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June 15, 2009

Public Utility Commission of Oregon
Attn: Vikie Bailey-Goggins
Administrative Regulatory Operations
550 Capitol St. N.E. Suite 215
Salem, OR 97308-2551

RE: UG171 – Opening Testimony

Avista Corporation d/b/a/ Avista Utilities, hereby submits for electronic filing the Opening Testimony. The original and five copies will be provided via overnight mail.

Sincerely,

A handwritten signature in black ink, appearing to read "David Meyer", with a horizontal line extending to the right.

David Meyer
Vice President and Chief Counsel
Avista Corporation
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Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I **HEREBY CERTIFY** that I have served the Opening Testimony in Docket UG 171, for Avista's 2007 Tax Report filing, by electronic mail, and by mailing a copy thereof where paper service has not been waived, to the following:

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Dated at Spokane, Washington this 15th day of June 2009.



Patty Olsness
Rates Coordinator

**PUBLIC UTILITY COMMISSION
OF
OREGON**

**UG 171 (1)
Phase II**

AVISTA EXHIBIT 300

**Direct Testimony of Kelly Norwood
On Behalf of
Avista Corporation
In the Matter of Avista's
SB 408 2007 Tax Report**

June 15, 2009

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, BUSINESS ADDRESS**
2 **AND QUALIFICATIONS.**

3 A. My name is Kelly O. Norwood. I am the Vice President for State and
4 Federal Regulation employed by Avista Corporation. My business address is
5 1411 E. Mission Avenue, Spokane, WA 99220. I am a graduate of Eastern
6 Washington University with a Bachelor of Arts Degree in Business
7 Administration, majoring in Accounting. I joined the Company in June of
8 1981. Over the past 27 years, I have spent approximately 16 years in the
9 Rates Department with involvement in cost of service, rate design, revenue
10 requirements and other aspects of ratemaking. I spent approximately 11
11 years in the Energy Resources Department (power supply and natural gas
12 supply) in a variety of roles, with involvement in resource planning, system
13 operations, resource analysis, negotiation of power contracts, and risk
14 management. I was appointed Vice-President of State & Federal Regulation
15 in March 2002.

16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

17 A. Avista provides this testimony in support of its claim, filed on May 5,
18 2009, that implementation of the automatic adjustment clause (AAC),
19 resulting in a refund of \$2.4 million to customers, would result in confiscatory
20 rates in violation of ORS 756.040, which requires that rates be just,
21 reasonable and sufficient.

22 On October 15, 2008, Avista filed its 2007 tax report under the terms of
23 SB 408 (2007 Tax Report). As filed, Avista's 2007 Tax Report would have

1 resulted in a refund to customers of \$1.98 million, plus approximately
2 \$400,000 of interest. As part of its initial filing, Avista filed a claimed violation
3 of ORS 756.040 pursuant to OAR 860-022-0041(10).

4 On November 4, 2008, Administrative Law Judge Michael Grant
5 entered a procedural schedule for the docket. Pursuant to the procedural
6 schedule (as amended), on December 23, 2008, Staff and other parties filed
7 their initial Issues List with respect to the 2007 Tax Report. On December 10,
8 2008, and January 7, 2009, the parties held settlement conferences that were
9 duly noticed. On January 20, 2009, the parties agreed to the terms of the
10 original Stipulation and submitted the Stipulation, along with Joint Testimony
11 in support of the Stipulation, to the Commission.

12 On April 10, 2009, the Commission issued Order No. 09-125, rejecting
13 the Stipulation, and ordering Avista to file tariffs establishing an automatic
14 adjustment clause to refund \$1.98 million plus interest to its customers,
15 effective June 1, 2009.

16 **Q. WHAT OTHER WITNESSES WILL BE PROVIDING TESTIMONY ON**
17 **BEHALF OF AVISTA?**

18 A. While I will provide a general overview of the evidence and arguments,
19 Dr. William Avera, President of FINCAP, Inc., will discuss the factors that
20 explain why any refund under these circumstances would result in
21 confiscatory rates. Ms. Jeanne Pluth, the other Company witness, will
22 provide an analysis of results under both the prior rule and the new

1 Temporary Rule, as each defines the earnings review period, and will quantify
2 the impacts on the Company's earnings.

3 **Q. NOTWITHSTANDING ITS ORDER REJECTING THE STIPULATION, DID**
4 **THE COMMISSION ALLOW THE OPPORTUNITY FOR AVISTA OR ANY**
5 **OTHER PARTY TO FILE A REQUEST THAT THE COMMISSION**
6 **TERMINATE THE AUTOMATIC ADJUSTMENT CLAUSE BASED ON**
7 **CLAIMS OF CONFISCATION?**

