SCOTT WOODBURY
DEPUTY ATTORNEY GENERAL
IDAHO PUBLIC UTILITIES COMMISSION
PO BOX 83720
BOISE, IDAHO 83720-0074
(208) 334-0320
BAR NO. 1895

Street Address for Express Mail:
472 W. WASHINGTON
BOISE, IDAHO 83702-5983

Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE PETITION OF AVISTA CORPORATION DBA AVISTA UTILITIES -WASHINGTON WATER POWER DIVISION (IDAHO) FOR PROPOSED MODIFICATIONS TO THE POWER COST ADJUSTMENTS (PCA) METHODOLOGY.	)))))))	**CASE NO. AVU-E-01-1** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Scott Woodbury, Deputy Attorney General, and in response to the Notice of Modified Procedure, Notice of Comment/Protest Deadline, Notice of Additional Scheduling, and Order No. 28673 issued on March 14, 2001, submits the following comments.

On January 16, 2001, Avista Corporation (Avista; Company) filed an Application with the Idaho Public Utilities Commission (Commission) seeking approval of proposed modifications to its existing Power Cost Adjustment (PCA) mechanism. As justification for the proposed changes, the Company states that the current PCA does not allow recovery of increased power supply costs associated with two specific situations. First, when the system load increases which causes the Company to make additional power purchases, and second, when there are generating problems at Colstrip or Kettle Falls generating stations which causes the Company to purchase replacement power. In both of these situations extremely high market prices result in dramatically increased power supply costs that the Company is required to pay but cannot pass on to customers through its existing PCA.

AVISTA'S EXISTING PCA

Avista's Power Cost Adjustment mechanism calculates the difference between two computerized power supply model runs. One model run being the power supply cost normalization study accepted in the Company's last general rate case and the other being the same study with two "actual" inputs as opposed to normalized inputs. The two actual inputs that cause the difference in the two computer runs are actual hydro power generation and actual market price. One-hundred percent of this difference is accumulated monthly and deferred in a balancing account until the balance reaches $3 million, approximately 2.5% of the Company's annual revenue requirement, which triggers a Company filing for a rate adjustment. After review and Commission approval customer rates are changed for a one-year period to refund or recover the balance in the deferral account.

Several modifications have been made to Avista's PCA since it was established in 1989. A change was made to account for changes in the Company's long-term contracts. Occasionally a contract expires and at other times new contracts were entered into. A PCA cost adjustment has been required when contract energy amounts change. The average monthly market price was adjusted to remove Palo Verde trading that did not properly reflect market conditions in the northwest where the regulated utility does its business. Later the average monthly market price was adjusted to properly account for Heavy Load Hour and Light Load Hour price differences within a month. One of the most recent adjustments was to include the Rathdrum turbines. They were included on an actual basis rather than a modeled basis. All of these modifications to Avista's original PCA have been done to make the "modeled actual" power supply costs more closely reflect actual power supply costs. This filing by the Company includes a request to use actual booked power supply costs and eliminates any further need to approximate them using a computer model. PCA changes to the original methodology have been moving in the direction of using actual booked costs for some time.

COMPANY PROPOSED PCA MODIFICATIONS

The Company proposes substantial changes to the existing PCA mechanism. The Company proposes the following.

1) That actual fuel costs, Accounts 501 and 547, actual purchased power costs, Account 555, and actual secondary sales revenues, Account 447, be used in the PCA calculation instead of computer modeled actuals.

2) That Centralia be removed from the PCA and that the "replacement contract" be included in the PCA.

3) That the Coyote Springs 2 generation station be included in the PCA when it comes on line in 2002.

4) That the PGE capacity sale remain unchanged for PCA purposes.

5) That a retail load revenue adjustment be made as a credit to customers through the PCA since the power supply costs associated with retail load growth will be captured in the actual power supply costs.

6) That power supply cost differences be shared 90/10 between the customers and the Company's shareholders.

7) That the trigger be increased from its current level of $3 million to $12 million, which is approximately 10% of the Company's annual revenue requirement.

8) That interest be paid monthly on the balance in the deferral account.

9) That the Company report the PCA status to the Commission on a monthly basis.

STAFF ANALYSIS

For the purpose of its analysis Staff chooses to identify some proposed PCA components as being like components in Idaho Power Company's PCA. Staff does this not to make an argument that the two PCA's should be the same but to facilitate the discussion. The Commission and Commission Staff have approximately eight years experience with the Idaho Power PCA and have a great deal of understanding of its components and how they work. On the other hand, the proposed Avista PCA components that are unlike Idaho Power PCA components may require more analysis and explanation.

