporation

 1 testimony?

 2 A Yes.

 3 Q Do you agree with his conclusions?

 4 A If we go back to the three questions I

 5 posed in my initial rehearing testimony, Mr. Lobb and I

 6 are in complete agreement on the first two.

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 D. PESEAU Di 4a

 Potlatch Corporation

 1 First, we agree that it is the payment of depreciation

 2 that establishes the customers' right to participate in

 3 the gain on sale. Second, we agree that Potlatch has

 4 paid its fair share of Centralia depreciation. But we

 5 disagree on two remaining issues.

 6 Q What is the first area of disagreement?

 7 A Mr. Lobb states, on P. 6, L. 18-21,

 8 that "... The depreciation reserve methodology provides

 9 the rationale to quantify general customer entitlement

 10 but it does not necessarily specify which ratepayers are

 11 entitled to participate." In support of this statement,

 12 he points out that customers who have left Avista's

 13 system don't receive their prorata share of the gain.

 14 Q Is Mr. Lobb correct on this point?

 15 A He is correct that departed customers do

 16 not benefit, but the observation doesn't justify his

 17 conclusion that Potlatch can be legally deprived of its

 18 right to participate.

 19 Q Why not?

 20 A In the first place, Potlatch has not left

 21 Avista's system, so that still leaves it in the position

 22 of being the only existing customer who is denied the

 23 right to participate. Consequently, the discrimination

 24 issue doesn't go away as Mr. Lobb implicitly suggests.

 25 Secondly, the reason why we don't award a portion

 369

 D. PESEAU Di 5

 Potlatch Corporation

 1 of the gain to departed customers is simply due to

 2 administrative feasibility. If we were to do perfect

 3 justice we would have to track down millions of prior

 4 customers (and their heirs) and calculate each of their

 5 entitlements

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 D. PESEAU Di 5a

 Potlatch Corporation

 1 based on their individual consumption and years on the

 2 system. This is literally impossible, so the award is

 3 confined to existing customers because that is the only

 4 practical remedy.

 5 Q What is the second difference you have with

 6 Mr. Lobb?

 7 A In my direct testimony, I argued that the

 8 Avista/Potlatch contract is irrelevant because the

 9 question here is one of ownership rights that have

 10 nothing to do with rates or ratemaking. Potlatch is an

 11 equitable owner of property that has been sold, and it is

 12 entitled to compensation in the same manner as all other

 13 owners. In addition, I point out that even if the

 14 contract is mistakenly deemed relevant, it does not

 15 prohibit Potlatch's participation in the gain. It is not

 16 a "contract standard" agreement in the sense Mr. Lobb

 17 suggests. It does not expressly impose a "contract

 18 standard" but simply provides that the parties can

 19 terminate the contract if the Commission intervenes. If

 20 one reads the transcript of the 1991 hearing, it is clear

 21 that the Commissioner who was most concerned about this

 22 issue understood this nuance.

 23 Q Is there anything else in the Staff's

 24 argument you find troubling?

 25 A I find it interesting that Staff is

 371

 D. PESEAU Di 6

 Potlatch Corporation

 1 concerned that paying Potlatch its proceeds from the

 2 Centralia sale changes the nature of the parties'

 3 contractual bargain, but it does not seem at all troubled

 4 by the fact that approving the sale itself effectively

 5 changes the nature of the underlying agreement.

 6 Q Please explain?

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 D. PESEAU Di 6a

 Potlatch Corporation

 1 A Obviously, the removal of Centralia from

 2 Avista's resource stack removes capacity that was

 3 included in the calculation of Potlatch's demand charges.

 4 This removes capacity Potlatch contracted for, and is

 5 paying for, in its demand rates. In addition, as I noted

 6 earlier, Potlatch's energy rates are based on Avista's

 7 incremental variable costs, so the removal of Centralia

 8 from the Avista resource stack tends to increase

 9 Potlatch's energy costs as well. Consequently, the

 10 Commission, by approving the sale at Avista's urging, has

 11 already changed the nature of the parties' bargain to

 12 Potlatch's detriment.

 13 But on the flip side of the coin, Avista and the

 14 Staff urge the Commission to confiscate the proceeds from

 15 the sale of Potlatch's property, and distribute it to

 16 other ratepayers who have no conceivable claim to it, all

 17 in the name of avoiding impacts on the contractual

 18 agreement between the parties. This seems to me not so

 19 much an analysis of the issues as a search for a

 20 rationale to deny Potlatch a benefit to which it is

 21 entitled as a matter of justice and equity. I also think

 22 the suggested result is "adverse to the public interest".

 23 Q Why is this important?

 24 A Even under Mr. Lobb's interpretation, the

 25 Commission can intervene in a contract if necessary to

 373

 D. PESEAU Di 7

 Potlatch Corporation

 1 prevent a result that is "adverse to the public

 2 interest". Isn't the confiscation of property that

 3 rightfully belongs to another adverse to the public

 4 interest? I have to believe if the shoe were on the

 5 other foot, and Potlatch was receiving the windfall

 6 benefit from proceeds that rightfully belong to the other

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 D. PESEAU Di 7a

 Potlatch Corporation

 1 ratepayers, the Staff would have no trouble concluding

 2 that such a manifest injustice is adverse to the public

 3 interest.

 4 Q Does this conclude your testimony?

 5 A Yes.

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 D. PESEAU Di 8

 Potlatch Corporation

 1 (The following proceedings were had in

 2 open hearing.)

 3 COMMISSIONER SMITH: And I assume he's

 4 available for cross or is there further?

 5 MR. WARD: I want to ask one additional

 6 question. In view of the speed with which we were

 7 preparing this, in reading this testimony over, and I'm

 8 referring to the rebuttal testimony, in reading this over

 9 this morning, it occurred to us that one point may not be

 10 clear, so I want to clarify that, if I may.

 11

 12 DIRECT EXAMINATION

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 14 BY MR. WARD: (Continued)

 15 Q Dr. Peseau, in your rebuttal testimony, you

 16 deal with the subject of Mr. McKenzie's characterization

 17 of Potlatch's energy rates as market based. Do you

 18 recall that testimony?

 19 A Yes, I do.

 20 Q And you explain why they're not. What

 21 provisions of the contract did you have in mind when you

 22 formed your explanation?

 23 A The definitions of incremental cost and the

 24 related concepts of system avoided energy rate underlie

 25 my arguments that the contract calls for first

 376

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 incremental cost which can be system avoided cost which

 2 can be either system resources or market prices, so I'm

 3 referring to pages 3 and 5 of the contract which contain

 4 those definitions to establish that the energy rate is

 5 not based upon a market price.

 6 MR. WARD: Madam Chair, the contract is

 7 already in evidence; however, I passed out pages 3 and 5

 8 which contain the relevant provisions which are on

 9 page 5, the system avoided energy rate. If you review

 10 that definition and then go to the incremental cost

 11 definition on the page 3, you will see how the

 12 determination of Potlatch's energy rate and its variable

 13 rate applies.

 14 COMMISSIONER SMITH: Okay, thank you.

 15 MR. WARD: With that clarification, I think

 16 Dr. Peseau is ready for cross-examination.

 17 COMMISSIONER SMITH: Thank you.

 18 Mr. Woodbury, do you have any questions?

 19 MR. WOODBURY: I do, Madam Chair.

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 377

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 CROSS-EXAMINATION

 2

 3 BY MR. WOODBURY:

 4 Q Good morning, Dr. Peseau.

 5 A Good morning.

 6 Q Looking at your direct testimony on page 5,

 7 you speak of the long and detailed Commission record with

 8 respect to the Potlatch contract. Are you referring to

 9 the Commission's record established in the Water Power

 10 E-91-5 case? That was the underlying case where the

 11 Commission approved the contract.

 12 A Yes, I am.

 13 Q Did you participate in that case?

 14 A I didn't testify. I couldn't tell you

 15 whether our firm participated or not.

 16 Q Did you participate in negotiation of the

 17 contract?

 18 A No, I don't recall that.

 19 Q Have you reviewed the filings of record in

 20 that case, including the transcript?

 21 A Yes.

 22 Q Are you referring to with respect to

 23 Commission record any other records with respect to the

 24 long and detailed Commission record?

 25 A No. Other than the contract itself, no.

 378

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 Q On page 7 of your testimony, you state the

 2 record conclusively demonstrates that Potlatch has paid

 3 its full share of depreciation on the Centralia plant and

 4 more.

 5 A Yes.

 6 Q Can you direct my attention to the Potlatch

 7 contract section expressly dealing with recovery of cost

 8 of service in rates?

 9 A In the contract, yes.

 10 Q And the contract in the underlying case was

 11 Exhibit 204; is that correct?

 12 A Yes, it was. I'll have it here in a

 13 moment, thanks.

 14 Q When you refer to record in that case, were

 15 you referring to the contract or were you referring to

 16 something else?

 17 A I believe I indicated, if I understand your

 18 question, you asked if it was the transcript and asked if

 19 there was anything else and I said other than the

 20 contract, I believe the transcript is --

 21 Q No, with respect to the language that you

 22 have on page 7 of your direct, you say the record

 23 conclusively demonstrates that Potlatch has paid its full

 24 share of depreciation, were you referring to particular

 25 language within the contract itself or are you referring

 379

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 to cost of service testimony in the Company's last rate

 2 case?

 3 A I'm referring to the contract, I'm

 4 referring to discussions in the transcript describing

 5 those conditions and, finally, the table I set out in my

 6 testimony.

 7 Q All right. You're not referring to

 8 anything that's not included in your testimony?

 9 A Well, there are discussions in the

 10 transcript which describe how the various components of

 11 rates contained in Exhibit 204 cover the embedded cost of

 12 service, plus additional fees, so I guess I am referring

 13 to more than just the contract and the cost of service

 14 studies.

 15 Q Page 9 of your testimony, you state that in

 16 Idaho, customers have no electric supply options other

 17 than the certificated utility.

 18 A Yes.

 19 Q Would you consider a supply option as being

 20 a customer's ability to self-generate?

 21 A That's a possibility, depending on the

 22 economics.

 23 Q Potlatch does have the ability to

 24 self-generate with its Lewiston plant, doesn't it?

 25 A Not under the contract.

 380

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 Q So none of its generation capability is

 2 serving its own load in Lewiston; is that what you're

 3 saying?

 4 A Pardon me?

 5 Q None of Potlatch's generation capability is

 6 serving its own load?

 7 A Yes, it is, but to the extent it's serving

 8 its own load, it's not available to serve any incremental

 9 load.

 10 Q But as a generic statement, a customer that

 11 has generation capability has some options other than

 12 just the certificated utility, you agreed to that?

 13 A Well, yes, I did. Of course, a

 14 certificated utility has some control over interconnects

 15 and things that are required practically to

 16 self-generate, but strictly speaking, I don't quibble

 17 with the fact that under the right set of circumstances

 18 it's possible to locate a generation facility on a --

 19 Q And if the company had that capability and

 20 had the capability of bringing on an additional

 21 generation unit, does it not have any leverage in

 22 negotiating a price for purchase?

 23 A It does to some extent, but usually the

 24 terms of the interconnect and standby and reserve

 25 capacity, the influence that the neighboring or incumbent

 381

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 utility has on that usually outweighs any negotiation

 2 power, as I would point out happened in the 1991

 3 negotiations.

 4 Q And why do you say that happened in the '91

 5 negotiations?

 6 A Well, despite the fact that Potlatch had

 7 generation facilities available to it, it ended up with a

 8 contract that was above the tariffed contract, that the

 9 prices were above the tariffed contract that it had

 10 presumably as an option and, secondly, Potlatch was

 11 required to reduce its levelized sale rate back to Water

 12 Power of some 20 percent in order to get the contract

 13 consummated.

 14 Q The contract that the parties negotiated is

 15 a purchase and sale contract?

 16 A That's correct.

 17 Q And those components of the contract were

 18 inextricably tied; would you agree?

 19 A Yes, I think there's testimony of

 20 Mr. Hessing to that effect, that he would prefer that

 21 they weren't, but in fact the long history, the ten-year

 22 history, of attempted negotiations seem to require that

 23 they go part and parcel with one another.

 24 Q On page 11 of your direct testimony, you

 25 ask yourself, "Is there anything in the Potlatch contract

 382

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 that waives Potlatch's rights or otherwise bars its right

 2 to participate in the Centralia gain?" And you answer

 3 "No."

 4 Is there any specific language that

 5 entitles Potlatch to a share of the Centralia gain?

 6 A Well, as I say in my rebuttal, there was no

 7 anticipation of utility --

 8 Q The answer is no?

 9 A The answer is that the contract is silent

 10 on that issue.

 11 Q Okay, were there any -- looking at the

 12 contract, were there any collateral or side agreements

 13 that were not presented in the underlying case for

 14 contract approval?

 15 A I have a vague recollection that there was

 16 some language or this could have been the transcript that

 17 referred to a separate agreement for another matter, but

 18 that's as specific as I can be.

 19 Q And the other matter dealing with what?

 20 A I don't recall.

 21 Q But you have had conversations with the

 22 principals to the negotiation for Potlatch?

 23 A Yes, I have.

 24 Q And as a result of those conversations,

 25 you're unaware of any collateral or side agreements?

 383

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 A That impact the rights with respect to the

 2 Centralia gain?

 3 Q Yes.

 4 A No, I would have probably included it as an

 5 exhibit if I had it.

 6 Q When you speak of the historical context

 7 for negotiation of the underlying agreement --

 8 A Where are we?

 9 Q Page 11.

 10 A Thanks.

 11 Q Yeah, page 11.

 12 A Yes.

 13 Q -- that historical context was an attempt

 14 to obtain two PURPA contracts that for different reasons

 15 were rejected by the Washington and Idaho commissions?