8 A. Yes. In its Order No. 09-125 at p. 5, the Commission stated: "At any
9 time after filing the tariffs, Avista or any other person may file a request that
10 the Commission terminate the automatic adjustment clause because allowing
11 the clause to become effective would result in a violation of the utility's
12 constitutional rights." On April 30, 2009, Avista made its compliance filing
13 establishing an automatic adjustment clause to effectuate a refund of \$1.98
14 million plus interest and by separate filing on May 5, 2009, submitted its
15 request to terminate the automatic adjustment clause based on a claimed
16 violation of its constitutional rights, insofar as the resulting rates would be
17 confiscatory.

18 **Q. DIDN'T THE COMMISSION ISSUE A "TEMPORARY ADMINISTRATIVE**
19 **RULE" THAT CHANGED THE TIME PERIOD FOR ANY EARNINGS**
20 **REVIEW?**

21 A. Yes. On April 14, 2009, the Commission issued a "Temporary
22 Administrative Rule" which changed the time period used for the earnings
23 review from the "applicable tax year" (i.e., 2007) to the period during which

1 the automatic adjustment clause would be in effect (June 1, 2009 – May 31,
2 2010). For the reasons discussed below, Avista is taking issue with the
3 application of the Temporary Rule to Avista's filing for the 2007 Tax Period.
4 Nevertheless, Avista is providing evidence as to the confiscatory nature of
5 any refund, regardless of whether the prior rule or the Temporary Rule were
6 to be applied. Accordingly, Avista is providing evidence relating to the
7 financial impact on the Company for both the 2007 tax year (old rule) and the
8 June 1, 2009–May 31, 2010 refund period (temporary rule). [See testimony
9 of Avista Witness Pluth.] The results for both periods indicate that any refund
10 would result in confiscatory rates by violating the “fair and reasonable” rate
11 provisions of ORS 756.040, irrespective of which period is used.

12 In Avista's 2007 Tax Report filed on October 15, 2008, Avista initially
13 claimed that a rate adjustment in connection with its tax report for 2007 would
14 violate ORS 756.040. Avista reasserted that claim in its May 5, 2009 filing.
15 Consideration of such a claim is expressly allowed by OAR 860-022-
16 0041(10). Accordingly, Avista is proposing no refund in connection with its
17 tax report for 2007 and requests that the AAC be terminated.

18 **Q. BRIEFLY SUMMARIZE THE LEGAL BASIS FOR THE CLAIM?**

19 A. OAR 860-022-0041(10) - Annual Tax Reports and Automatic
20 Adjustment Clauses Relating to Utility Taxes, provides for relief where there
21 has been a demonstration that the AAC would violate the “fair and
22 reasonable” rate provisions of ORS 756.040:

1 At any time, a utility may file a claim that a rate adjustment
2 under the automatic adjustment clause violates ORS 756.040
3 or other applicable law. In making a determination regarding a
4 potential violation of ORS 756.040, the Commission will
5 perform an earnings review using the utility's results of
6 operations report for the applicable year.
7

8 Avista's position finds support in the Attorney General's Opinion of
9 December 27, 2005, addressing several questions concerning the
10 implementation of SB 408. In its Opinion, at page 16, the Office of Attorney
11 General opined that "[r]egardless of the approach finally adopted by the
12 Commission, the rate ultimately allowed must be 'fair and reasonable' under
13 ORS 756.040(1)." The Opinion noted that ORS 756.040 "essentially codifies"
14 the constitutional standard established by the United States Supreme Court
15 for avoiding confiscatory utility rates. See *Federal Power Commission v.*
16 *Hope Natural Gas Pipeline* ("Hope"), 320 US 591, 64 SCt 281, 88 LEd 333
17 (1944). It went on to observe, at page 16, that:

18 ORS 756.040 thus limits utilities' exposure to rate reductions,
19 regardless of how the Commission exercises its discretion in
20 the application of the expression "properly attributed." In other
21 words, chapter 845 addresses the tax component of rates.
22 ORS 756.040 deals more broadly with the Commission's
23 obligation to set rates at or above the constitutional floor.
24

25 Specifically, ORS 756.040 provides, in part, that rates are fair and
26 reasonable if the rates provide a return to the equity holder that is
27 "commensurate with the return on investments in other enterprises having
28 corresponding risks."

