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Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF)
AVISTA CORPORATION FOR AN ORDER) **CASE NO. AVU-E-04-2**
APPROVING THE SALE OF ITS INTEREST IN)
THE SKOOKUMCHUCK HYDRO-ELECTRIC)
PLANT AND FOR EWG DETERMINATIONS.) **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 Application, Notice of Modified Procedure and Notice of Comment/Protest Deadline issued on March 10, 2004, submits the following comments.

BACKGROUND

On February 23, 2004, Avista Corporation (Avista; Company) filed an Application with the Idaho Public Utilities Commission (Commission) regarding the proposed sale by Avista of its ownership interest in the Skookumchuck dam, hydroelectric plant and related facilities (Skookumchuck; Project). Skookumchuck is co-owned by Avista Corporation, PacifiCorp, Public Utility District No. 1 of Snohomish County, Puget Sound Energy, Inc., City of Tacoma, City of Seattle, and Public Utility District No. 1 of Grays Harbor County (collectively the

“Owners”). PacifiCorp is the majority owner with a 47.5% share. Avista is a minority owner with a 17.5% share.

Skookumchuck is an earth-filled dam and small electric generation facility located in the vicinity of Centralia, Washington on property adjacent to the Centralia Power Plant, a large coal-fired generating facility. The Skookumchuck Dam was constructed in 1973 as a water storage facility for the Centralia Power Plant. In 1991, a generating plant with a capacity of approximately 1 MW was constructed at the dam.

Avista has entered into a Purchase and Sale Agreement to sell its interest in the Skookumchuck hydroelectric plant to 2677588 Washington, LLC, a Washington Limited Liability Company and a direct wholly-owned subsidiary of TransAlta USA, Inc. (TransAlta). TransAlta is the indirect owner of the Centralia Power Plant and the Centralia Coal Mine. In 2000, the Owners sold the Centralia Power Plant to a direct wholly-owned subsidiary of TransAlta, TECWA Power, Inc., and PacifiCorp sold the Centralia coal mine to another direct wholly-owned subsidiary of TransAlta, TECWA Fuel, Inc. The Commission approved the sale of Avista’s share of the Centralia Power Plant in Order No. 28297. TransAlta Centralia Generation LLC, a direct wholly-owned subsidiary of TECWA Power, Inc., now owns and operates the Centralia Power Plant as an Exempt Wholesale Generator (EWG).

Avista and the other Owners propose to sell and transfer to Washington LLC the dam, powerhouse, water rights, land, easements and other assets of Skookumchuck, including certain fixtures, contracts and other rights. Washington LLC intends to operate the Skookumchuck Project as an EWG within the meaning of Section 32 of the Public Utility Holding Company Act of 1935 (PUHCA). To qualify as an EWG, Washington LLC must be engaged exclusively in the business of owning or operating an "eligible facility" and selling electric energy at wholesale. If the costs of a generation facility were included in the rates of a regulated utility on October 24, 1992 (the date of enactment of Section 32 of PUHCA), then in order for the facility to be considered an “eligible facility,” every state Commission having jurisdiction over such rates must specifically determine that allowing the facility to become an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate state law. 15 USC. § 79z-5a(c). Washington LLC cannot process its EWG Application with the FERC until all of the Company’s regulatory commissions have made the three determinations required by Section 32 of PUHCA.

Avista requests Commission approval of the Company's sale of its minority ownership interest in Skookumchuck, seeks a Commission Order making certain public interest findings required in order for Skookumchuck to qualify as an exempt facility and for the new owner/operator to qualify as an Exempt Wholesale Generator (EWG) under Section 32 of PUHCA, and seeks approval of proposed accounting treatment of the gain on the sale.

