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.

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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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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

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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

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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.

5 There is

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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

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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

342

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.

9

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.)

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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

CSB REPORTING PESEAU (Di)

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

367

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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CSB REPORTING PESEAU (Di)

Wilder, Idaho 83676 Potlatch Corporation

1 CROSS-EXAMINATION

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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

CSB REPORTING PESEAU (X)

Wilder, Idaho 83676 Potlatch Corporation

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

CSB REPORTING PESEAU (X)

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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Wilder, Idaho 83676 Potlatch Corporation

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)

Wilder, Idaho 83676 Potlatch Corporation

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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Wilder, Idaho 83676 Potlatch Corporation

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

CSB REPORTING PESEAU (X)

Wilder, Idaho 83676 Potlatch Corporation

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

CSB REPORTING PESEAU (X)

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

CSB REPORTING PESEAU (X)

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

CSB REPORTING PESEAU (X)

Wilder, Idaho 83676 Potlatch Corporation

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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Wilder, Idaho 83676 Potlatch Corporation

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

CSB REPORTING PESEAU (Di)

Wilder, Idaho 83676 Potlatch Corporation

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

7

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?

410

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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McKenzie, Di 1a

Avista

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

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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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McKenzie, Di 2a

Avista

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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McKenzie, Di 3a

Avista

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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McKenzie, Di 4a

Avista

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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McKenzie, Di 5a

Avista

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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McKenzie, Di 6a

Avista

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

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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.

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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

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Wilder, Idaho 83676 Staff

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

CSB REPORTING LOBB (X)

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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

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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

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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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Wilder, Idaho 83676

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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Wilder, Idaho 83676

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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Wilder, Idaho 83676

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

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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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CONSTANCE S. BUCY

20 Certified Shorthand Reporter #187

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473

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