29 ORS 756.040 General powers. (1)... In respect thereof the
30 commission shall make use of the jurisdiction and powers of
31 the office to protect such customers, and the public generally,

1 from unjust and unreasonable exactions and practices and to
2 obtain for them adequate service at fair and reasonable rates.
3 The commission shall balance the interests of the utility
4 investor and the consumer in establishing fair and reasonable
5 rates. Rates are fair and reasonable for the purposes of this
6 subsection if the rates provide adequate revenue both for
7 operating expenses of the public utility or telecommunications
8 utility and for capital costs of the utility, with a return to the
9 equity holder that is:

10 (a) Commensurate with the return on investments in other
11 enterprises having corresponding risks; and

12 (b) Sufficient to ensure confidence in the financial integrity
13 of the utility, allowing the utility to maintain its credit and attract
14 capital.

15 (2) – (3) [omitted]
16

17 **Q. HAS THE COMPANY ANALYZED THE IMPACT OF A REFUND UNDER**
18 **THE PRE-EXISTING RULE FOR CALENDAR YEAR 2007?**

19 A. Yes, it has. Company Witness Pluth will provide additional support for
20 this analysis. The imposition of a \$2.38 million dollar refund (\$1.98 million
21 plus interest) would violate ORS 756.040, based on an earnings review for
22 Avista using its results of operations report for the 2007 tax year.

23 As shown in Witness Pluth's Exhibit 501, by removing the \$2.38 million
24 accrual for SB 408, the ROE would have been 3.17%. The ROE drops to
25 -0.44% with the accrual of the \$1.98 million 2007 SB 408 refund including
26 interest. This ROE of -0.44% is well below any measure of what would be
27 considered to be a return on equity that is "commensurate with the return on
28 investments in other enterprises having corresponding risks" or that is
29 "sufficient to ensure confidence in the financial integrity of the utility." The
30 range of ROE recommendations, by all parties, in general rate cases is well

1 above this result. The table below provides a summary comparison of these
2 ROEs:

3	Authorized ROE	10.25%
4	Actual 2007 ROE (Excluding 2007 SB 408 refund)	3.17%
5	Actual ROE with 2007 SB 408 refund accrued	-0.44%
6		

7 The parties had previously reviewed the data and other assumptions
8 surrounding the derivation of the -0.44% return on equity and agreed that it
9 accurately reflected the impact on Avista's 2007 return on equity, were it to
10 refund the agreed-upon level of \$1.98 million plus interest. As such, Avista
11 believes it would result in confiscatory rates by violating the "fair and
12 reasonable" rate provisions of ORS 756.040.

13 **Q. HAS THE COMPANY PREPARED A SIMILAR ANALYSIS UNDER THE**
14 **TEMPORARY RULE?**

15 A. Yes. After the Commission issued its "Temporary Administrative Rule"
16 on April 14, 2009, which changed the time period used for the earnings
17 review from the "applicable tax year" to the period during which the automatic
18 adjustment clause would be in effect, Avista undertook a study to determine
19 the ROE during the rate adjustment period (June 1, 2009 – May 31, 2010).
20 Exhibit 502 of Witness Pluth shows actual results of operations for 2008
21 adjusted for a variety of customary restating adjustments, including weather
22 and additional revenues, and further pro forms the results beyond 2008 to the
23 refund period, including potential general rate relief in early 2010. It
24 demonstrates that excluding any SB 408 refund, the ROE is projected to be
25 5.94% and that a refund of \$2.4 million would result in an ROE of only 3.78%,

1 even pro forming in all of Avista's pending request for rate relief in its general
2 rate case (GRC) soon to be filed with the Commission. That ROE would, of
3 course, decline even further were the Commission to award only a fraction of
4 the relief requested in the GRC: at 50%, the implied ROE would become
5 2.32% and at 75%, the implied ROE would become 3.06%. Based on these
6 ROE results, any refund would result in confiscatory rates by violating the "fair
7 and reasonable" rate provisions of ORS 756.040.

8 Hence, the ROE results for both the 2007 tax period and the June 1,
9 2009-May 31, 2010 refund period show that any refund would result in
10 confiscatory rates by violating the "fair and reasonable" rate provisions of
11 ORS 756.040.