STAFF ANALYSIS

Compliance with State Law

Avista contends that the sale of Skookumchuck to Washington, LLC and allowing the generating facilities to become an "eligible facility" will not violate Idaho state law. Because the Project assets are located in the state of Washington, the Company contends that Idaho's property transfer statute *Idaho Code* § 61-328 is not applicable to the contemplated sale. *Idaho Code* § 61-328 states in part:

No electric public utility ... owning, controlling or operating any property located in this state which is used in the generation, transmission, distribution or supply of electric power and energy to the public shall merge, sell, lease, assign or transfer ... any such property or interest therein, or the operation, management or control thereof ... except when authorized to do so by order of the public utilities commission. (Emphasis added.)

Commission Staff has reviewed the referenced U.S. Code language regarding Exempt Wholesale Generators (see Attachment A, 15 USCA § 79z-5a). The ownership interest of Avista in the Skookumchuck facilities are a part of the utility's rate base in Idaho on which Avista receives a return on investment and is now and has been included in the rate base of Avista since or prior to October 24, 1992. Based on Staff's review of the Idaho Code, Staff represents that it has discovered no Idaho laws that address the issues raised by this request, and none prohibit or limit the authority of Washington, LLC as an EWG to operate Skookumchuck as a wholesale facility.

As discussed in these comments, Staff notes further that although the Project is located in Washington, this transaction complies with the intent and meets the standards of *Idaho Code* § 61-328.

In compliance therewith, Staff represents:

- (a) that the transaction is consistent with the public interest;
- (b) that the cost of and rates for supplying service will not be increased by reason of such transaction; and
- (c) that the applicant for such acquisition or transfer has the bona fide intent and financial ability to operate and maintain said property in the public service.

Benefits to Customers

The aggregate sale price of the transaction is approximately \$7.57 million, adjusted for changes in PacifiCorp's net book value of the facilities from September 30, 2003 to the closing date. *See* Section 2.3(a) of the Sale Agreement. Avista's share of this amount is 17.5%, or approximately \$1.32 million on a system basis prior to closing costs. After taxes and closing costs, Avista estimates a net gain from the sale of \$216,000.

In addition to the relatively small projected financial gain on the sale, Staff believes there are other factors that should also be considered. First, as one of the Owners, Avista must pay its proportionate share of the ongoing costs of the Project. The Company contends that customers will not be harmed if the project is sold because the cost of power generated from Skookumchuck substantially exceeds the projected cost of market power. Hence, the Company's revenue requirement will be lower as a result of the sale of Skookumchuck. According to Avista, the Project's bus-bar cost in fiscal year 2003 (12 months ending March 31, 2003) was approximately \$250 per MWh. Market prices are not forecast to approach that level for any extended period of time in the near future. According to Avista, the expected impact of the sale is to lower the Company's future revenue requirement by removing the Project from the Company's rate base and revenue requirement.

Second, Avista notes that the proposed transaction eliminates the risk that the Company will be required to fund its share of expenditures for ensuring the structural integrity of the Skookumchuck Dam. The Company believes it is likely that the FERC will mandate dam modifications to meet stability criteria.

Third, Skookumchuck has an electrical capacity of only 1 MW. Moreover, because the Project is operated for purposes of supplying cooling water to the Centralia Power Plant, Avista states that it has relatively low energy output. Over the last eight years, the average annual production has been approximately 3,000 MWh per year, and over the last four years the output

has been limited to about 1,000 MWh/year. This represents a very low capacity factor for a hydroelectric plant. Avista's share of the Plant's output is extremely small in comparison to the Company's other generating resources.

Finally, the Project no longer represents "core business" assets to any of the current Owners because they no longer have any ownership interest in the Centralia Steam Plant. Operation of such a small plant located so far from any other of the Owner's facilities is problematic.

In summary, Avista contends that the benefits from the proposed sale outweigh the risks of rising costs of continuing to invest in and operate and maintain Skookumchuck. Continued operation of the Project as a hydroelectric project, the Company contends, would be uneconomic, and such operation would not be in the public interest. Staff agrees. All things considered, Staff believes that selling the Project is a lower cost long-term option than continuing to invest in and operate and maintain the Project.