 16 A That's certainly --

 17 Q Is that part of the context that you're

 18 referring to?

 19 A That was part of it and then The Washington

 20 Water Power was in a sense holding a gun to Potlatch's

 21 head with respect to filing a provision with the

 22 Commission that would not allow Potlatch to take tariffed

 23 power off the designated schedule, that's the 25-megawatt

 24 limit, in which case Potlatch was out of -- would have

 25 been precluded the ability to take off the designated

 384

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 1 service Schedule 25.

 2 Q And if the parties were unable to reach

 3 agreement on a special contract, how would the company

 4 have been served?

 5 A I don't know. It depends on the outcome of

 6 the 25-megawatt provision. Absent that, they presumably

 7 had the right to resume service off Schedule 25 and I

 8 presume that's the reason why the whole provision, the

 9 25-megawatt provision, was filed, to take that option

 10 away.

 11 Q Page 13 of your direct testimony, you

 12 state, "The contract does not expressly bar Commission

 13 ordered price adjustments." Does the contract by

 14 implication bar Commission ordered price adjustments?

 15 A No.

 16 Q And was it the understanding of the parties

 17 that there would be adjustments during the ten-year

 18 period of the contract?

 19 A That there would be? I don't think they

 20 were -- there were no designated changes, but at least in

 21 the transcript, Commissioner Miller was very concerned

 22 that the Commission was giving that right, jurisdictional

 23 right, up and at least at the end of that colloquy, and I

 24 think it was a redirect of Mr. Ward, Mr. Miller seemed to

 25 understand or at least said he felt better about that and

 385

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 Wilder, Idaho 83676 Potlatch Corporation

 1 I took that to mean that he understood that there were

 2 opportunities to do so; however, there would be

 3 ramifications to doing that.

 4 Q Well, with respect to Potlatch's

 5 understanding, didn't Mr. Nicholson testify, "What we

 6 have here is a contract that we would believe would be in

 7 place for ten years and the Commission would not be

 8 concerned with it in that time frame"?

 9 A With respect to rates, I think that's

 10 right.

 11 Q With respect to rate adjustments that have

 12 come about within that ten-year period, power cost

 13 adjustment rebates and surcharges, demand side management

 14 tariff rider, would it be your testimony that it would

 15 have been reasonable for the Commission to make those

 16 adjustments applicable to Potlatch?

 17 A I think that would have been very fair in

 18 the negotiations to do that provided you didn't saddle

 19 Potlatch with a higher than cost of service rate to begin

 20 with and incremental rates which were higher than

 21 embedded costs on all the fixed cost components and then

 22 provide for an automatic escalation in its energy rate,

 23 because in retrospect --

 24 Q That interpretation, though, is really not

 25 reflected in the record below, is it?

 386

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 1 A Sure it is. Mr. Prekeges talked about why

 2 the contract was good. Absent the contract, the

 3 ratepayers in Idaho were looking at a substantial rate

 4 increase. Mr. Prekeges talks about the cost of service

 5 principles by which each of the rate components for the

 6 Exhibit 204 contract were made and indicated that the

 7 ratepayers were avoiding any rate increase as a result of

 8 that, so all of that, I think, went -- was considered at

 9 the time; otherwise, I think Potlatch, from my review

 10 Potlatch, would have been better off staying on

 11 Schedule 25 and selling its power on PURPA contract.

 12 Q Would you agree that any adjustment to the

 13 rates and the revenue under the Potlatch agreement with

 14 Avista would trigger rights on behalf of either Potlatch

 15 or Avista to terminate the contract?

 16 A If the Commission attempted to change a

 17 general rate within the contract, I think that would

 18 trigger. That's not what this proceeding is all about.

 19 It's about return of an equity interest in a plant.

 20 Q That's your interpretation, I think,

 21 whether this affects rates or not.

 22 A I guess it's my interpretation.

 23 Q Page 13 of your testimony, testimony with

 24 respect to contract standard and the question that you

 25 ask, "Is it clear that the contract standard governs the

 387

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 Wilder, Idaho 83676 Potlatch Corporation

 1 Potlatch contract?"

 2 And you state, "The Staff clearly assumed

 3 so in the 1991 proceedings," and yet it seems to be your

 4 testimony that Staff was wrong in its assumption.

 5 A No, I said assumed so. If one looks at the

 6 testimony of Staff in that case, Staff clearly recognizes

 7 that there were different considerations, as you've just

 8 pointed out, in this single contract and it dealt with

 9 the purchase agreement from Water Power and the sale back

 10 to Water Power and Mr. Hessing, for example, said that

 11 certainly the sale to Water Power was not a tariff,

 12 couldn't be a tariff consideration, while he preferred

 13 that the purchase would have been a tariff and as I

 14 understand his testimony, it was the fact that there was

 15 a commingling which precluded a tariff schedule and,

 16 therefore, the default was a contract.

 17 Now, the fact that it was not a tariff I

 18 don't think opens the door to say that everything that is

 19 not a tariff is a contract standard or at least not a

 20 typical contract standard.

 21 Q But the Commission had historical practice

 22 of treating things as tariff standard or contract

 23 standard and it was the company's preference that the

 24 Commission treat this under the contract standard which

 25 required essentially leaving the contract in place for

 388

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 the ten-year contract term.

 2 MR. WARD: Madam Chair, can I have a

 3 question in there somewhere?

 4 MR. WOODBURY: Is there a question?

 5 COMMISSIONER SMITH: I think that's

 6 Mr. Ward's comment, Mr. Woodbury, is there a question?

 7 MR. WOODBURY: I thought I had started it

 8 with a question, but there's a question someplace.

 9 Q BY MR. WOODBURY: Let's explore this a

 10 little more. You indicate that what was presented, what

 11 the Commission is presented with in the Potlatch

 12 agreement contains paragraph 21 which is a subtle, but

 13 crucial, departure from the contract standard.

 14 A Yes. With respect to other contracts that

 15 I've been familiar with, it's quite different.

 16 Q And it essentially allowed the contract

 17 parties the opportunity to terminate should there be any

 18 adjustment by the Commission of the contract rates.

 19 A I guess I interpret it, it gives the

 20 Commission the opportunity to change rates if it so

 21 chooses with the resulting potential for contract

 22 termination.

 23 Q If we were not talking about a gain, but

 24 were instead talking about a loss with respect to

 25 Centralia, in fact, something that was envisioned by

 389

 CSB REPORTING PESEAU (X)

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 1 Mr. Nicholson as being perhaps improbable, but the

 2 destruction of one of the company's generation resources,

 3 would Potlatch be in here arguing the equity of sharing

 4 that loss?

 5 A I don't know what it would be in here

 6 arguing, but certainly, it's very clear from the contract

 7 provisions that if a plant went off line for any length

 8 of time or indeed, if the company did sell Centralia,

 9 which it's done, that Potlatch is affected. Its very

 10 energy rate is based upon the resource stack that was

 11 evident in 1991 and today and selling a facility or

 12 losing a facility affects Potlatch. It increases its

 13 rates.

 14 Q And if the company were to recover that

 15 loss through a surcharge, but instead, as Potlatch argues

 16 in this case, wants just a one-time check, could it have

 17 requested a check from Potlatch in the amount and not

 18 triggered the rights of termination under the agreement?

 19 A If there's a legal basis to charge Potlatch

 20 in that case and it didn't go -- to me, it wouldn't need

 21 to go through the exercise of trying to make it into a

 22 rate. Whatever its legal rights are, it could exercise

 23 and if the equity is negative, then I suppose there's an

 24 argument there.

 25 Q You state that the agreement between

 390

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 1 Potlatch and Water Power contemplated that the scheduled

 2 prices would not be altered in general rate cases. Does

 3 the agreement specifically state that? Do agreements

 4 contemplate -- I mean, don't they come right out and say

 5 it?

 6 COMMISSIONER SMITH: Mr. Woodbury, why

 7 don't we let him answer the first question before you

 8 start a new one.

 9 THE WITNESS: I'm sorry, I was listening to

 10 the second question. I lost track of the first one.

 11 Q BY MR. WOODBURY: Does the agreement

 12 specifically state that?

 13 A That the Commission will not --

 14 Q That the scheduled prices will not be

 15 altered in general rate cases.

 16 A I don't recall that language.

 17 Q And when you say that the agreement

 18 contemplates that, are you referring to what, then?

 19 A Well, you referred me to the testimony of

 20 Mr. Nicholson. The contract contemplated general

 21 parameters for pricing which were somewhat known and

 22 built in any, you know, negotiated escalations and so

 23 forth to act in lieu of any general rate case. That's my

 24 interpretation of it.

 25 Q On page 15 of your testimony, you state

 391

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 1 that obviously, neither of the parties to the contract

 2 foresaw in 1991 the possibility that electric generation

 3 would be partially deregulated or that Water Power would

 4 sell a generating plant and I've confirmed that

 5 conclusion with Potlatch's representatives. Which

 6 representatives are you referring to?

 7 A I know it was Mr. Ward.

 8 Q Mr. Ward is Potlatch's attorney in this

 9 case?

 10 A Yes.

 11 Q That's who you spoke with? Did you speak

 12 with any of the underlying negotiators to the contract

 13 with respect to this language?

 14 A Yeah, I was going to finish that sentence.

 15 I'm certain it was Mr. Ward. I'm not sure whether maybe

 16 Mr. Myers or Mr. Nicholson were part of that in my

 17 presence or whether I discussed it with Mr. Ward and he

 18 indicated he confirmed it with Mr. Nicholson and

 19 Mr. Myers. I just don't recall.

 20 Q And when you say it's obvious on the face

 21 of the document, what language are you referring to

 22 within the contract?

 23 A I guess I'm referring to the absence of any

 24 language. I don't see anything that says we don't

 25 anticipate deregulation. We didn't know what

 392

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 deregulation was in 1991.

 2 Q And you state that if the parties had

 3 anticipated this situation, they likely would have

 4 addressed it in the agreement, probably by a mutual

 5 reservation of rights.

 6 A Yes.

 7 Q And this statement is a result of

 8 conversations with who?

 9 A It was probably primarily Mr. Ward in

 10 conjunction with the fact that changes in resource base

 11 that we're talking about here affect the rates of

 12 Potlatch independently of the contract.

 13 Q And should we read this in the context of

 14 the testimony of Potlatch in the underlying contract case

 15 where the company through its attorney Mr. Ward is saying

 16 what we have here is a wager that we're asking the

 17 Commission to accept?

 18 A A wager?

 19 Q You don't recall that testimony in the

 20 transcript? Mr. Ward asks Mr. Nicholson on page 152 of

 21 the underlying transcript, "It's a wager, is it not, from

 22 the Commission's point of view?"

 23 Mr. Nicholson answers, "It is."

 24 And Mr. Ward questions, "And if the wager

 25 turns out badly, then the Commission having surrendered

 393

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 Wilder, Idaho 83676 Potlatch Corporation

 1 its normal ratemaking standard will look badly at the

 2 time of the contract; correct?"

 3 Mr. Nicholson responds, "That's true."

 4 "Conversely, if these forecasted numbers

 5 are correct, the ratepayers will benefit?"

 6 Mr. Nicholson responds, "Considerably."

 7 And then in another response, Mr. Nicholson

 8 answers, "There's no way that the Commission can be

 9 absolutely 100 percent sure that a circumstance would

 10 occur that if you approve this arrangement you might

 11 seven or eight years later say, golly, we never thought

 12 of that."

 13 Isn't this one of those instances that have

 14 happened?

 15 A Has that instance happened?

 16 Q Yeah, the sale of Centralia.

 17 A No, I think what that's referring to are

 18 circumstances that would by setting the contract rates

 19 that they could be too high or too low and in fact,

 20 they've proven to be, as I testify in my direct

 21 testimony, far too high. I didn't see that as a wager

 22 about structural change in the industry. We didn't think

 23 in those terms in 1990.

 24 Q But in the context of Mr. Nicholson's

 25 testimony, wasn't he talking about construction of

 394

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 thermal generating facilities as being one of the factors

 2 that might occur?

 3 A Well, sure, there's nothing unique about

 4 the construction of thermal facilities, but he would have

 5 been concerned because the economics of the thermal

 6 facilities that were sited had a direct impact, so if

 7 you're suggesting that the contract insulated Potlatch

 8 from the construction, the economics of the construction,

 9 of thermal facilities, it's not true. We just defined

 10 incremental costs and system avoided costs and those are

 11 directly related to the resource stack in place at the

 12 time.

 13 Q Sale of utility generation resources is

 14 something that is just outside of your thoughts when

 15 negotiating a contract as perhaps having an effect?

 16 A Yeah, I certainly wouldn't have thought of

 17 it in 1990.

 18 Q And did you discuss that with anybody who

 19 negotiated the contract?

 20 A With regard to the construction of thermal

 21 facilities or --

 22 Q With respect to the sale of a thermal

 23 facility or sale of a generation resource.

 24 A I think that's addressed on page 15, 5

 25 through 12. Those were the general discussions. We just

 395

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 Wilder, Idaho 83676 Potlatch Corporation

 1 didn't see deregulation happening. I don't know that I

 2 recall any representative of Potlatch saying that they

 3 had or had not anticipated the sale of Centralia.

 4 Q And did -- this was conversation that you

 5 said you had with Mr. Ward. Do you know whether Mr. Ward

 6 participated in the negotiation of that contract?

 7 A Yes.

 8 Q Yes, you know?

 9 A Yes, I believe he did.

 10 MR. WOODBURY: Thank you, Dr. Peseau.

 11 Madam Chair, I have no further questions.

 12 COMMISSIONER SMITH: Thank you,

 13 Mr. Woodbury.

 14 Mr. Dahlke.

 15 MR. DAHLKE: Yes, a few questions.

 16

 17 CROSS-EXAMINATION

 18

 19 BY MR. DAHLKE:

 20 Q Mr. Peseau, I wanted to ask you about the

 21 concept of equitable ownership that you refer to in your

 22 testimony.