12 **Q. IN HER PREHEARING CONFERENCE MEMORNDUM, ISSUED MAY 14,**
13 **2009, JUDGE WALLACE REQUESTED EVIDENCE AND ARGUMENT**
14 **CONCERNING THE "VARIOUS FACTORS" THAT ARE TO BE**
15 **CONSIDERED WHEN EVALUATING A CLAIM OF CONFISCATION**
16 **BEYOND RETURN ON EQUITY. WOULD YOU RESPOND?**

17 A. Yes. In a very real sense, the starting point (and perhaps "ending
18 point" as well) is with the plain meaning of ORS 756.040, which codifies the
19 Hope and Bluefield decisions of the U.S. Supreme Court. Rates must be "fair
20 and reasonable" under ORS 756.040 and are only such if:

21 ...the rates provide adequate revenue both for operating
22 expenses of the public utility, or telecommunications utility, and
23 for capital costs of the utility, with a return to the equity holder
24 that is

- 1 (a) Commensurate with the return on investments in other
2 enterprises having corresponding risks; and
3 (b) Sufficient to ensure confidence in the financial integrity of
4 the utility, allowing the utility to maintain its credit and attract
5 capital...(emphasis added)
6

7 What does the evidence show?

8 (1) With a refund, Avista will not be provided with “adequate revenue” to
9 cover both its “operating expenses” and “capital costs” together with a fair
10 “return to the equity holder.” The regulatory compact on which all utility
11 regulation is based imposes on the utility the obligation to serve in exchange
12 for a reasonable opportunity to earn a fair return on its investment. That
13 “compact” would be breached were any refund ordered under these
14 circumstances. Indeed, SB 408, by its terms, expressly acknowledges that,
15 at the end of the day, the resulting rates must still be fair and reasonable.
16 The evidence demonstrates that, even under the most optimistic scenario,
17 Avista will not cover its costs, which must include a “fair return to the equity
18 holder.” Avista’s presently authorized return on equity in Oregon is 10.0%
19 and its rate of return is 8.21%. (In its soon-to-be filed GRC, it is requesting a
20 11.0% ROE and a 8.96% ROR.) A 3-4% ROE resulting from a refund would
21 be well-below any definition of a reasonable return on equity. Indeed, it
22 would be well below Avista’s current cost of debt at 6.92%. Avista is unaware
23 of any regulatory jurisdiction which has approved a ROE of 3-4% as “fair” or
24 has otherwise established a ROE below the debt costs of the utility.
25 Company Witness Dr. Avera will elaborate on the range of fair returns on
26 equity, not only for Avista, but also for the industry as a whole. The simple

1 point is this: A “fair return on equity” is a necessary cost of doing business;
2 any refund under these circumstances would deprive Avista of the opportunity
3 to recover these costs.

4 (2) Nor would a 3-4% ROE be “commensurate with the return on investments
5 in other enterprises having corresponding risks.” (ORS 756.040) In a very
6 real sense, Avista is competing with others for the same investment dollar.

7 Our ability to attract new capital, especially equity capital, under
8 reasonable terms is dependent on our ability to offer a risk/reward opportunity
9 that is better than or at least competitive with the equity investors’ other
10 alternatives. We are competing with not only other utilities, but businesses in
11 other sectors of the economy. As an example, if an equity investor believes,
12 or perceives, that the risk/reward opportunity is better with WalMart than with
13 Avista, or the utility industry in general, the investor will put the equity dollars
14 in WalMart stock. Demand for the stock supports the stock price, which
15 provides the opportunity to issue additional stock under reasonable terms to
16 fund capital investment requirements.

17 To the extent that the equity investor holds a diversified portfolio of
18 companies that includes utilities and other energy companies, we would be
19 competing with those companies to attract those equity dollars. In the debt
20 markets, utilities are the third largest issuers, right behind governments and
21 financial services. Therefore, it is a very competitive market and the
22 Company must be able to attract debt investors as well as equity investors.

1 Recovery of costs together with the opportunity to earn a competitive
2 return on equity is critically important if the Company is to have continuing
3 access to debt and equity capital under reasonable terms on a sustainable
4 basis.

5 (3) A 3-4% return on equity does nothing to “ensure confidence in the
6 financial integrity of the utility” nor does it allow the utility to attract capital on
7 reasonable terms. (ORS 756.040) One needs to examine the stand-alone
8 impact of any refund on Avista’s ability to recover its costs with respect to
9 property dedicated to serve Oregon customers. Avista could not sustain its
10 operations in Oregon, on a stand-alone basis, were it to earn only 3-4% on its
11 equity investment. As Dr. Avera explains, it could not ensure confidence in its
12 financial integrity, maintain its credit or attract capital. It should be
13 remembered that “cost of equity capital” is a true cost of doing business,
14 without which Avista will not be able to attract capital on reasonable terms.