Avista states that it is informed that Washington LLC will continue operation of the Project to provide cooling water supply to the Centralia Power Plant and that it will produce power from the Project either as an EWG or as a Qualifying Facility under PURPA. None of the electrical output of the Project will be used to serve Avista's retail customers, except perhaps indirectly through the wholesale power markets. The facility is interconnected with the distribution system of Puget Sound Energy, Inc. (PSE) and historically all of the power from the Project has been sold to PSE.

Public Interest Standard

Avista contends that the transfer of Skookumchuck to Washington LLC is in the public interest because it will benefit Avista's customers by lowering the Company's cost of providing electrical service. In addition, Avista states the transfer will give TransAlta greater control of the water flows in the Skookumchuck River for providing cooling water to the Centralia Power Plant, thus increasing the electrical output of the Centralia Power Plant for the benefit of all electricity consumers.

As always, the public interest standard can be rather difficult to define, but in this case Staff believes the appropriate measure of whether the public interest standard is met is the effect of the sale on Avista's ratepayers. Staff agrees that the Company's ratepayers will not be

harmful by the sale, thus Staff believes that the sale does, in fact, meet the public interest standard.

Ratemaking Treatment

Avista projects that the sale of Skookumchuck will result in a small after-tax gain. The Idaho jurisdictional share (33.01%) of the after-tax gain is projected to be approximately \$216,000. Avista proposes to allocate the after-tax Skookumchuck gain between jurisdictions and between ratepayers and shareholders in the same manner that Avista's after-tax gain on the sale of the Centralia Power Plant was allocated in Case No. AVU-E-99-6. Applying the depreciation reserve method ratio (accumulated depreciation to gross plant) of 69.70% for allocating proceeds to ratepayers set forth in Order No. 28297 approving the sale of the Centralia Power Plant to the estimated Idaho share of the Skookumchuck after-tax gain of approximately \$216,000 yields an allocation to ratepayers of approximately \$151,000 and an allocation to shareholders of approximately \$65,000. For Avista, a portion of the Skookumchuck facilities were originally booked as part of the Centralia Power Plant and retired when Avista's share of that plant was sold. As such, the plant book value on Avista's books for Skookumchuck is lower and the resulting gain on the sale will be slightly higher than for other project owners.

Avista is proposing that the estimated portion of the Skookumchuck after-tax gain allocated to ratepayers of approximately \$151,000 be deferred and added to the deferred gain on the Centralia Power Plant which is currently being passed on to ratepayers through a rate credit on Schedule 65 – Temporary Rate Adjustment. The Centralia gain rate credit was originally put into effect on August 1, 2000 and will expire when the deferred gain has been passed on to customers. The credit period will be extended with the final Skookumchuck gain amount added to the deferral.

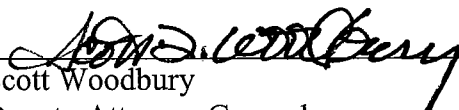
Staff recommends Avista be directed to file the final accounting entries associated with the sale within 45 days of closing. Any revenue requirement reduction from not operating the Project will be reflected in Avista's results of operation. As such, Staff represents that this change should be reflected in the current Avista rate proceeding.

STAFF RECOMMENDATION

Staff recommends approval of the Company's Application to transfer Skookumchuck to Washington LLC. In addition, to allow the Project to become an "eligible facility" within the meaning of Section 32 of PUHCA, Staff recommends that the Commission's Order specifically state that the proposed sale (1) will benefit consumers, (2) is in the public interest, and (3) does not violate Idaho state law. Staff also recommends the final accounting entries be filed with the Commission within 45 days of closing.

Respectfully submitted this

1st day of April 2004.


Scott Woodbury
Deputy Attorney General

Technical Staff: Rick Sterling
Terri Carlock

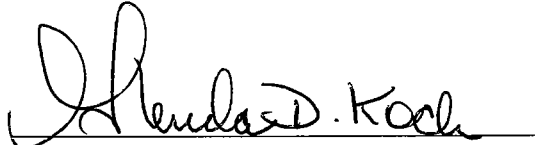
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 1ST DAY OF APRIL 2004, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. AVU-E-04-2, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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