 23 A Yes.

 24 Q And I believe that you've referred to it

 25 specifically in regard to Potlatch as its equitable

 396

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 right, that is, that it's specific to Potlatch; is that

 2 correct?

 3 A Yes, I believe it's specific to Potlatch.

 4 Q And what confused me about that, I had a

 5 question regarding customers leaving the system or

 6 customers coming on to the system, isn't it the case with

 7 regard to the distribution of the Centralia gain that

 8 customers that leave the Avista system aren't going to

 9 receive any allocation of that gain if they leave prior

 10 to the time that the distribution is made?

 11 A As a practical matter, that's right, people

 12 who leave the system. I'm referring to current customers

 13 and Potlatch is, of course, a current customer.

 14 Q And wouldn't the same be true with respect

 15 to new customers that come on to the system at the time

 16 that the gain is being distributed, they would receive

 17 the gain even though they didn't participate in the

 18 payment of any depreciation of Centralia?

 19 A Right. That's not a preferred outcome, of

 20 course, but it's an administrative practicality.

 21 Q So in that sense, then, aren't we treating

 22 the equitable ownership concept as a concept that belongs

 23 to customers as a group and does not belong to any

 24 specific customer individually?

 25 A It refers to any current customer in my

 397

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 mind.

 2 Q You were asked about the provisions of

 3 section 21 of the contract and the reference to

 4 Commission authority there to change the rates or impose

 5 new regulations. When you reviewed that, were you

 6 considering just actions of the Idaho Commission or were

 7 you also considering the potential for actions of the

 8 Washington Commission?

 9 A Could you refer me? Are you talking about

 10 my direct testimony or my rebuttal?

 11 Q No. In response to the cross-examination

 12 by Mr. Woodbury, you were asked about section 21 and

 13 whether that permitted any change in the rates in the

 14 contract and I believe that you answered with respect to

 15 actions by the Idaho Commission. I just wanted to

 16 establish that there's also potential for actions by the

 17 Washington Commission, is there not?

 18 A With respect to Potlatch rates, this

 19 contract?

 20 Q Yes.

 21 A I suppose there's room for adverse

 22 allocations to the company.

 23 Q And those would be with respect to the sale

 24 of the generation portion and the costs of the sale of

 25 generation from Potlatch to Avista?

 398

 CSB REPORTING PESEAU (X)

 Wilder, Idaho 83676 Potlatch Corporation

 1 A I don't understand the question.

 2 Q Would the Washington Commission have any

 3 jurisdiction to consider the price at which power was

 4 sold by Potlatch to Avista for ratemaking purposes?

 5 MR. WARD: Madam Chair?

 6 COMMISSIONER SMITH: Mr. Ward.

 7 MR. WARD: I guess just for the purposes of

 8 clarity, I ought to object. My memory of this is kind of

 9 dim because it was 15 to 20 years ago, but as I recall,

 10 that was a huge issue in the whole proceedings or course

 11 of proceedings regarding approval of the Potlatch

 12 contracts that were subsequently turned down; that is, it

 13 was a bone of contention between not only the parties but

 14 also the two state commissions whether the Washington

 15 Commission had jurisdiction and if they had any

 16 jurisdiction how it applied, so I just want to clarify

 17 that this is a pretty complex legal issue for Dr. Peseau

 18 to give an off-the-cuff opinion on.

 19 COMMISSIONER SMITH: Is that an objection?

 20 MR. WARD: It is an objection, I guess.

 21 COMMISSIONER SMITH: Mr. Dahlke.

 22 MR. DAHLKE: Well, all I'm trying to

 23 establish is that the provisions of section 21 are not

 24 specific to the Idaho Commission, but also relate to

 25 potential actions by the Washington Commission and I

 399

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 1 think that -- I don't believe that should be an issue

 2 relative to any legal conclusion. What I want to

 3 establish with the witness is that it's not just the sale

 4 of power for consumption by Avista to Potlatch that's

 5 involved here, but also the price for the sale of power

 6 from Potlatch to Avista and that that latter transaction

 7 has multi-jurisdictional issues associated with it, not

 8 just the Idaho Commission.

 9 MR. WARD: I would accept Mr. Dahlke's

 10 testimony.

 11 COMMISSIONER SMITH: Well, good, because I

 12 was going to overrule your objection and ask Mr. Dahlke

 13 to see if he could put that into questions and see what

 14 the witness knows.

 15 Q BY MR. DAHLKE: Well, I guess what I'm

 16 getting at, Dr. Peseau, is that there are two prices

 17 involved in this contract. There's a price for the power

 18 sold by Potlatch and a price for power purchased by

 19 Potlatch.

 20 A Yes.

 21 Q And the price for power that is purchased

 22 by Potlatch, absent the contract, would have been one

 23 exclusively under the jurisdiction of the Idaho

 24 Commission; is that correct?

 25 A That's my understanding, yes.

 400

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 1 Q The price of power sold by Potlatch to

 2 Avista would have been one of many components of an

 3 overall system cost that Avista Corporation has for all

 4 of its power resources; is that correct?

 5 A Yes, and my reading of the transcript and

 6 the historical development of the eventual contract,

 7 there were several sessions back and forth, at least

 8 between the Washington Commission and Idaho Commission,

 9 with different sets of, first, PURPA based rates and

 10 then, secondly, negotiated rates, so the answer is yes.

 11 Q And for ratemaking purposes, the two

 12 commissions have not historically had location specific

 13 resources for ratemaking purposes, but rather have used

 14 system resources for purposes of setting rates; is that

 15 correct?

 16 A Yes. In fact, I think that was some

 17 testimony of Mr. Faull who suggested that maybe that

 18 wasn't the way to go, but I think the Commission rejected

 19 that.

 20 Q Do you know also whether Potlatch has in

 21 the past historically generated into its own load?

 22 A What do you mean "historically"?

 23 Q Looking retrospectively, has Potlatch in

 24 the past generated into its own load at the Lewiston

 25 location?

 401

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 1 A I just meant are you talking about prior to

 2 1991 or just in general?

 3 Q Yes, prior to 1991.

 4 A I believe it has.

 5 Q And this contract expires in --

 6 A 2001.

 7 Q -- 2001? After that time period, is there

 8 anything that prevents Potlatch from generating into its

 9 own load?

 10 A Legally?

 11 Q Legally.

 12 A I don't know.

 13 Q And I think you also stated that Potlatch

 14 is obligated to be a customer of Avista Corporation, that

 15 it doesn't have an option to leave the system; did I

 16 understand you correctly?

 17 A Yes.

 18 Q And are you familiar with the appeal that's

 19 currently pending in the Ninth Circuit Court of Appeals

 20 involving the Snake River Co-op case?

 21 A No.

 22 MR. DAHLKE: No further questions.

 23 COMMISSIONER SMITH: Do we have questions

 24 from the Commission?

 25 COMMISSIONER KJELLANDER: I do.

 402

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 1 COMMISSIONER SMITH:

 2 Commissioner Kjellander.

 3

 4 EXAMINATION

 5

 6 BY COMMISSIONER KJELLANDER:

 7 Q Good morning, Mr. Peseau.

 8 A Good morning.

 9 Q I think I just have one question. You

 10 mentioned repeatedly that at the time the contract was

 11 established that no one anticipated the sale of Centralia

 12 or assets like that, but you also mentioned that with

 13 restructuring of the electric industry that the sale of

 14 generation assets has become more commonplace in the

 15 industry and I was wondering if you were aware of any

 16 other states, PUCs' orders or any other court decisions

 17 that have treated special contract customers in the

 18 manner that you're seeking in this case.

 19 A I'm not sure if this legally is conclusive,

 20 but in Nevada right now the divestiture proceeding of all

 21 the generation resources owned by Sierra Pacific and

 22 Nevada Power are -- that process is past the first stage

 23 of bidding and it looks like the bids are substantial and

 24 there will be a substantial gain. The past cost

 25 regulations which are still not 100 percent finalized,

 403

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 1 but I think I can predict that they'll remain pretty much

 2 as they stand now, there have been several iterations,

 3 the provisions provide for the distribution of the gain

 4 after certain deductions for qualifying facility

 5 commitments and so forth, but to the extent there is a

 6 gain after that, that's to be shared with ratepayers and

 7 to date, there's been no exclusion of special contracts,

 8 the large mines, the Nellis Air Force Base and so forth,

 9 so I'm not familiar with what happened in California or

 10 even whether that generated a gain, but as we work almost

 11 daily in Nevada, I think that's going to happen in

 12 Nevada, but I suppose a late edit to the present

 13 conditions, but so far as I know, all current customers

 14 will receive the benefits of the gain.

 15 Q So then you haven't had an opportunity to

 16 review any of those special contracts that may be part of

 17 the case or record to see if there's any explicit

 18 language that deals with the treatment of gain in those

 19 special contracts?

 20 A I haven't, no.

 21 COMMISSIONER KJELLANDER: Thank you.

 22 COMMISSIONER SMITH: Redirect? Oh,

 23 Commissioner Hansen.

 24 COMMISSIONER HANSEN: I just had one

 25 question just to clarify.

 404

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 1 EXAMINATION

 2

 3 BY COMMISSIONER HANSEN:

 4 Q After reviewing your testimony and

 5 listening today, am I correct in that you don't feel that

 6 the contract should have any influence in Potlatch's

 7 participation in the gain; is that correct?

 8 A I think that's a fair characterization,

 9 Commissioner. I think at least my testimony and I

 10 thought what I read on the depreciation reserve

 11 methodology establishes customers' rights to gain based

 12 on depreciation and I think Mr. Lobb certainly agrees

 13 with my conclusion that Potlatch has paid its

 14 depreciation, its fair share of depreciation, and I think

 15 to me as an economist that does it.

 16 Now, I don't see anything in the contract

 17 that prohibits it and I read Staff's testimony at least

 18 as saying, well, there's nothing that forces you to do

 19 it, so let's not do it and I guess I don't fully

 20 understand that, but I don't see anything in the contract

 21 that controls that. I see this as something distinctly

 22 different from rates. It's a matter of a market value

 23 exceeding book value. That's called a capital gain and

 24 who's entitled to the capital gain, I think people who

 25 contributed to the gain and for me, at least from the

 405

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 1 financial standpoint, it's that simple.

 2 COMMISSIONER HANSEN: Thank you. That's

 3 all the questions I have.

 4 COMMISSIONER SMITH: Redirect, Mr. Ward?

 5 MR. WARD: Yes, if I may approach the

 6 witness.

 7 (Mr. Ward approached the witness.)

 8 MR. WARD: I'm somewhat reluctant to chase

 9 this rabbit of what the contract standard means further,

 10 but I want to add one element. I think our next exhibit

 11 number is 210.

 12 COMMISSIONER SMITH: We'll mark this as

 13 Exhibit 210.

 14 (Potlatch Exhibit No. 210 was marked

 15 for identification.)

 16

 17 REDIRECT EXAMINATION

 18

 19 BY MR. WARD:

 20 Q I want to make this relatively quick,

 21 Dr. Peseau. Counsel questioned you extensively over what

 22 the contract standard means and what the intention of the

 23 parties was when they negotiated the contract. Wouldn't

 24 it be fair to say that Potlatch is not disputing the fact

 25 that the parties hoped and intended that the designated

 406

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 1 rates in that agreement would remain in place without

 2 Commission alteration on general rate case principles?

 3 A Yes.

 4 Q However, the language, does the language

 5 preclude the Commission from intervening in that

 6 contract?

 7 A No, it does not.

 8 Q And in fact, what it provides, does it not,

 9 is that if the Commission does intervene, the parties can

 10 then look to their own interests and determine whether

 11 one or both want to terminate the agreement?

 12 A Yes, that's my understanding.

 13 Q Now, by contrast, if you take -- have you

 14 reviewed other contracts that have explicit contract

 15 language in the sense Mr. Woodbury is using the term?

 16 A Yes, I have.

 17 Q And do those contracts typically provide

 18 that once the Commission approves the contract, the

 19 initial agreement, that it may thereafter either not

 20 intervene or intervene only if it satisfies the adverse

 21 to the public interest standard?

 22 A I think that's what we typically

 23 characterize a pure contract standard as being.

 24 Q And I've just passed out a document to you

 25 which has been labeled as Exhibit 210. Do you recognize

 407

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 1 that document?

 2 A Yes, that's portions of the FMC contract

 3 with Idaho Power which our firm had a hand in.

 4 Q And without reading the whole thing, would

 5 you point to the section that governs the ability of the

 6 Commission to intervene for ratemaking purposes?

 7 A Yes, those are contained in section 6,

 8 Changes to Prices.

 9 Q And how does that differ from the Potlatch

 10 agreement?

 11 A The Potlatch agreement says basically that

 12 the door is open for the Commission to make rate changes,

 13 but that changes the ability of contract participants to

 14 opt out. This is quite different. This says that the

 15 Commission will not act upon -- well, it designates the

 16 exact areas in which the Commission can change the rates

 17 and my assumption is that anything not directly drawn out

 18 and specified here are prohibited.

 19 Q And doesn't it provide that with the

 20 exception of the noted exceptions, the agreement shall

 21 not be subject to change and then goes on to talk about

 22 the regulatory agency?

 23 A That's correct.

 24 Q All right, just one other thing.

 25 Mr. Woodbury asked you a number of questions about

 408

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 1 whether the contract has any provision in it reserving

 2 the right to participate in the gains from the sale of

 3 the utility's property, and I believe you conceded that

 4 it does not. I recognize you're probably not all that

 5 familiar with Avista's tariffs, but you do have

 6 familiarity with tariffs in many states, do you not?