<u>Actual Accounting Data</u>

Avista proposes to use actual accounting data from its books in its PCA calculations. The actual accounting data include fuel costs from Accounts 501 and 547, power purchase costs from Account 555 and power sales revenues from Account 447. The heart of the PCA is the calculation of the total of these accounts in comparison to the total of the same accounts from the last general rate case. This difference is called the difference between "actual" and "authorized" power supply costs. As previously discussed, Avista's current PCA captures the difference between "authorized" power supply costs from the last general rate case and a computer "modeled actual" power supply cost which only contained two "actual" inputs, actual hydro generation and actual average monthly market price. In addition to these two actuals, Avista's proposed PCA would capture the effects on power supply costs of actual loads, unit costs of fuel, availability of generation resources, energy purchases for the system, energy sales from the system and anything else that affects the balances in the previously identified power supply cost accounts. The modeled actual power supply costs currently used in Avista's PCA calculation assume all input information remains the same for an entire month. In reality market prices, system loads and generation availability change continuously throughout the month. The Company's actual booked accounting data reflects the costs associated with the constantly changing power supply situation.

To the extent that power purchase costs and power sales revenues are limited to energy purchases and sales contracts for terms less than one year, this part of Avista's proposal is the same as Idaho Power's existing PCA. However, Avista proposes to also include capacity contracts and all purchase and sale contracts without regard to the length of the contract. Relative to Idaho Power Company, Avista has many long term purchase and sale contracts that make their inclusion in the PCA a much more important issue with Avista.

A concern of including long term contracts in the PCA is that the PCA mechanism not inappropriately influence the decisions of the utility regarding resource additions. If the mechanism favors long term contracts as opposed to construct and rate base options, the Company may make decisions that are not in the best interest of ratepayers. In its recommendations Staff proposes a solution to this potential problem.

<u>Centralia vs. Replacement Contract</u>

Avista proposes that the Centralia generating station be replaced by the "replacement contract" in the modified PCA. Centralia was sold, with Commission approval, in May of 2000 and the Company began receiving energy from the replacement contract in July of 2000. The change proposed by the Company is automatically captured in the actual booked power supply account numbers previously discussed except for the fixed costs of Centralia which are currently included in rates. The Company proposes a credit in the PCA for these costs that are identified as operation, maintenance, depreciation, taxes and return on investment. Staff recognizes that if actual costs, that do not include generation from Centralia, are tracked in a modified PCA, then replacement power costs will be included. If the Centralia "replacement contract" is excluded from the modified PCA, then the default resource will be market purchases. Although the terms of the "replacement contract" have not been formally reviewed by the Commission, Staff believes that the "replacement contract" is much more cost effective than market purchases. Also, the "replacement contract" expires in just over a year, so the Commission will have opportunity to review subsequent replacement resource decisions and determine ratemaking treatment. Finally, to deny this change would be technically difficult since the elimination of Centralia and the inclusion of the replacement contract and the associated effects are captured in the actual booked accounting entries that the Company proposes to use. Unwinding the effects from the actual booked power supply costs could in theory be done using a computer simulation but it would be complicated and not completely accurate.

Coyote Springs 2

The Company proposes to include the Coyote Springs 2 generating station in the PCA when it comes on line in 2002. Staff does not believe that the Commission should make a decision now concerning the future PCA treatment of Coyote Springs 2. Staff believes that the Company should file a ratemaking proposal for Coyote Springs 2 at or just prior to project completion. The Commission should then decide on the appropriate treatment of the new project. If Coyote Springs 2 were to be excluded from PCA treatment, the unwinding of the actual costs from PCA accounts would have to be done with a less than perfect computer simulation.

PGE Capacity Sale

The Company proposes that the PGE capacity sale treatment, as captured in rates in the Company's last general rate case, remain unchanged at this time. This proposal requires no changes to actual booked power supply costs. The actual accounting data correctly captures the power supply effects of the contract. Treating the contract the same way it was treated in the general rate case will cause no PCA impacts because there will be no difference between "actual" and "authorized" amounts until the contract expires.

Load Growth Adjustment

The Company proposes a retail load revenue adjustment to the PCA. The revenue adjustment would be a credit to offset the costs of power supply incurred due to load growth. The adjustment would prevent the double recovery of the variable cost of supplying power to new load. Without the adjustment, most of the costs would be double recovered because the PCA captures actual power supply costs and the rates received by the Company from the sale of load growth energy has a component that recovers the average variable cost of power supply. New load is served at the marginal cost of power supply. The PCA is not designed to permanently recover the higher marginal cost of serving new load outside of a general rate case. The Company proposes to calculate total revenue from load growth and reduce it by the distribution costs of serving new load and credit the remaining amount back to the PCA to offset PCA power supply costs.

Staff has an alternate proposal that borrows from the Idaho Power PCA methodology. The Idaho Power PCA methodology has the same potential problem of double counting the variable costs of power supply. Instead of crediting back a portion of revenue to offset one set of power supply costs, the method used in Idaho Power's PCA removes the variable cost of load growth related power supply costs from the PCA costs and allows the Company to keep the retail revenue as it normally would. The adjustment uses the variable cost of power supply on the margin that can be determined using the power supply model accepted in the Company's last general rate case. For Avista this number is 21.23 mills/kWh. Each month the average marginal cost of power supply is multiplied times the growth in load and the product is used to reduce actual monthly power supply costs. Staff believes that this adjustment is easily computed and more accurate than the Company proposed adjustment.