15 **Q. WHAT ABOUT THE IMPACT ON CUSTOMERS, AS ANOTHER FACTOR**
16 **TO BE CONSIDERED?**

17 A. Even though customers would enjoy the near-term benefit of any
18 refund, the longer term repercussions for these same customers would be
19 more severe. Again, viewed on a stand-alone basis, no utility could afford
20 to invest in necessary infrastructure to maintain safe, adequate and
21 reliable service, if it could not access capital markets on reasonable terms.
22 A return to equity investors of 3-4% would not allow Avista to attract capital
23 to sustain its operations.

1 It should be remembered that the SB 408 tax calculation is just the
2 starting point in the determination of whether a refund or surcharge is
3 appropriate. Under ORS 756.040 a determination must be made taking into
4 consideration all Oregon revenues, expenses, and return on investment,
5 whether rates are fair, just, and reasonable for customers and the Company,
6 and whether a refund or surcharge is appropriate. Therefore, a \$1.98 million
7 refund calculation does not in and of its self mean that customers are harmed
8 in any way if a refund is not implemented. In fact, the review of results of
9 operations for both the 2007 tax year and the June 2009 to May 2010 refund
10 period show that without the refund, customers have not, and will not, pay
11 retail rates that will cover the costs of providing service to them. Thus, the
12 absence of a refund will not result in harm to customers in any way. To the
13 contrary, if a refund were to be implemented, customers would benefit
14 inappropriately at the further expense of shareholders.

15 **Q. IS IT NECESSARY FOR THE COMMISSION TO ESTABLISH AN**
16 **ABSOLUTE EARNINGS THRESHOLD IN THIS CASE THAT WILL**
17 **SERVE TO DEFINE CONFISCATION FOR AVISTA AND ALL OTHER**
18 **REGULATED UTILITIES FOR THE FORSEEABLE FUTURE?**

19 A. No. What is fair and reasonable will depend on the circumstances for
20 each utility and may change over time. This case does not present a close
21 call. This is not a case where the parties are arguing over whether an 8% or
22 9% ROE is confiscatory, when the authorized ROE is 10.0%. What we do

1 know is that a 3-4% ROE is well below even Avista's cost of debt of 6.92%,
2 and is below any reasonable measure.

3 **Q. IN THE FINAL ANALYSIS, NO MATTER HOW DERIVED, MUST THE**
4 **"END RESULT" BE JUST AND REASONABLE?**

5 A. Yes, and that is why the drafters of SB 408 specifically provided for an
6 "off ramp" where application of the statute would violate the just and
7 reasonable provision of ORS 756.040. As the Supreme Court explained in
8 the Hope Natural Gas case, the requirement that rates be "fair, just and
9 reasonable" does not define a method by which rates are calculated; instead,
10 the fixing of fair, just and reasonable rates involves a balancing of investor
11 and consumer interests. Fed. Power Comm'n v. Hope Natural Gas Co., 320
12 U.S. 591,603 (1944). Simply put, the "end result" must be reasonable. These
13 standards have been incorporated into ORS 756.040.¹

14 **Q. WHAT WOULD BE "THE EFFECT OF REDUCING THE REFUND**
15 **AMOUNT OR SPREADING THE REFUND OVER SEVERAL YEARS ON**
16 **AVISTA'S RATES DURING THE PERIOD THE REFUND WOULD BE IN**
17 **EFFECT," AS QUERIED BY JUDGE WALLACE?**

18 A. Under the pre-existing rule, for the calendar year 2007 period, even if
19 one were to cut in half the \$2.4 million refund, the resulting ROE would only
20 rise to 1.35% -- still well below any reasonable definition of a fair return. The
21 same holds true with the application of the Temporary Rule. Even under the

¹ F.P.C. v Natural Gas Pipeline Co., 315 U.S. 575, 586, 62 S. Ct. 736, 743 (1942) (Constitution does not "bind ratemaking bodies to the service of any single formula or combination of formulas." As long as an agency's order "in its entirety, produces no arbitrary result, our inquiry is at an end.").

1 most optimistic assumptions (e.g., assuming 100% of the \$14.2 million of rate
2 relief were granted in Avista's soon-to-be filed GRC), cutting the refund in half
3 would only provide a 4.87% ROE for the period June 1, 2009 – May 31, 2010.

4 Nor would spreading the refund out over several years be reasonable
5 or appropriate. If taken to the extreme, one could propose that the refund be
6 deferred until a future period when the Company over-recovered its costs and
7 over-earned, and then implement the refund. Arbitrarily spreading the refund
8 over some future period would violate the very basic fundamental principle of
9 "matching" the revenues, expenses and return on investment during the
10 period that retail rates are in effect, such that rates are fair, just and
11 reasonable for both the customer and the shareholder during that same
12 period.