 7 A Yes.

 8 Q And do tariffs typically contain a

 9 provision that reserves the ratepayer's right to

 10 participate in gains?

 11 A I'm not familiar with any that do.

 12 Q Doesn't that suggest that the right

 13 originates somewhere else?

 14 A It suggests it, although I don't know the

 15 answer to that.

 16 MR. WARD: Thank you. That's all I have.

 17 COMMISSIONER SMITH: Thank you, Mr. Ward.

 18 Thank you, Doctor.

 19 (The witness left the stand.)

 20 COMMISSIONER SMITH: Do you have any

 21 further witnesses, Mr. Ward?

 22 MR. WARD: No, we do not.

 23 COMMISSIONER SMITH: Mr. Dahlke.

 24 MR. DAHLKE: Yes, our witness is Mr. Ronald

 25 McKenzie.

 409

 CSB REPORTING PESEAU (Di)

 Wilder, Idaho 83676 Potlatch Corporation

 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

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 8 BY MR. DAHLKE:

 9 Q Please state your name.

 10 A My name is Ronald L. McKenzie.

 11 Q And are you the Ronald L. McKenzie that

 12 previously testified in this proceeding?

 13 A Yes.

 14 Q And have you caused to be prepared and

 15 prefiled direct testimony for this rehearing?

 16 A Yes, I have.

 17 Q And are there exhibits to that testimony?

 18 A Yes, I have two exhibits. They've been

 19 identified as Exhibit No. 9 and Exhibit No. 10.

 20 Q And do you have any corrections or

 21 additions to either your prefiled testimony or your

 22 exhibits?

 23 A No, I do not.

 24 Q Are the answers given in the prefiled

 25 testimony true to the best of your knowledge?

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 CSB REPORTING McKENZIE (Di)

 Wilder, Idaho 83676 Avista Corporation

 1 A Yes.

 2 MR. DAHLKE: We would request that

 3 Mr. McKenzie's prefiled testimony be spread on the record

 4 and that his Exhibits 9 and 10 be marked for

 5 identification.

 6 COMMISSIONER SMITH: Without objection, it

 7 is so ordered.

 8 (The following prefiled testimony of

 9 Mr. Ronald McKenzie is spread upon the record.)

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 CSB REPORTING McKENZIE (Di)

 Wilder, Idaho 83676 Avista Corporation

 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 provided testimony in

 8 these proceedings?

 9 A Yes. I have previously provided direct and

 10 rebuttal testimony in these proceedings.

 11 Q What is the scope of your testimony in this

 12 rehearing proceeding?

 13 A My testimony in this rehearing proceeding

 14 reiterates and explains the Company's position that the

 15 Potlatch special contract should not receive any part of

 16 the customer share of the gain on the sale of Centralia.

 17 Q Did your previous rebuttal testimony

 18 contain the Company's position that the Potlatch special

 19 contract should not receive any part of the customer

 20 share of the gain?

 21 A Yes. At page 8 of my rebuttal testimony

 22 beginning at line 22 I stated:

 23 "Any rate reduction should be spread to customer

 classes, excluding the Potlatch special contract, on a

 24 uniform percentage basis as proposed by Mr. Lobb at page

 12 of his direct testimony, beginning at line 16. The

 25 Potlatch special contract is not subject to price

 412

 McKenzie, Di 1

 Avista

 1 adjustments, either increases or decreases. The Potlatch

 special contract has been exempted from Power Cost

 2 Adjustment (PCA) rebates and surcharges, from the Demand

 Side Management (DSM) tariff rider and from the recent

 3 general rate increase effective August 1, 1999. The

 Potlatch special contract should get no share of any

 4 price reduction associated with gain on sale of the

 Centralia Power Plant."

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 6 Q What did the Commission direct in its Order

 7 No. 28297 regarding the Potlatch contract receiving a

 8 portion of the customer share of the gain?

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 1 A At the bottom of page 11 of Order No. 28297

 2 the Commission found:

 3 "The Potlatch-Lewiston facility is a special

 contract customer and its rates are determined within the

 4 four corners of its service contract. We find that the

 Company in this case presents a persuasive argument for

 5 denying Potlatch any share of the customer portion of the

 Centralia gain."

 6

 7 Q Does the Potlatch special contract contain

 8 any provision to adjust rates for the Centralia gain?

 9 A No. The Potlatch special contract does not

 10 contain any provisions to adjust rates. That is why the

 11 Potlatch special contract has been exempted from Power

 12 Cost Adjustment (PCA) rebates and surcharges, from the

 13 Demand Side Management (DSM) tariff rider and from the

 14 recent general rate increase effective August 1, 1999, as

 15 I testified earlier in my rebuttal testimony.

 16 Q Would you please comment on Dr. Peseau's

 17 contention that giving a share of the gain to the

 18 Potlatch special contract is not a change in rates?

 19 A Yes. Dr. Peseau is trying to use semantics

 20 to justify Potlatch receiving a portion of the gain under

 21 the Potlatch special contract. The fact is that giving

 22 the Potlatch special contract a share of the Centralia

 23 gain would result in revenues being less than they are

 24 specified to be under the contract. It doesn't matter

 25 whether or not the gain is given through a reduction in

 414

 McKenzie, Di 2

 Avista

 1 rates or a lump-sum refund; it is not appropriate to give

 2 Potlatch any portion of the Centralia gain.

 3 Q Would you please comment on Dr. Peseau's

 4 contention at pages 6 and 7 of his direct testimony that

 5 Potlatch has been paying more than its full cost of

 6 service and has been paying for its share of depreciation

 7 for Centralia as well as other assets?

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 1 A The contract rates charged to Potlatch

 2 have nothing to do with depreciation for Centralia.

 3 Dr. Peseau's claims are not true. Potlatch is charged a

 4 monthly fixed firm demand service rate and a monthly

 5 interruptible service charge. These rates were designed

 6 to recover costs, other than energy costs, including

 7 transmission costs, distribution costs, and

 8 administrative and general costs. The monthly fixed firm

 9 demand service rate and the monthly interruptible service

 10 charge as well as the rate for power purchases from

 11 Potlatch were negotiated rates between Potlatch and the

 12 Company. These negotiated rates have nothing to do with

 13 the recovery of Centralia depreciation.

 14 The energy components of the sales rates are based

 15 on short-term market purchase prices, short-term market

 16 sales prices or the incremental cost of resources. The

 17 contract rates are not based in any way on the recovery

 18 of Centralia depreciation. The cost of service study

 19 submitted by the Company in Case No. WWP-E-98-11 should

 20 have assigned an energy cost equivalent to Potlatch's

 21 energy revenues. It was simply an oversight not to have

 22 done so. Potlatch pays market-based rates for energy.

 23 The market-based energy rates have nothing to do with the

 24 recovery of Centralia depreciation.

 25 Q What about the fact that prior to 1991,

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 McKenzie, Di 3

 Avista

 1 Potlatch was paying a tariffed rate?

 2 A Had Potlatch continued to be a tariffed

 3 customer instead of becoming a special contract customer

 4 in 1991, I would agree that Potlatch should be entitled

 5 to a share of the Centralia gain just like any other

 6 tariffed customer. However, Potlatch accepted special

 7 contract rates for both the purchase and sale of power.

 8 Potlatch opted for market-based energy

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 1 purchase rates rather than tariffed rates. The special

 2 contract provides for no adjustments to revenues or rates

 3 outside of the rates contained in the contract. As a

 4 special contract customer, Potlatch should receive no

 5 portion of the Centralia gain.

 6 Q Do you agree with Dr. Peseau's numbers

 7 regarding rate increases?

 8 A No. At page 6, beginning at line 5,

 9 Dr. Peseau claims that while Potlatch was subject to

 10 floor and ceiling rates that escalated every year, the

 11 rest of Avista's customers saw no increases until the

 12 Commission approved a 7.58% general rate increase

 13 effective August 1, 1999. Dr. Peseau's statement is

 14 incorrect. Schedule 25 rates were subject to the DSM

 15 tariff rider increase of about 1.55% effective March 10,

 16 1995. Since the beginning of 1991 there have been 3 PCA

 17 surcharges and 7 rebates. The general rate increase

 18 applicable to Schedule 25 effective August 1, 1999 was

 19 9.97%. A second step Schedule 25 rate increase of 2.32%

 20 is to be effective August 1, 2000.

 21 Q If one were to accept Potlatch's argument

 22 that Potlatch has paid for Centralia depreciation, hasn't

 23 Potlatch more than recovered those costs through revenues

 24 received by Potlatch from comparable sales to Avista?

 25 A Yes. The Potlatch special contract covers

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 McKenzie, Di 4

 Avista

 1 both purchases from Potlatch as well as sales to

 2 Potlatch. Potlatch has been paid more for its sales to

 3 Avista than Potlatch has paid for its purchases from

 4 Avista for comparable amounts of energy. If one were to

 5 accept the argument that Potlatch has paid for Centralia

 6 depreciation through its purchases from Avista, then one

 7 can also make the argument that Potlatch has more than

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 1 fully recovered such costs through revenues received by

 2 Potlatch from comparable sales to Avista. Avista's

 3 tariffed customers pay for the higher cost of energy

 4 related to purchases by Avista from Potlatch. One could

 5 then conclude that Avista's tariffed customers are due

 6 any gain on Centralia that might be allocated to

 7 Potlatch. If the Commission can reduce revenue from the

 8 Potlatch contract for a share of the Centralia gain, then

 9 the Commission can also reduce the amount paid to

 10 Potlatch for power purchases by a like amount.

 11 Q What ratemaking treatment did the

 12 Commission reflect in its Order No. 28297?

 13 A The Commission directed at the top of page

 14 12 of Order No. 28297 that the customer portion of the

 15 gain be amortized over eight years with a return on the

 16 unamortized balance and that current rates to Idaho

 17 tariff customers be reduced by a uniform 1.318%.

 18 Q Assuming that Potlatch were to share the

 19 customer portion of the gain on a uniform percentage

 20 basis, what would be the resulting amount of revenue

 21 decrease applicable to Potlatch?

 22 A Exhibit No. 9 shows the allocation of the

 23 revenue decrease associated with the customer share of

 24 the gain assuming a uniform percentage decrease including

 25 the Potlatch special contract. The amount allocated to

 420

 McKenzie, Di 5

 Avista

 1 Potlatch under a uniform percentage basis is $332,195.

 2 The calculation is for illustrative purposes only. The

 3 Company's position is that no portion of the gain be

 4 allocated to Potlatch.

 5 Q Has Dr. Peseau calculated what he believes

 6 to be Potlatch's share of the Centralia gain?

 7 A Yes. Dr. Peseau's Exhibit No. 209 shows a

 8 calculation of a

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 1 lump sum Potlatch share of $255,000. However, his figure

 2 of $255,000 is based on Dr. Peseau's mistaken premise

 3 that the Commission ordered a 5-year amortization period

 4 instead of the 8-year amortization period actually

 5 ordered by the Commission. Avista sent Potlatch a

 6 production request, Request No. 4, asking whether or not

 7 an 8-year amortization period would change Exhibit No.

 8 209 and to fully explain and provide all calculations and

 9 supporting documentation associated with the

 10 recalculation of Exhibit No. 209. I have included

 11 Potlatch's response to Avista's Request No. 4 as my

 12 Exhibit No. 10. Exhibit No. 10 shows a revised lump sum

 13 Potlatch share of $408,000, according to Dr. Peseau.

 14 Q Do you agree with Dr. Peseau's calculations

 15 shown on Exhibit No. 10?

 16 A No. Dr. Peseau apparently recalculates an

 17 overall percentage reduction of 1.275% by including

 18 Potlatch revenues. The 1.275% overall percentage

 19 reduction is based on the first-year revenue reduction of

 20 an 8-year amortization period that includes a return on

 21 the unamortized balance of the gain. He then applies the

 22 1.275% to an approximate Potlatch Schedule 28 revenue

 23 number of $4 million to arrive at an annual Potlatch

 24 amount of $51,000. He then multiplies the annual amount

 25 of $51,000 by 8 years to arrive at a lump sum Potlatch

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 McKenzie, Di 6

 Avista

 1 amount of $408,000.

 2 Dr. Peseau's calculations are flawed in that he

 3 uses a revenue reduction percentage that has a embedded

 4 return component, even though he wants the revenue

 5 reduction as an up front, lump sum payment. He is

 6 attempting to take the return on the unamortized portion

 7 of the gain for all eight years of the amortization

 8 period assuming the first-year return occurs during all

 9 eight years of the amortization period. The return

 10 component

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 1 declines over time as the deferred gain is amortized.

 2 Potlatch should receive no return component, especially

 3 not 8 times the first year return component, under the

 4 assumption that a lump sum amount is paid.

 5 My Exhibit No. 9 shows the appropriate amount

 6 allocated to Potlatch under a uniform percentage basis to

 7 be $332,195. Again, the calculation is for illustrative

 8 purposes only. The Company's position is that no portion

 9 of the gain be allocated to Potlatch.

 10 Q Would you please summarize your testimony?

 11 A Yes. Potlatch should receive no share of

 12 the customer portion of the Centralia gain. Potlatch

 13 opted for market-based energy purchase rates under a

 14 special contract rather than tariffed rates. The

 15 market-based energy rates do not recover Centralia

 16 depreciation or any fixed costs. The special contract

 17 provides for no adjustments to revenues or rates outside

 18 of the rates contained in the contract. Dr. Peseau's

 19 calculations are flawed. If the Commission were to

 20 decide to reduce revenues under the Potlatch special

 21 contract, the Commission could and should reduce the

 22 amount paid to Potlatch under the special contract for

 23 the purchase of energy by a like amount.