<u>90/10 Sharing</u>

The Company proposes to share the variable costs of power supply 90/10 between customers and shareholders. These are the same sharing percentages currently contained in Idaho Power's PCA. Staff believes that sharing is essential to provide the Company with the correct economic incentives to make the best possible decisions. To the extent that customers and shareholders win and lose together as the Company makes power supply decisions, Staff believes that the best possible decisions will be made.

The Company's PCA proposal would exclude fixed power supply cost adjustments associated with Centralia and Coyote Springs 2 from 90/10 sharing. Once again these costs are fixed operation, maintenance, depreciation, taxes and return on investment. The Company's proposal is that these increases or decreases in costs be passed to ratepayers through the PCA with no shareholder sharing.

Staff is concerned about the Company proposal to not share the fixed cost of new Company owned generation supplies. If fixed power supply costs are subsequently allowed in the PCA and are not shared, the playing field for new resource additions is not level. Through the PCA the Company proposes to recover 100% of the fixed costs of build and rate base options but only 90% of all costs of long-term purchase contract options. This inequity could inappropriately influence Company choices for new resources. Staff believes that this issue should be further addressed when the Company requests cost recovery for Coyote Springs.

Interest on Deferred Balance

The Company proposes to accrue interest on the monthly accumulations in the deferral account. The Company's current PCA balancing account does not accrue interest. The Company currently accrues interest on the balance in its Purchased Gas Adjustment (PGA) balancing account. This interest rate is the same as the interest rate on deposits, currently 6%, that is reviewed and established annually by the Commission. The Company proposes that the interest rate applied to its PGA balancing account also be applied to the PCA balancing account proposed in this proceeding. Idaho Power Company accrues interest at the same rate on balances in its PCA balancing account.

Monthly Reporting

Avista proposes to continue to file detailed monthly reports with the Commission. Such reports are valuable to the Commission and Commission Staff in tracking accumulations in the account as well as for tracking surcharge and rebate amounts while they are in progress. Staff uses the reports along with other information when the PCA is audited.

Effective Date and PCA Trigger

The Company proposes that modifications be effective January 1, 2001. The Company has represented to Staff that for the months January through March of 2001 the proposed methodology is more beneficial to ratepayers than the existing PCA methodology. A limited review supports the Company's contention.

The Company proposes a soft surcharge/rebate trigger of $12 million that is approximately 10 percent of the Company's annual revenue requirement. One of the reasons that the Company proposes a large soft trigger is that it hopes to ride through the current period of large accumulations in the deferral account due to anticipated poor water conditions and high market prices until the situation changes and the surcharge balance is gradually eaten away. The Company hopes to do this with no further PCA rate increases if the PCA modifications are approved. The Company is counting on a few things to make this happen. Next year two wholesale sales contracts expire which will return resources for native load customer use. If water conditions return to near normal and market prices stay high, the balance to surcharge will decline as the Company sells excess energy into a high priced market.

STAFF RECOMMENDATIONS

Staff recommends that Avista be allowed to modify its existing PCA as it proposes with the following exceptions. Staff believes that its alternative to the Company proposed Retail Load

Adjustment is an improvement in correcting the potential for double counting the variable costs of power supply in a load growth situation. Staff recommends that the Commission accept its solution to this problem.

Staff recommends that the "one-month lag" accounting treatment approved in Avista's current PCA be eliminated. Staff represents that this has been discussed with the Company and that the Company is in agreement. This will allow monthly PCA results to be booked in the month that the costs are incurred instead of the following month.

Staff recommends that the ratemaking treatment of Coyote Springs 2 not be determined at this time. Staff believes that the Company should propose treatment to the Commission near the time of project completion in a formal Application.

In addition, Staff recommends that other generation additions and power supply contracts with terms longer than one year be submitted to the Commission for review and Commission approval. Staff understands that actual accounting entries will be effective starting with the delivery of energy. If for some reason Commission approval for PCA treatment is not granted the cost differences can be unwound. Staff recommends a maximum review period of 90 days.

If new Company-owned generation is approved for PCA treatment, Staff recommends that any Fixed costs included in the PCA be shared between customers and shareholders on a 90/10 basis instead of a 100% pass through to customers as proposed by the Company. As previously discussed, this levels the playing field for new resource acquisitions.

Staff recognizes that the proposed changes to Avista's PCA are extensive and that they depart from the philosophy that the PCA only capture power supply cost changes outside of the Company's control. This new proposal captures all differences between "authorized" and "actual" Power supply costs which includes many discretionary decisions by the Company. The proposed 90/10 sharing is in Staff's view a necessary component that addresses the change in philosophy. With sharing, good decisions benefit ratepayers and shareholders and poor decisions harm ratepayers and shareholders. Recent dramatic increases in prices on the wholesale market have caused Avista's current PCA calculated power supply costs to depart entirely from reality. This is a substantial reason for Staff's support of these modifications.

Respectively submitted this day of April 2001.

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Scott Woodbury
Deputy Attorney General

Technical Staff: Keith Hessing
Terri Carlock

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