13 Attempting to spread the refund across other periods of time that are
14 unrelated to the circumstances of the period giving rise to the refund would
15 violate the matching principal and would be inappropriate.

16 **Q. YOU MENTIONED EARLIER THAT AVISTA IS TAKING ISSUE WITH**
17 **THE APPLICATION OF THE TEMPORARY RULE IN THIS CASE.**
18 **PLEASE EXPLAIN.**

19 A. The Temporary Rule arbitrarily imposes an earnings review period of
20 June 1, 2009 through May 31, 2010, that simply does not match the period
21 covered by the 2007 Tax Report at issue in these proceedings. The prior rule
22 had it right, insofar as it "matched" the 2007 earnings review period with the
23 2007 Tax Report, for purposes of analyzing any claim to confiscation. To

1 otherwise compare the actual 2007 tax report information with projected
2 earnings information for 2009-2010 under the Temporary Rule mixes apples
3 and oranges.

4 It is also fraught with other impracticalities. The Temporary Rule would
5 require the parties to essentially create a fully normalized and pro formed
6 hypothetical rate case for a projected period (i.e. June 2009 – May 2010) and
7 to fully audit the same, in order to simply compare these hypothetical results
8 with a prior tax refund obligation to analyze the earnings impact of a refund.
9 The creation of a hypothetical rate case for this purpose works a tremendous
10 drain on the resources of the Commission and all affected parties. The only
11 reason Avista could even timely produce results to show the impact of the
12 Temporary Rule was because it already was nearly finished with the
13 preparation of its soon-to-be filed rate case. This still required Commission
14 Staff to dedicate extensive resources to analyzing the results for purposes of
15 evaluating Avista's claim under the Temporary Rule.

16 Going forward, the need to create a "hypothetical rate case" for a
17 future refund period in order to evaluate any claim of confiscation for the prior
18 tax period is simply unworkable, in addition to otherwise violating the
19 matching principle.

20 **Q. FINALLY, DO YOU HAVE OTHER CONCERNS ABOUT HOW THE**
21 **TEMPORARY RULE WAS APPLIED TO AVISTA UNDER THESE**
22 **PARTICULAR CIRCUMSTANCES?**

1 A. Yes. Previously, all interested parties had worked very hard to craft a
2 settlement (since rejected by the Commission) that was the result of hard
3 bargaining and compromise over many months. In return for eliminating the
4 refund for the 2007 Tax Year, Avista agreed to absorb up to \$500,000 of any
5 surcharge in a particular year in which it would be entitled to a surcharge
6 under SB 408 (up to \$2 million on a cumulative basis). The parties
7 reasonably relied on the prior rules then in effect over a period of many
8 months and submitted a settlement in reliance of these rules. Indeed, nearly
9 three months after the settlement was signed and submitted, the
10 Commission, on its own and with no prior notice to the parties, enacted
11 emergency Temporary Rules that entirely changed the definition of the rate
12 refund period. To reject the settlement and retroactively apply these new
13 Temporary Rules to the 2007 Tax Report previously filed in October of 2008
14 was unfair to the participants, resulted in the waste of the parties resources,
15 and is legally suspect, in its retroactive application.

16 Accordingly, Avista believes the Commission should waive the
17 application of the Temporary Rule as it may be applied to Avista under these
18 circumstances and approve the settlement previously reached by the parties
19 on January 20, 2009.

20 **Q. DOES THIS CONCLUDE YOUR PRE-FILED TESTIMONY?**

21 A. Yes.

**PUBLIC UTILITY COMMISSION
OF
OREGON**

**UG 171 (1)
Phase II**

AVISTA EXHIBIT 400

**Direct Testimony of William E. Avera
On Behalf of
Avista Corporation
In the Matter of Avista's
SB 408 2007 Tax Report**

June 15, 2009

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, BUSINESS ADDRESS**
2 **AND QUALIFICATIONS.**

3 A. My name is William E. Avera. I am the President of FINCAP, Inc. My
4 business address is 3907 Red River St., Austin, Texas 78751. I received a
5 B.A. degree with a major in economics from Emory University. After serving
6 in the U.S. Navy, I entered the doctoral program in economics at the
7 University of North Carolina at Chapel Hill. Upon receiving my Ph.D. in
8 economics and finance, I joined the faculty at the University of North Carolina
9 and taught finance in the Graduate School of Business. I subsequently
10 accepted a position at the University of Texas at Austin where I taught
11 courses in financial management and investment analysis. I then went to
12 work for International Paper Company in New York City as Manager of
13 Financial Education, a position in which I had responsibility for all corporate
14 education programs in finance, accounting, and economics.