 24 Q Does that conclude your direct testimony in

 25 this proceeding?

 A Yes, it does.

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 McKenzie, Di 7

 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.

 6 MR. WARD: Just a couple of areas,

 7 Mr. McKenzie.

 8

 9 CROSS-EXAMINATION

 10

 11 BY MR. WARD:

 12 Q If you'd turn to page 4, line 21 of your

 13 testimony.

 14 A I'm there.

 15 Q There begins an answer in response to a

 16 question of counsel in which you basically suggest that

 17 Potlatch has been paid more for its sales to Avista than

 18 the amounts involved in this case and that forms a reason

 19 for denying Potlatch the right to participate in this

 20 capital gain; correct?

 21 A No, that's not correct. That's not the

 22 point I'm making at this spot in my testimony. I'm

 23 saying that if the Commission were to decide to give

 24 Potlatch a portion of the gain, they could just as easily

 25 decide to reduce the price that Avista pays for power

 425

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 purchased from Potlatch and those two amounts could

 2 offset.

 3 I'm not suggesting that that's a reason

 4 that Potlatch isn't it entitled to the gain. I'm saying

 5 that Potlatch is not entitled to the gain, but if the

 6 Commission were to decide to give Potlatch a piece of the

 7 gain, they could take it right back through the purchased

 8 rate that Avista pays and those higher costs are

 9 recovered from other ratepayers, so then the Potlatch

 10 power cost piece could be passed on to other customers.

 11 Q Do you recognize that Potlatch had in 1991

 12 and has today a federal statutory right to sell

 13 cogenerated power to Avista and Avista has a statutory

 14 obligation to buy?

 15 A I'm aware of that. This contract is a

 16 negotiated contract that includes negotiated purchase and

 17 sales rates. They aren't tied specifically to any PURPA

 18 rate.

 19 Q Now, would you answer my question?

 20 A I believe I already did.

 21 Q Avista has other suppliers in its service

 22 territory that sell it goods and services, does it not?

 23 A Yes.

 24 Q Presumably under contract?

 25 A Yes.

 426

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 Q Could the Commission on the grounds that

 2 it's changed the nature of the relationship between the

 3 parties then intervene in those parties' contracts with

 4 Avista?

 5 A I don't believe so and that's why I'm

 6 arguing in my testimony that the contract rates, both

 7 purchases and sales rates, shouldn't be adjusted, but

 8 what I'm saying is that if the Commission decides to

 9 adjust one rate in the contract, they could just as

 10 easily decide to adjust an offsetting rate.

 11 Q Let's turn to another matter,

 12 Mr. McKenzie. If you'd go to page 3, lines 1 through 10,

 13 if I understand this correctly here, at this point you're

 14 trying to rebut Dr. Peseau's contention that Potlatch

 15 paid depreciation on the Centralia plant, correct?

 16 A Correct.

 17 Q And you do that by referring to the demand

 18 and customer charges and the intention of what elements

 19 those charges were to recover; correct?

 20 A Correct.

 21 Q And you say there, and I want to draw your

 22 attention particularly to the lines 4 through 6, and it

 23 says, "These rates were designed to recover costs, other

 24 than energy costs, including transmission costs,

 25 distribution costs, and administrative and general

 427

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 costs." Do you see that testimony?

 2 A Yes.

 3 Q And I take it from that that you're arguing

 4 that there was no generating cost recovered in those

 5 rates and no depreciation.

 6 A That's correct. The demand rates did not

 7 recover generation costs and were not established on that

 8 basis.

 9 MR. WARD: May I approach the witness?

 10 COMMISSIONER SMITH: Yes.

 11 (Mr. Ward approached the witness.)

 12 MR. WARD: In the interests of speeding

 13 this along while I pass this out, I'll go ahead and ask a

 14 question.

 15 Q BY MR. WARD: Mr. McKenzie, do you know who

 16 Gregory Prekeges is?

 17 A Yes.

 18 Q Who is he?

 19 A Well, he's retired, but he was a company

 20 employee that participated in the contract negotiation

 21 with Potlatch.

 22 Q Did he testify in the 1991 case regarding

 23 approval of the contract?

 24 A Yes.

 25 Q I've passed you out a document which I will

 428

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 represent to you is a page from the transcript of that

 2 testimony and I want to refer you to lines 21 through 23,

 3 if you would read that sentence, please, out loud.

 4 A "The Firm Demand Service Rate includes the

 5 cost of capacity, transmission, distribution facilities,

 6 and administrative and general costs."

 7 Q Now, when I your compare that sentence with

 8 the sentence I had you read from your testimony, they're

 9 almost identical in structure, except there's one big

 10 omission. Mr. Prekeges says the demand service rate

 11 includes the cost of capacity, transmission, distribution

 12 facilities, and administrative and general costs, yours

 13 refers to transmission costs, distribution costs, and

 14 administrative and general costs and notably eliminates

 15 his reference to cost of capacity. How do you account

 16 for that, Mr. McKenzie?

 17 A You're correct, it does exclude a reference

 18 to capacity and the way I account for it is I spoke with

 19 Brian Hirschkorn, who is a current employee, that

 20 participated in the contract negotiations and he said

 21 that the capacity referred to by Mr. Prekeges was a

 22 market estimate of capacity. It had nothing to do

 23 whatsoever with fixed costs of any of the company's

 24 resources and there was no cost of service study

 25 prepared. This was strictly a negotiated rate between

 429

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 the two companies. The negotiated rate included both

 2 purchase and sales rates and Potlatch was concerned with

 3 the net of the two.

 4 Q Are you telling me there were no cost of

 5 service studies prepared in connection with that

 6 proceeding and that there was no evidence that these

 7 costs were above cost of service?

 8 A No, I'm not saying that. I'm saying that

 9 the rates that were negotiated were not based on

 10 Centralia fixed costs or Centralia generation or

 11 Centralia depreciation.

 12 Q How can you have a rate that incorporates

 13 cost of capacity that does not incorporate depreciation

 14 payments on that capacity?

 15 A I already explained that the capacity cost

 16 was based on a market estimate of capacity and had no

 17 relationship or bearing whatsoever to embedded costs of

 18 the company.

 19 Q Mr. McKenzie, if you assume -- well, first

 20 of all, isn't it true that this contract was actually

 21 derived in two parts and I assume you've read

 22 Mr. Prekeges' testimony?

 23 A Yes.

 24 Q And in fact, Mr. Prekeges points out, does

 25 he not, that as to the then existing load of Potlatch

 430

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 that that portion of the contract was based on embedded

 2 costs; isn't that true?

 3 A I have his testimony. Could you refer me

 4 to that section, please?

 5 Q Well, I didn't anticipate that you would

 6 deny the cost of capacity means what it says, and do you

 7 remember whether in fact those rates were set in a

 8 two-part analysis; that is, one part on embedded costs

 9 and the addition to load to be determined based on in

 10 part incremental costs?

 11 A I don't, but I have the testimony. If

 12 you'd refer me to the testimony, we can go over it.

 13 MR. WARD: That's all I have.

 14 COMMISSIONER SMITH: Thank you, Mr. Ward.

 15 Mr. Woodbury.

 16 MR. WOODBURY: Thank you, Madam Chair.

 17

 18 CROSS-EXAMINATION

 19

 20 BY MR. WOODBURY:

 21 Q Mr. McKenzie, did you participate at all in

 22 the Potlatch contract case, the 91-5 case?

 23 A No.

 24 Q Did you participate in negotiation of that

 25 contract?

 431

 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 A No.

 2 Q To your knowledge, are there any collateral

 3 or side agreements that were not represented in the

 4 underlying case?

 5 A To my knowledge, there are none.

 6 MR. WOODBURY: Thank you. No further

 7 questions.

 8 COMMISSIONER SMITH: From the Commission.

 9 COMMISSIONER KJELLANDER: No.

 10 COMMISSIONER SMITH: Redirect.

 11 MR. DAHLKE: I have no redirect.

 12 COMMISSIONER SMITH: Thank you very much,

 13 Mr. McKenzie.

 14 (The witness left the stand.)

 15 COMMISSIONER SMITH: Mr. Woodbury.

 16 We have finally realized that all of these

 17 witnesses have been previously sworn.

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 CSB REPORTING McKENZIE (X)

 Wilder, Idaho 83676 Avista Corporation

 1 RANDY LOBB,

 2 produced as a witness at the instance of the Staff,

 3 having been previously duly sworn, resumed the stand and

 4 was further examined and testified as follows:

 5

 6 DIRECT EXAMINATION

 7

 8 BY MR. WOODBURY:

 9 Q Mr. Lobb, will you please state your name

 10 for the record?

 11 A My name is Randy Lobb.

 12 Q Are you the same Mr. Lobb who previously

 13 testified in the underlying case in this matter?

 14 A Yes, I am.

 15 Q And have you prepared 14 pages of direct

 16 testimony on reconsideration for today's hearing?

 17 A Yes, I have.

 18 Q And have you had the opportunity to review

 19 that testimony prior to this hearing?

 20 A Yes.

 21 Q And if I were to ask you the questions set

 22 forth in your testimony, would your answers be the same?

 23 A Yes, they would.

 24 MR. WOODBURY: Madam Chair, I'd ask that

 25 the testimony be spread on the record and I'd present

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 CSB REPORTING LOBB (Di)

 Wilder, Idaho 83676 Staff

 1 Mr. Lobb for cross-examination.

 2 COMMISSIONER SMITH: Is there any objection

 3 to spreading the testimony of Mr. Lobb across the record

 4 as if read? None noted, then it is so ordered.

 5 (The following prefiled testimony of

 6 Mr. Randy Lobb is spread upon the record.)

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 CSB REPORTING LOBB (Di)

 Wilder, Idaho 83676 Staff

 1 Q Please state your name and business address

 2 for the record.

 3 A My name is Randy Lobb and my business

 4 address is 472 West Washington Street, Boise, Idaho.

 5 Q By whom are you employed?

 6 A I am employed by the Idaho Public Utilities

 7 Commission as Engineering Supervisor.

 8 Q What is your educational and professional

 9 background?

 10 A I received a Bachelor of Science Degree in

 11 Agricultural Engineering from the University of Idaho in

 12 1980 and worked for the Idaho Department of Water

 13 Resources from June of 1980 to November of 1987. I

 14 received my Idaho license as a registered professional

 15 Civil Engineer in 1985 and began work at the Idaho

 16 Public Utilities Commission in December of 1987. My

 17 duties at the Commission include analysis of utility

 18 rate applications, rate design, tariff analysis and

 19 customer petitions. I have testified in numerous

 20 proceedings before the Commission including cases

 21 dealing with rate structure, cost of service, power

 22 supply, line extensions and facility acquisitions.

 23 Q Are you the same Randy Lobb that previously

 24 filed direct testimony in Case AVU-E-99-6?

 25 A Yes.

 435

 AVU-E-99-6 LOBB, R (Rec) 1

 06/14/00 STAFF

 1 Q What is the purpose of your testimony in

 2 this case?

 3 A Pursuant to Commission Order No. 28297 in

 4 Case No. AVU-E-99-6, the Potlatch-Lewiston facility, a

 5 special contract customer of Avista, was denied any

 6 share of the customer portion of the gain associated

 7 with the sale of the Company's 15% interest in the coal-

 8 fired Centralia plant. Potlatch filed a Petition for

 9 Reconsideration. The Commission has provided Potlatch

 10 with additional opportunity to present its claim of

 11 entitlement. The purpose of my testimony is to present

 12 Commission Staff's position.

 13 Q Would you please summarize your testimony?

 14 A. Yes. In its Order approving the sale of

 15 Centralia, the Commission found the depreciation reserve

 16 methodology to be a reasonable method for distributing

 17 the gain associated with the sale. The depreciation

 18 reserve methodology adopted by the Commission recognizes

 19 that customers acquired an equitable interest in the

 20 Centralia coal fire power plant through the payment of

 21 depreciation expenses and are therefore entitled to gain

 22 from the sale. The equity interest is essentially

 23 created because customers have paid more depreciation

 24 expense than is actually required to return the

 25 Company's investment. This type of overpayment also

 436

 AVU-E-99-6 LOBB, R (Rec) 2

 06/14/00 STAFF

 1 occurs with excessive positive salvage value and lower

 2 than anticipated removal costs associated with

 3 retirement of Company assets. The resulting

 4 depreciation reserve imbalance constitutes a change in

 5 cost of service and requires periodic change in Company

 6 revenue requirement. The Commission used the gain

 7 attributable to customers in this case to reduce the

 8 revenue requirement of the Company over the next eight

 9 years.

 10 Potlatch is one of many specific customers of

 11 Avista that paid depreciation expenses associated with

 12 Centralia but do not pay tariffed retail rates subject

 13 to non-contractual cost of service adjustments. The

 14 benefit from the gain is available to all customers

 15 paying tariffed rates based on Company revenue

 16 requirement during the amortization period. Potlatch

 17 negotiated and signed a "contract standard" Agreement in

 18 1991 that specified the terms and conditions under which

 19 Potlatch takes service from the Company. See Potlatch

 20 Exhibit No. 204. As a result of the Agreement (or

 21 Contract), Potlatch is neither entitled to savings that

 22 result from reductions in cost of service nor subject to

 23 higher costs resulting from increases in cost of service

 24 during the term of its Agreement. That this was the

 25 understanding of Potlatch as to how its Contract should

 437

 AVU-E-99-6 LOBB, R (Rec) 3

 06/14/00 STAFF

 1 be regarded and interpreted by the Commission is

 2 reflected in the transcript of proceedings in Case

 3 No. WWP-E-91-5, the case in which the Commission approved

 4 the Potlatch Agreement.

 5 There has been no showing in this case that

 6 failure of the Commission to adjust the Contract rates

 7 will adversely affect the public interest, which is the

 8 "Agricultural Products" standard for Commission

 9 intervention in private Company/customer contracts.

 10 Potlatch's entire relationship (rights and obligations)

 11 with Avista is defined by its Contract. Potlatch on

 12 reconsideration claims entitlement to a benefit apart

 13 from and outside its Contract. Potlatch has no

 14 contractual right to a share of the Centralia gain. The

 15 Commission should not intervene to modify or abrogate the

 16 terms of the Avista/Potlatch Contract.

 17 Q Did you address the issue of Potlatch's

 18 entitlement to gain proceeds from the sale of the

 19 Centralia coal fired power plant in previously filed

 20 testimony?

 21 A Yes, but only briefly. My recommendation

 22 in previous testimony was that the customer share of the

 23 gain from the sale of Centralia be used to reduce the

 24 revenue requirement of all customer classes, excluding

 25 special contracts, by a uniform percentage.

 438

 AVU-E-99-6 LOBB, R (Rec) 4

 06/14/00 STAFF

 1 Q Why did your recommendation specifically

 2 exclude special contracts from sharing in the gain?

 3 A Although not discussed in original testimony,

 4 my recommendation to exclude special contracts was based

 5 on Staff's understanding that "contract standard" rates

 6 remain at contract levels over the life of the contract,

 7 except upon a showing that the public interest would be

 8 adversely affected. The Potlatch Contract, the only

 9 special contract Avista has in Idaho, contains

 10 specifically defined rates. Potlatch contracted for a

 11 certainty in its rates, excluding itself from the

 12 vagaries in future forecasting and non-contractual

 13 changes in cost of service. Any equitable claim

 14 Potlatch had to a share of the gain, it contracted away.

 15 Q Dr. Peseau presents a sequential analysis

 16 that he believes provides a rational argument that justifies

 17 sharing the gain from the Centralia sale with Potlatch.

 18 Do you agree with his analysis and conclusion?

 19 A No. The first question addressed in the

 20 analysis was what is the basis for allocating the gain to

 21 Avista's Idaho ratepayers. The philosophy/

 22 methodology adopted by the Commission for allocating

 23 gain between ratepayers and shareholders is that

 24 ratepayers acquired an equity interest in the plant

 25 based on the payment of Centralia depreciation expense.

 439

 AVU-E-99-6 LOBB, R (Rec) 5

 06/14/00 STAFF

 1 The ratepayer equity was essentially created because

 2 ratepayers paid depreciation expense in excess of that

 3 needed to recover the Company's Centralia investment.

 4 The result was a book value that was significantly below

 5 the actual plant residual value at the time of the sale.

 6 Consequently, customers "invested" in the plant by

 7 virtue of the excessive depreciation expense included in

 8 the Company's revenue requirements during the period it

 9 owned the plant.

 10 This mismatch between net book value and

 11 residual value materializes in the form of a

 12 depreciation reserve imbalance because asset useful

 13 lives, salvage values or removal costs are not

 14 accurately estimated. Reserve imbalances represent a

 15 change in cost of service that occasionally require a

 16 periodic revenue requirement adjustment through

 17 amortization.

 18 In this regard, the depreciation reserve

 19 methodology provides the rationale to quantify general

 20 customer entitlement but it does not necessarily specify

 21 which ratepayers are entitled to participate.

 22 Consequently, in response to the second question posed

 23 in Dr. Peseau's analysis, the rationale does not

 24 necessarily apply with equal force to Potlatch.

 25 Q Aren't all ratepayers that paid Centralia

 440

 AVU-E-99-6 LOBB, R (Rec) 6

 06/14/00 STAFF

 1 depreciation expense entitled to a portion of the gain?

 2 A Not necessarily. There are three distinct

 3 groups of ratepayers/customers that have arguably paid

 4 depreciation expenses associated with the Centralia

 5 plant. The first is tariffed rate retail customers that

 6 have been and continue to be served by Avista. The

 7 second is tariffed rate retail customers that have been,

 8 but are no longer served by Avista, and the third group

 9 is the contract rate retail customer that includes only

 10 Potlatch.

 11 The Commission has historically treated gains

 12 as a reduction in revenue requirement or used them to

 13 pay for system improvements for the benefit of the

 14 general body of customers. It has never, to my

 15 knowledge, tried to assure that specific customers who

 16 may have contributed to the existence of a gain, receive

 17 their pro rata share of such gain. In this case only

 18 the tariffed rate retail customers that are served by

 19 Avista during the eight-year amortization period have

 20 been allowed by the Commission to share in the gain from

 21 the sale of Centralia. Specific customers that do not

 22 pay tariffed Avista rates are not subject to the

 23 benefit. Should Potlatch become a customer subject to

 24 tariffed retail rates during this period, then it too

 25 would benefit from the gain through reduced Company

 441

 AVU-E-99-6 LOBB, R (Rec) 7

 06/14/00 STAFF

 1 revenue requirement.

 2 Q Do you agree with Dr. Peseau that the Potlatch

 3 contract rates are in excess of cost of service and

 4 Potlatch has therefore contributed to Centralia

 5 depreciation expenses?

 6 A Yes. Evidence presented in Case

 7 No. WWP-E-91-5, the Contract approval case, and again in

 8 Case No. AVU-E-99-6, the general rate case, indicated

 9 that the Potlatch Contract was above cost of service

 10 that included a component for Centralia depreciation

 11 expense. However, while the Contract was generally

 12 perceived to be above cost of service at its inception

 13 in 1991 and above cost of service in 1999, it is

 14 inconsequential in determining Potlatch's entitlement to

 15 a portion of the gain. Potlatch argues equity when its

 16 rights are determined by contract. Absent a showing

 17 that it adversely affects the public interest, no

 18 modification of the Contract should occur.

 19 Q Is it clear that the Contract standard is

 20 the appropriate standard to follow in considering

 21 Potlatch's entitlement to a portion of the gain?

 22 A Yes. This Contract specifically established

 23 rates that did not change with non-contractual changes

 24 in cost of service. It therefore constitutes a contract

 25 standard agreement rather than a tariff standard

 442

 AVU-E-99-6 LOBB, R (Rec) 8

 06/14/00 STAFF

 1 agreement. Moreover, the perception that rates within

 2 the Agreement were specifically established using the

 3 contract standard seemed to be shared by Staff, Potlatch

 4 and the Commission. Potlatch witness Peseau on

 5 reconsideration provides evidence that the Commission

 6 Staff in Case No. WWP-E-91-5 clearly believed rates

 7 within the Agreement were established based on the

 8 contract standard rather than the tariff standard.

 9 Potlatch stopped short of saying that it agreed with

 10 Staff's interpretation. It should be precluded from

 11 inferring otherwise.

 12 Testimony of Potlatch witness Nicholson in Case

 13 No. WWP-E-91-5 states:

 14 Commissioner Miller to Nicholson

 (participant in Contract

 15 negotiations)

 16 Q. Do I understand correctly that

 the proposal is that the agreement

 17 during its term could be reviewed by

 the Commission under what's called

 18 the contract standard as opposed to

 the tariff standard?

 19 A. What we have here is a

 contract that we believe would be in

 20 place for ten years and the

 Commission would not be concerned

 21 with it in that time frame.

 Tr p 144

 22

 23 The Commission, in its subsequent

 24 consideration of an Idaho Power/FMC contract

 25 acknowledged in footnote, its prior approval of

 443

 AVU-E-99-6 LOBB, R (Rec) 9

 06/14/00 STAFF

 1 "contract standard" rates for Potlatch. Reference Order

 2 No. 27463, page 4, footnote 3, Case No. IPC-E-97-13.

 3 The Commission in furtherance of its understanding has

 4 also excluded Potlatch from all non-contractual changes

 5 in Avista's cost of service over the term of the

 6 Contract. Avista witness, McKenzie, in rebuttal

 7 testimony previously filed in this case, highlighted the

 8 changes that affected tariff rates but not rates in the

 9 Potlatch Contract. The changes include the Power Cost

 10 Adjustment (PCA), the Demand Side Management (DSM)

 11 tariff rider and the increase, effective August 1, 1999,

 12 that resulted from the general rate case.

 13 Q Potlatch witness Peseau points to paragraph

 14 21 of the Contract, COMPLIANCE WITH THE LAWS, as a unique

 15 contract provision that specifies neither a contract

 16 standard nor a tariff standard. Does this section

 17 require or prohibit the Commission from changing the

 18 Potlatch rates?

 19 A It does neither. It simply puts the

 20 Commission on notice that either party can get out of the

 21 Contract if the Commission imposes new or changed

 22 regulations or policies that affect the rates. The

 23 significance of Agreement Paragraph 21 was discussed by

 24 Potlatch witness Nicholson in Case No. WWP-E-91-5:

 25

 444

 AVU-E-99-6 LOBB, R (Rec) 10

 06/14/00 STAFF

 1 Commissioner Miller to Nicholson

 2 Q. As I understand it, the

 contemplation is that the rates

 3 contained in the contract wouldn't be

 subject to Commission adjustment

 4 during the term of the contract, and

 if they were adjusted, the contract

 5 could be terminated; is that right?

 A. There is, there was the

 6 contemplation that these rates would

 stay in place for the life of the

 7 contract as they are defined in the

 contract

 8 Tr page 145

 9 Q. The terms of this contract are

 such that if its accepted, the

 10 Commission accepts a constraint upon

 its normal scope of authority; that

 11 is, it's accepting a constraint to

 the general effect that it will forgo

 12 the usual right the Commission has to

 adjust contract rates. Can you

 13 accept that assumption.

 A. I'll accept that assumption.

 14 Tr page 146

 15 The nature of the Potlatch Contract, vis a vis

 16 the Commission and the Company's other ratepayers, was

 17 further articulated by Potlatch witness Nicholson in its

 18 contract case:

 19 A. There's no way that the

 Commission can be absolutely 100%

 20 sure that a circumstance would occur

 that if you approve this arrangement

 21 you might seven or eight years later

 say, golly, we never thought of it ...

 22 Tr. Page 149, Nicholson

 23 Potlatch atty. Conley Ward to

 Nicholson

 24

 Q. Mr. Nicholson, it is a wager, is

 25 it not from the Commission's point of

 view?

 445

 AVU-E-99-6 LOBB, R (Rec) 11

 06/14/00 STAFF

 1 A. It is.

 2 Q. And if the wager turns out badly,

 then the Commission having

 3 surrendered its normal ratemaking

 standard will look badly at the end

 4 of the contract; correct?

 A. That's true.

 5

 Q. Conversely, if these forecasted

 6 numbers are correct, the ratepayers

 will benefit.

 7 A. Considerably

 Tr. Page 152

 8

 9 Both paragraph 21 and testimony in the

 10 Potlatch contract approval case, support the position

 11 that alteration of the Contract by the Commission allows

 12 either party to terminate the Agreement.

 13 Q Dr. Peseau states that returning a portion of

 14 the sale gain to Potlatch is not a change in rates. Do

 15 you agree?

 16 A No. It may not be a change in the unit prices

 17 specified in the Contract but if the gain is returned in

 18 an annual lump sum as recommended, it certainly

 19 constitutes a change in net annual costs and revenues

 20 for both parties. The Contract specifies both the price

 21 that Potlatch will pay for electrical service and the

 22 price that Potlatch will receive for its generation. The

 23 Contract therefore specifies the annual cost and the

 24 annual revenue that will result. A reduction in the

 25 annual cost to Potlatch implies a net reduction in the

 446

 AVU-E-99-6 LOBB, R (Rec) 12

 06/14/00 STAFF

 1 unit price of electrical service, an increase in the

 2 unit price of generation sold to Avista or changes in

 3 the unit price of both. The change requested by

 4 Potlatch on reconsideration could trigger the right of

 5 the parties to terminate the Contract.

 6 Q Why does the contract standard Agreement

 7 generally insulate Potlatch from cost increases and

 8 prohibit it from benefiting from cost decreases?

 9 A Staff's position regarding the contract

 10 standard comes from a 1976 Idaho Supreme Court ruling in

 11 Agricultural Products vs. Utah Power and Light Company

 12 (98 Idaho 23, 557 P2d 617 (1976)). The Court's decision

 13 at page 29 states in part that:

 14 Private contracts with utilities are

 regarded as entered into subject to

 15 reserved authority of the state to

 modify the contract in the public

 16 interest...

 To justify state interference with

 17 the utility contract, there must be a

 finding that the rate "is so low as

 18 to adversely affect the public

 interest - as where it might impair

 19 the financial ability of the public

 utility to continue its service, cast

 20 upon other consumers an excessive

 burden, or be unduly discriminatory.

 21

 22 I maintain that no showing has been made to

 23 demonstrate that the public interest will be adversely

 24 affected by failure of the Commission to intervene in

 25 the Contract and return a portion of the Centralia gain

 447

 AVU-E-99-6 LOBB, R (Rec) 13

 06/14/00 STAFF

 1 to Potlatch. Therefore, the answer to question three of

 2 Dr Peseau's analysis is yes; the Potlatch Contract does

 3 waive Potlatch's entitlement to a portion of the gain.

 4 Q Does that conclude your reconsideration

 5 testimony?

 6 A Yes it does.

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 448

 AVU-E-99-6 LOBB, R (Rec) 14

 06/14/00 STAFF

 1 (The following proceedings were had in

 2 open hearing.)

 3 COMMISSIONER SMITH: Mr. Ward, do you have

 4 questions for Mr. Lobb?