15 In 1977, I joined the staff of the Public Utility Commission of Texas
16 (PUCT) as Director of the Economic Research Division. During my tenure at
17 the PUCT, I managed a division responsible for financial analysis, cost
18 allocation and rate design, economic and financial research, and data
19 processing systems, and I testified in cases on a variety of financial and
20 economic issues. Since leaving the PUCT, I have been engaged as a
21 consultant. I have participated in a wide range of assignments involving
22 utility-related matters on behalf of utilities, industrial customers, municipalities,
23 and regulatory commissions. I have previously testified before the Federal

1 Energy Regulatory Commission ("FERC"), as well as the Federal
2 Communications Commission ("FCC"), the Surface Transportation Board
3 (and its predecessor, the Interstate Commerce Commission), the Canadian
4 Radio-Television and Telecommunications Commission, and regulatory
5 agencies, courts, and legislative committees in 42 states, including Oregon.

6 In 1995, I was appointed by the PUCT to the Synchronous
7 Interconnection Committee to advise the Texas legislature on the costs and
8 benefits of connecting Texas to the national electric transmission grid. In
9 addition, I served as an outside director of Georgia System Operations
10 Corporation, the system operator for electric cooperatives in Georgia.

11 I have served as Lecturer in the Finance Department at the University
12 of Texas at Austin and taught in the evening graduate program at St.
13 Edward's University for twenty years. In addition, I have lectured on
14 economic and regulatory topics in programs sponsored by universities and
15 industry groups. I have taught in hundreds of educational programs for
16 financial analysts in programs sponsored by the Association for Investment
17 Management and Research, the Financial Analysts Review, and local
18 financial analysts societies. These programs have been presented in Asia,
19 Europe, and North America, including the Financial Analysts Seminar at
20 Northwestern University. I hold the Chartered Financial Analyst (CFA®)
21 designation and have served as Vice President for Membership of the
22 Financial Management Association. I have also served on the Board of
23 Directors of the North Carolina Society of Financial Analysts. I was elected

1 Vice Chairman of the National Association of Regulatory Commissioners
2 (“NARUC”) Subcommittee on Economics and appointed to NARUC’s
3 Technical Subcommittee on the National Energy Act. I have also served as
4 an officer of various other professional organizations and societies. A resume
5 containing the details of my experience and qualifications is attached to my
6 testimony.

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

8 A. My testimony analyzes the impact of requiring Avista Corporation
9 (“Avista” or “Company”) to implement the tax adjustment clause resulting in a
10 substantial refund to customers. My review is based on my education and
11 experience in the disciplines of economics, finance, and regulatory policy. My
12 testimony establishes that any refund relative to Avista’s earnings on its
13 Oregon jurisdictional utility service would preclude the opportunity to earn a
14 fair rate of return on equity (“ROE”) and would result in confiscation of
15 investment in the utility. Avista witnesses Kelly Norwood and Jeanne Pluth
16 establish that under various scenarios Avista’s ROE, with the refund, would
17 range from less than zero to less than 4 percent. My testimony demonstrates
18 that ROE’s in the range implied by implementation of the income tax
19 adjustment would fall woefully short of any opportunity for any utility to earn a
20 fair ROE given today’s capital market realities. It is less than the yields on
21 relatively risk-free debt backed by the U.S. Treasury, far less than the
22 observable yields on utility bonds, and certainly less than the required return
23 on utility common equity by any reasonable metric. The prospect of such low

1 ROE's would be particularly damaging to Avista given its efforts to recover
2 financial flexibility and its greater investment risk relative to other utilities.
3 Imposing such a financial burden on Avista would not only be contrary to the
4 regulatory policy prohibiting taking of investment value through an
5 unreasonably low ROE, such confiscation would ultimately harm Avista's
6 customers in Oregon.

7 **Q. WHY IS CONFISCATION CONTRARY TO SOUND REGULATORY**
8 **POLICY?**

9 A. Central to the determination of reasonable rates for utility service is the
10 understanding that owners of public utility properties are protected from
11 confiscation by the assurance that utilities will be allowed an opportunity to
12 earn a fair rate of return on invested capital. In this arrangement, sometimes
13 called "the regulatory compact", owners of utility property give government
14 agencies the ability to set the price of their services, with the understanding
15 that regulatory authorities will allow the utility an opportunity to earn a fair
16 return. The ROE compensates common equity investors for the use of their
17 capital to finance the plant and equipment necessary to provide utility service.
18 Investors commit capital only if they expect to earn a return on their
19 investment commensurate with returns available from alternative investments
20 with comparable risks. To be consistent with sound regulatory economics
21 and the standards set forth by the Supreme Court in the *Bluefield*¹ and *Hope*²
22 cases, a utility's allowed ROE should be sufficient to: (1) fairly compensate

¹ *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923).