 5 MR. WARD: Yes, I have a few.

 6

 7 CROSS-EXAMINATION

 8

 9 BY MR. WARD:

 10 Q Mr. Lobb, on page 4 and page 6 and again on

 11 page 6 of your testimony, you argue that what we have

 12 here is a reserve imbalance that is being adjusted and

 13 that this constitutes a change to cost of service; do I

 14 understand you correctly?

 15 A It's essentially the same.

 16 Q And I take it, then, that the implication

 17 is that Potlatch's rates shouldn't be adjusted and

 18 Potlatch shouldn't be allowed to participate in this gain

 19 because it's really just a rate adjustment and a cost

 20 adjustment.

 21 A That's basically the way the Commission has

 22 handled it in the past. Different types of return of

 23 gain have been through, made to ratepayers through

 24 reduction in revenue requirement of the company and that

 25 can be done immediately or in a subsequent rate case as a

 449

 CSB REPORTING LOBB (X)

 Wilder, Idaho 83676 Staff

 1 result of an amortization of a gain.

 2 Q Didn't you in your prior testimony in this

 3 case argue that it was -- that at this juncture we cannot

 4 determine whether there will be any change in the

 5 company's costs as a result of this sale?

 6 A Do you have my testimony?

 7 Q Let me ask you this: As you will recall,

 8 the company argued that there would be long-term cost

 9 savings with the sale of Centralia; correct?

 10 A That's correct.

 11 Q And your testimony basically, as I

 12 understand it, said maybe and then maybe not. Since it

 13 depends on projections, we really can't know; isn't that

 14 what you said essentially?

 15 A That's true.

 16 Q All right; so underlying costs haven't

 17 really changed here, have they?

 18 A To the extent that depreciation expenses

 19 more than covered the return on the capital for

 20 Centralia, it's essentially a modification of

 21 depreciation expense through the amortization.

 22 Q Is that what's really going on here, that

 23 we have a restatement of the depreciation reserve?

 24 A Not specifically.

 25 Q And in fact, if you restated the

 450

 CSB REPORTING LOBB (X)

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 1 depreciation reserve, you'd have to restate income,

 2 wouldn't you?

 3 A Perhaps. I don't know the answer to that.

 4 Q And isn't it true that this is not an

 5 income matter at all, that this is a capital gain?

 6 A It is a capital gain, but it's a capital

 7 gain because of the difference between the residual value

 8 of the plant and the book value of the plant and the book

 9 value of the plant is established as a result of the

 10 accumulated depreciation.

 11 Q Okay. Now, previously I passed out copies

 12 of the Boise Water decision and a page from what I'll

 13 represent to you is Black's Law Dictionary, the edition

 14 number I've forgotten, and I asked you to bring those two

 15 to the stand with you. Do you have those?

 16 A Yes, I do.

 17 Q Now, I'd like you to turn to page 1092 of

 18 the Boise Water decision and I've marked the passage

 19 there. Do you see that?

 20 A Yes.

 21 Q And in that passage the court is saying,

 22 essentially, and I believe witness Stockton testified to

 23 this earlier, that in effect, the right to participate in

 24 a capital gain arises because the ratepayers purchase a

 25 portion of that depreciable property; isn't that correct?

 451

 CSB REPORTING LOBB (X)

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 1 A That's the way it's been stated, yes.

 2 Q And on the next page the court refers to

 3 this, if you look three, six, seven lines down, refers to

 4 the ratepayer situation as equitable owners. Do you see

 5 that phrase?

 6 A Yes, I do.

 7 Q Now, the Black's Law Dictionary excerpt I

 8 gave you has a definition of equitable owner and if you

 9 would just read that underlined passage.

 10 A On page 1092?

 11 Q 1259 on the Black's Law Dictionary

 12 excerpt.

 13 A I'm sorry. It says, "One who is recognized

 14 in equity as the owner of property, because the real and

 15 beneficial use and title belong to him, although the bare

 16 legal title is vested in another, a trustee for his

 17 benefit."

 18 Q Okay. Now, I'd like you to return to your

 19 testimony on page 4. There beginning on line 11 you say,

 20 "Potlatch on reconsideration claims entitlement to a

 21 benefit apart from and outside its Contract." Do you see

 22 that sentence?

 23 A On line 9 on page 4?

 24 Q I've got 11 on mine.

 25 A I'm sorry, what page are you on?

 452

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 1 Q I'm on page 4.

 2 A Page 4.

 3 Q It's line 11 on my text.

 4 A And what sentence?

 5 Q "Potlatch on reconsideration," do you see

 6 that sentence?

 7 A Yes.

 8 Q Are we okay now?

 9 A Yes, I'm with you.

 10 Q All right. Now, let me represent to you

 11 that Potlatch agrees with that statement. It also agrees

 12 with the next statement, "Potlatch has no contractual

 13 right to a share of the Centralia gain." Wouldn't it be

 14 true that no other party has any contractual right to a

 15 share of the Centralia gain?

 16 A To the extent that this is depreciation

 17 expense, that it's based on depreciation expense paid by

 18 the company or paid by the ratepayers and the Commission

 19 historically through several, in several cases has chosen

 20 to pass that back through rates or improvements in

 21 service quality to the general body of ratepayers that

 22 are affected by tariff rates, then the fact that those

 23 costs or benefits are passed back through the tariffs,

 24 then they are entitled to rates based on cost of service.

 25 Q Mr. Lobb, does reading what you've just

 453

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 1 read of the Supreme Court's decision in Boise Water and

 2 the excerpt from Black's Law Dictionary, does the

 3 entitlement of ratepayers have anything to do with

 4 contractual provisions or, for that matter, tariff

 5 provisions or does it arise because the ratepayers have

 6 an ownership interest in the plant in question?

 7 A The general body of ratepayers have an

 8 ownership interest and to the extent that they are under

 9 tariffed rates and the Commission has historically done

 10 this, they've passed back the benefit of gains through

 11 tariffed rates. Now, the basic position is the contract

 12 specifies the rates under which Potlatch pays for its

 13 energy. This is not one of the -- it doesn't specify any

 14 particular or exclude any particular change in the

 15 underlying basis of tariffed rates, the underlying cost

 16 of service, the underlying rates that the general body of

 17 ratepayers are entitled to, so the difference is the

 18 specifics of the contract and what Potlatch has chosen to

 19 pay under that contract.

 20 Q Let me ask it again. First of all, let me

 21 respond to your statement about the traditional passing

 22 through in rates. Isn't it true that the Commission has

 23 used a credit, a billing credit, in the past to

 24 distribute these sorts of proceeds?

 25 A Sometimes. Sometimes they've just made

 454

 CSB REPORTING LOBB (X)

 Wilder, Idaho 83676 Staff

 1 investments in the system for the benefit of the general

 2 body of ratepayers. Sometimes they've offset taxes that

 3 were due and would have been paid for by the general body

 4 of ratepayers subject to tariffed rates.

 5 Q And in those cases can we even under a

 6 stretch definition characterize that as a change in

 7 costs?

 8 A Certainly, it offsets costs and that

 9 changes the underlying costs.

 10 Q All right, let me go back to my original

 11 question and I still want an answer to it. Does the

 12 nature of the customer's right arise from anything having

 13 to do with contracts, tariffs or any other consideration

 14 beyond the fact that the customers have an ownership

 15 interest?

 16 MR. DAHLKE: I'll object to the form of the

 17 question. The Boise Water, the words that the witness

 18 was asked to read were that they were to be treated as if

 19 they had an ownership interest. It doesn't say that they

 20 have an ownership interest.

 21 COMMISSIONER SMITH: Mr. Ward?

 22 MR. WARD: And on the following page the

 23 court characterizes this as an equitable ownership.

 24 COMMISSIONER SMITH: Mr. Ward, I guess we

 25 could maybe have a legal discussion about that, but I

 455

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 1 think the court has moved on on the second page to the

 2 discussion of the interests [inaudible].

 3 MR. WARD: That's true, Commissioner, but

 4 in entering into that discussion, it contrasts it with

 5 those who have an interest in personal property which is

 6 who they characterize as equitable owners.

 7 THE WITNESS: I would like to respond.

 8 COMMISSIONER SMITH: Is this witness one we

 9 want to have discuss the Supreme Court decision or is he

 10 going to get in trouble practicing law without a

 11 license?

 12 MR. WARD: I'll withdraw it and let me go

 13 another way.

 14 Q BY MR. WARD: Mr. Lobb, assume for me that

 15 Avista held some property of Potlatch's in trust. Can

 16 you make that assumption, let us say a fleet of

 17 automobiles?

 18 A Okay.

 19 Q Do you know what it is to hold something in

 20 trust?

 21 A Sure.

 22 Q And under that trust arrangement, Avista

 23 has the title, but Potlatch is the equitable owner of the

 24 vehicles. They literally bought and paid for them. Can

 25 you hypothesize that?

 456

 CSB REPORTING LOBB (X)

 Wilder, Idaho 83676 Staff

 1 A Okay.

 2 Q Now, the trustee sells the vehicles, could

 3 the contract that we are considering in this case be

 4 interposed as an objection to the trustee's duty to

 5 account to Potlatch?

 6 MR. DAHLKE: I apologize, I --

 7 COMMISSIONER SMITH: Mr. Dahlke.

 8 MR. DAHLKE: -- I don't have any problem

 9 with the hypothetical, but we intermix a question

 10 concerning the facts of this case and the specific

 11 Potlatch contract which doesn't relate to Mr. Ward's

 12 hypothetical.

 13 COMMISSIONER SMITH: Mr. Ward.

 14 MR. WARD: Madam Chair, that's exactly the

 15 point. The contract does not relate to ownership

 16 interests and that's the point I'm trying to get the

 17 witness to answer and I think it's fair to ask him to go

 18 this far considering how far into the law he went in his

 19 testimony.

 20 COMMISSIONER SMITH: Mr. Woodbury.

 21 MR. WOODBURY: Madam Chair, Mr. Ward has

 22 attempted to take language out of the Supreme Court from

 23 the Boise Water case. I think he has taken this out of

 24 context, this language that he has underlined, and what

 25 puts it into context is the following sentence where the

 457

 CSB REPORTING LOBB (X)

 Wilder, Idaho 83676 Staff

 1 court indicates how those monies would be distributed and

 2 the court says, "The revenue ought to be included in the

 3 utility's revenue receipts which reduce the rate charges

 4 to customers."

 5 In this particular case, the company is

 6 saying we're not dealing with rates here. The court says

 7 this is a rate matter and I believe that what the

 8 Commission has done is consistent with the court's

 9 language in the Boise Water case. Potlatch is not a

 10 general tariffed customer and so we're not dealing with

 11 it here.

 12 COMMISSIONER SMITH: It sounds to me like

 13 this is fruitful fodder for legal arguments on closing

 14 and perhaps not so much as questions for witnesses.

 15 Mr. Ward, I will overrule the objection if you want to

 16 try to continue.

 17 MR. WARD: If I'm on a short leash, I want

 18 to go to the better hypothetical.

 19 COMMISSIONER SMITH: Okay.

 20 MR. WARD: I think we can all answer the

 21 first one anyway.

 22 Q BY MR. WARD: Mr. Lobb, let me give you

 23 this hypothetical: Potlatch is not an equitable owner in

 24 the plant. Potlatch instead actually purchased a

 25 percentage ownership in Centralia. Can you hypothesize

 458

 CSB REPORTING LOBB (X)

 Wilder, Idaho 83676 Staff

 1 that?

 2 A Yes.

 3 Q With real green money, okay?

 4 A Okay.

 5 Q Again, Avista sells the plant and then what

 6 happens to Potlatch's interest? Can Avista refuse to

 7 account to Potlatch for that profit on the grounds that

 8 it has what you regard as a fixed price contract?

 9 A I would say under that hypothetical they

 10 would not, they could not; however, I would also point

 11 out that the Commission has in the past in light of the

 12 ruling made by the Supreme Court that there is an

 13 equitable interest, they have not tried to return the

 14 gain to every person or every party that has paid it.

 15 They have returned it through rates and that is a fairly

 16 common occurrence and they have -- and the Staff's

 17 position is that is a reasonable way to go, particularly

 18 in light of the contract specific revenues and expenses

 19 paid by Potlatch.

 20 Q Mr. Lobb, wouldn't you agree with me that

 21 the correct statement is that sometimes the Commission

 22 has returned the gain through rates?

 23 A Sometimes they have.

 24 Q And don't you recognize the legitimacy of

 25 Dr. Peseau's observation about why we don't try to track

 459

 CSB REPORTING LOBB (X)

 Wilder, Idaho 83676 Staff

 1 down millions of customers that have departed the system

 2 to give them their share of the gain, isn't that because

 3 it's administratively impossible?

 4 A Perhaps that's the reason.

 5 MR. WARD: That's all I have. Thank you.

 6 COMMISSIONER SMITH: Thank you.

 7 Mr. Dahlke?

 8 MR. DAHLKE: I have no questions.

 9 COMMISSIONER SMITH: From the Commission?

 10 COMMISSIONER KJELLANDER: No.

 11 COMMISSIONER SMITH: I just have one.

 12

 13 EXAMINATION

 14

 15 BY COMMISSIONER SMITH:

 16 Q And I've forgotten, Mr. Lobb, whether you

 17 participated in Avista's last rate case.

 18 A I did.

 19 Q So you recall that there was a suggestion

 20 that the rate case should be postponed and refiled to

 21 take account of the sale of Centralia.

 22 A Yes, I do recall that.

 23 Q And you recall that the Commission

 24 proceeded without doing that?

 25 A Yes.

 460

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 1 Q Now, my question is when the Commission

 2 does take Centralia essentially out of the company's rate

 3 base and adjusts, which I assume will happen in the next

 4 rate case, will Potlatch's rates change?

 5 A It's difficult to say what the next

 6 contract is going to be. I believe it's up for -- it

 7 will be expired in 2001.

 8 Q Well, assume the next rate case happens and

 9 is concluded prior to January 1st of 2002, so before the

 10 new contract.

 11 A No. In fact, they wouldn't, their rates

 12 wouldn't change and in fact, in my testimony in the rate

 13 case, one of the reasons that I gave for spreading the

 14 gain was the fact that customers would be subject to the

 15 risk of changes in cost of service in subsequent rate

 16 cases as a result of Centralia being eliminated from

 17 rates.

 18 Q If we had required the refiling of the past

 19 rate case to recognize the sale of Centralia, would

 20 Potlatch's rates have changed?

 21 A No, they would not have.

 22 COMMISSIONER SMITH: Redirect,

 23 Mr. Woodbury?

 24 MR. WARD: Madam Chair, could I follow that

 25 up?

 461

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 1 COMMISSIONER SMITH: Mr. Ward.

 2

 3 CROSS-EXAMINATION

 4

 5 BY MR. WARD:

 6 Q Mr. Lobb, on one level I recognize the

 7 accuracy of your response to the Commissioner, but I want

 8 to make sure that it's not mistaken. Isn't it true that

 9 in just the same fashion as other customers are at risk

 10 that costs will change and rates will change, the same

 11 thing applies to Potlatch under the contract, to the

 12 extent that Centralia is removed from the natural

 13 resource stack, there is a risk that their prices will

 14 change; isn't that true?

 15 A To the extent that it's the incremental

 16 non-firm price paid by Avista, that is true, but their

 17 demand charges do not change with changes in cost of

 18 service, only the non-firm energy price and that is a

 19 variable cost.

 20 Q That's true, but as to their demand

 21 charges, weren't those calculated in part on the

 22 resources that were going to be available?

 23 A In '91?

 24 Q Uh-huh.

 25 A Yes, but they won't change as a result of

 462

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 1 any changes in cost of service.

 2 Q Yes, but hasn't Centralia been removed now

 3 from those resources?

 4 A Sure, and it could be a lot more costly and

 5 Potlatch is not going to be subject to those changes.

 6 Q One final question, and isn't it also true

 7 that to the extent Potlatch is subject to changes in

 8 costs as a result of Centralia's removal that those will

 9 happen automatically, it doesn't wait for a general rate

 10 case?

 11 A And that is contractual.

 12 MR. WARD: That's all I have.

 13 COMMISSIONER SMITH: Redirect,

 14 Mr. Woodbury?

 15 MR. WOODBURY: Just one question.

 16

 17 REDIRECT EXAMINATION

 18

 19 BY MR. WOODBURY:

 20 Q Mr. Lobb, do you recall

 21 Commissioner Kjellander's questions to Dr. Peseau with

 22 respect to whether he was aware of any other state

 23 commission dealing with this particular type of matter?

 24 A Yes.

 25 Q And this Commission also, the Idaho

 463

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 1 Commission also, dealt with PacifiCorp's share of

 2 Centralia, did it not?

 3 A Yes, it did.

 4 Q And does PacifiCorp -- is Solutia a special

 5 contract customer of PacifiCorp?

 6 A Yes.

 7 Q And do you know, was there any sharing of

 8 gain among customers with respect to PacifiCorp's share

 9 of the gain?

 10 A No. I believe that was left to a

 11 subsequent rate case.

 12 MR. WOODBURY: Thank you.

 13 COMMISSIONER SMITH: Thank you.

 14 MR. WOODBURY: No further questions.

 15 COMMISSIONER SMITH: Thank you, Mr. Lobb.

 16 (The witness left the stand.)

 17 COMMISSIONER SMITH: Are there any other

 18 matters that should come before the Commission we close

 19 our hearing?

 20 MR. WARD: Madam Chair, I'd like to make a

 21 brief closing argument.

 22 COMMISSIONER SMITH: I think that would be

 23 good. Mr. Ward.

 24 MR. WARD: Thank you. On at least a couple

 25 of occasions, I've been approached in the last few weeks

 464

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 1 by knowledgeable participants in the regulatory scene

 2 here who have asked me how the Potlatch contretemps came

 3 to be, and my response always starts with the fact that,

 4 and to a great extent it's my fault, I did not take as

 5 seriously as I should have in the original case the

 6 objections to Potlatch's participation in the gain and

 7 then compounded that by assuming that in cross

 8 examination of Mr. McKenzie we could get the matter

 9 straightened out.

 10 Unfortunately, as you'll recall,

 11 Mr. McKenzie was under the mistaken impression that we

 12 were dealing with the equivalent of a natural gas bypass

 13 contract here and so that led to nothing, but having

 14 taken my fair and probably overwhelming share of the

 15 blame for the first error, I think it's important to

 16 distinguish what happens in persisting in an error and in

 17 this case, with all due respect, I submit to the

 18 Commission that you have erred.

 19 The problem here is that we have become

 20 entangled in considerations about what the contract does

 21 and does not state with regard to the fixing of rates.

 22 We have only tried to point out that there's a subtle

 23 distinction between this contract and those that really

 24 are fixed rate contracts in which the Commission buys off

 25 of that up front, but in sum, that is really all beside

 465

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 1 the point.

 2 This issue is all about ownership and

 3 property rights. Potlatch is literally, along with the

 4 other ratepayers literally, an owner of this plant and to

 5 say that returning Potlatch's interest to it would be the

 6 equivalent of adjusting rates or changing the cost of

 7 service is -- I want to find a delicate word. One can, I

 8 guess, dance around the subject long enough and construct

 9 that argument, but if you ask anybody on the street

 10 whether that made any sense whatsoever, they would

 11 dismiss it as ludicrous.

 12 If I am right and if the court's statement

 13 of the nature of the interest that Potlatch and other

 14 ratepayers acquired means exactly what it says, that is,

 15 that they become owners, equitable owners, of an interest

 16 in this property, then I do not see how one can

 17 characterize taking that ownership interest without

 18 compensation as anything other than confiscation, and the

 19 nature of the wrong becomes readily apparent when you

 20 look what happens when you take Potlatch's interest.

 21 First of all, you deprive Potlatch of its

 22 rights, of course, but second of all, then what do you do

 23 with it? Who has an entitlement to that interest other

 24 than Potlatch? The other ratepayers don't. They didn't

 25 pay that depreciation. Water Power doesn't. It doesn't

 466

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 1 have an entitlement to something that's already been paid

 2 for -- excuse me, I said Water Power, Avista.

 3 It's very important that the Commission

 4 focus on this and I want to make one more point and I

 5 brought the dictionary definition of equitable owner for

 6 a particular purpose. The term equitable owner or

 7 beneficial owner does not mean as the Staff seemed to

 8 assume at least in the earlier proceedings; that is, an

 9 ownership interest that is subject to competing claims or

 10 has to be sorted out on the basis of the parties'

 11 relative bona fides. It doesn't mean that at all.

 12 An equitable owner is an owner who is an

 13 actual undisputed owner, but mere title is held by

 14 another. The definition gives the example of a trustee,

 15 but there's many others; securities held in a street

 16 name, et cetera, and that's the case here. Potlatch has

 17 purchased an interest in this plant. It's identical as

 18 if they paid real money for a portion of this plant.

 19 Water Power holds the mere title, but neither they,

 20 neither Avista or this Commission has the right to

 21 confiscate Potlatch's interest without compensation and

 22 there is nothing in the contract to the contrary.

 23 There's nothing in the contract that cedes any ownership

 24 rights, cedes any rights that Potlatch has at law.

 25 Finally, I'd like to mention one

 467

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 1 parenthetical matter and I bring this up with some

 2 trepidation because I don't want to -- I've never

 3 suggested in these proceedings whether a party that I

 4 represented would or would not appeal, but we have a

 5 delicate situation here. If the Commission should

 6 wrongfully in my view decide against us on this issue,

 7 Potlatch will be faced with a determination of whether it

 8 needs to appeal.

 9 In that event, I would like some assurances

 10 from the Commission that all parties will act in an

 11 equitable manner and this is what I'm referring to: If

 12 we appeal, in order to prevent the payment of the

 13 proceeds, we would have to seek a stay. I do not want to

 14 stay the other ratepayers' benefit from this decision.

 15 On the other hand, I don't want to go on appeal, come

 16 back two years later after winning and be told, well, all

 17 right, you won, but part of those proceeds have been

 18 disbursed and so, therefore, you're not entitled to that

 19 portion that's already been paid and I trust you see my

 20 dilemma.

 21 All I'm asking for is if the Commission

 22 rules against us, give the assurance that as long as

 23 there's proceeds -- that the proceeds that would be

 24 appropriate for Potlatch to receive will be preserved

 25 until the appeal is decided and that no party will argue

 468

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 1 that down the road that we have no entitlement to those

 2 proceeds that were disbursed. That way, the other

 3 ratepayers are whole, we're whole and all parties are

 4 preserved in status quo; so I'd like to ask that as a

 5 consideration; otherwise, we have no way around the fact

 6 that we would have to seek a stay.

 7 With that, thank you, Madam Chair.

 8 COMMISSIONER SMITH: Thank you, Mr. Ward.

 9 It occurs to me I did this backwards, but did

 10 Mr. Woodbury or Mr. Dahlke wish to make any closing

 11 remarks?

 12 MR. WOODBURY: Thank you, Madam Chairman.

 13 I really don't have much to say. I think that Staff's

 14 testimony in this case said it quite clearly, that

 15 Potlatch on reconsideration in our view is claiming

 16 entitlement to a benefit apart from and outside its

 17 contract. Potlatch contracted for certainty in its

 18 rates, excluding itself from some vagaries of the

 19 future. That's clearly evident from the underlying case

 20 where the contract was presented. I didn't participate

 21 in the negotiation or I wasn't a contract party. There

 22 are always things that are excluded which parties didn't

 23 think about, but any equitable claim Potlatch has had to

 24 a share of the gain it's Staff's opinion that it

 25 contracted away.

 469

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 1 I'm wondering whether we would be here if

 2 this sale occurred in year three as opposed to year nine

 3 when they only had one year remaining on the contract.

 4 COMMISSIONER SMITH: Thank you.

 5 Mr. Dahlke.

 6 MR. DAHLKE: Yes. We continue to take the

 7 position that the prices for Potlatch's service were

 8 fixed in the special contract that was entered into with

 9 Avista Corporation. It did not detract from what the

 10 Commission's jurisdiction would otherwise be, but

 11 represented a clear bargain between the parties that as

 12 between them those prices where fixed in that agreement.

 13 For the remainder of the service, the

 14 tariffed customers clearly were in a situation where in

 15 the event that any resource on the system was disposed of

 16 and there was a gain Boise Water could be applied and

 17 those customers would be treated as if they were

 18 equitable owners, and perhaps what bears emphasis there

 19 is that it's the public in general, the customers in

 20 general, and I don't believe this case stands for the

 21 proposition that you take the next step and treat

 22 individual customers as though they were actual equitable

 23 owners whose interests cannot be confiscated as Mr. Ward

 24 has characterized it in a regulatory proceeding.

 25 We're not proposing to treat customers

 470

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 1 generally in that fashion with regard to this gain or

 2 other gains, as I understand it, in the past and I think

 3 it would be extraordinarily difficult to set the

 4 precedent that we would go take that step and treat them

 5 in that fashion. If we did take that step, then we fall

 6 back to the question of whether that right was waived or

 7 wasn't waived in the overall agreement.

 8 That's one I hope we don't have to reach

 9 because I wouldn't reach it. I don't believe that actual

 10 equitable ownership derives from the Boise Water case. I

 11 read it to say that a certain group of customers are to

 12 be treated for ratemaking purposes as if they were

 13 equitable owners and therein lies the difference, so I

 14 think the Commission correctly decided this case in the

 15 first instance and would urge you not to grant

 16 reconsideration.

 17 Thank you.

 18 COMMISSIONER SMITH: Any further comments,

 19 Mr. Ward, since I believe you should have had the

 20 opportunity to go last?

 21 MR. WARD: Just one observation. I'd like

 22 the Commission to conjure with the scenario in which if

 23 you accept the other parties' interpretation, can they in

 24 fact -- and we have a customer who's contracted for

 25 service from a utility based, at least we all agree in

 471

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 1 part, on what the perception of costs were at the time,

 2 could that utility in fact sell all of its generation

 3 capacity, all of its assets, leave the customer holding

 4 an empty contract and not pay them a dime in compensation

 5 for the loss of their equitable interest? I'll leave you

 6 to think about that one.

 7 Thank you.

 8 COMMISSIONER SMITH: Thank you. The

 9 Commission thanks all the parties for participating today

 10 and for their help. I don't know what the statutory

 11 deadline is on this, but I know it's fairly short, so

 12 you'll be hearing from us soon. With that, the record

 13 will be closed and the Commission will deliberate as

 14 speedily as possible.

 15 Thank you.

 16 (All exhibits previously marked for

 17 identification were admitted into evidence.)

 18 (The Hearing adjourned at 11:40 a.m.)

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 472

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 1 AUTHENTICATION

 2

 3

 4 This is to certify that the foregoing

 5 proceedings held in the matter of the application of

 6 Avista Corporation for authority to sell its interest in

 7 the coal-fired Centralia power plant, commencing at

 8 9:30 a.m., on Wednesday, June 21, 2000, at the Commission

 9 Hearing Room, 472 West Washington, Boise, Idaho, is a

 10 true and correct transcript of said proceedings and the

 11 original thereof for the file of the Commission.

 12 Accuracy of all prefiled testimony as

 13 originally submitted to the Reporter and incorporated

 14 herein at the direction of the Commission is the sole

 15 responsibility of the submitting parties.

 16

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 20 Certified Shorthand Reporter #187

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 473

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