² *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

1 investors for capital invested in the utility, (2) enable the utility to offer a return
2 adequate to attract new capital on reasonable terms, and (3) maintain the
3 utility's financial integrity. If a utility has an opportunity to earn an ROE that
4 meets these end result requirements, investors will be treated fairly under the
5 "regulatory compact" and customers will be well-served by a utility that can
6 raise the capital necessary to provide safe, reliable, and economical service
7 to its customers. The utility will also have the financial integrity and financial
8 flexibility to respond to unexpected challenges and requirements that
9 unfortunately arise in providing utility service. Because utility service is one of
10 the most capital intensive activities in the modern economy, financial
11 wherewithal is all too often required to meet the challenges facing utilities.
12 The prospects of an ROE below the level required to adequately compensate
13 investors would undermine, or completely prevent, the utility from responding
14 to these challenges. The end result would be that the customers and the
15 community suffer the dire consequences of being served by a financially
16 impaired utility. Thus, from an economic perspective, maintaining the
17 opportunity to earn a fair ROE as defined in the *Hope* and *Bluefield* cases
18 avoids confiscation and in so doing, serves the interest of utility's customers
19 and the community by protecting investors and maintaining their willingness
20 to provide the capital that is the life blood of utility service,

21 **Q. DOES THE REQUIREMENT FOR A FAIR ROE APPLY REGARDLESS**
22 **OF THE CIRCUMSTANCES THAT CAUSE THE UTILITY TO NOT HAVE**
23 **AN OPPORTUNITY TO EARN THAT ROE?**

1 A. Yes. While the *Hope* and *Bluefield* end result standards are most often
2 referenced in rate cases where a fair ROE is being established, the
3 requirement to avoid regulatory actions that deny the utility an opportunity to
4 earn a fair ROE applies to all regulatory actions. Whenever a utility is denied
5 an opportunity to earn a fair ROE through regulatory actions, the investors
6 suffer confiscation and the ability of a utility to access capital markets on
7 reasonable terms is threatened. The investors in the utility suffer directly, but
8 in the long-run the customers of the utility and the economy of the community
9 it serves suffer as a result of the financial impairment. For example, in the
10 Telecommunications Act of 1996 Congress directed the FCC to develop
11 pricing guidelines for negotiations between incumbent telephone companies
12 and competitors who wish to pay to use the existing network elements owned
13 by incumbent telephone companies. I have testified in many cases
14 throughout the U.S. on the application of these pricing rules. The U.S.
15 Supreme Court has reaffirmed that the end result test must be applied to the
16 pricing rules based on the actual returns that investors expect if they put their
17 money at risk to finance telephone utilities.³

18 The end result test also applies to the income tax adjustment
19 mechanism being implemented by this Commission in Order No. 09-125 in
20 UG 171(1). The necessary end result test can only be achieved for Avista if

³ *Verizon Communications, et al v. Federal Communications Commission, et al*, 535 U.S. 467 (2002). While I cannot comment on the legal significance of this case, I found the economic wisdom of looking to the reasonable expectations of actual investors compelling and completely consistent with the economic logic of the *Hope* and *Bluefield* end-result tests. But economic logic and common sense confirm that a utility cannot attract capital on reasonable terms if investors expect future returns to fall short of those offered by comparable investments.

1 the Company has an opportunity to earn a fair ROE after taking into account
2 the effect of these required accounting entries and rate adjustments, such as
3 that required by the income tax clause in this case. This Commission
4 acknowledges this issue. In its Order No. 09-125 at p. 5, the Commission
5 stated: "At any time after filing the tariffs, Avista or any other person may file
6 a request that the Commission terminate the automatic adjustment clause
7 because allowing the clause to become effective would result in a violation of
8 the utility's constitutional rights." In the Attorney General's Opinion of
9 December 27, 2005, addressing several questions concerning the
10 implementation of SB 408, at page 16, it found "[r]egardless of the approach
11 finally adopted by the Commission, the rate ultimately allowed must be 'fair
12 and reasonable' under ORS 756.040(1)." The Opinion noted that ORS
13 756.040 "essentially codifies" the constitutional standard established by the
14 United States Supreme Court for avoiding confiscatory utility rates. See
15 Federal Power Commission v. Hope Natural Gas Pipeline ("Hope"), 320 US
16 591, 64 SCt 281, 88 LEd 333 (1944). The Attorney General Opinion went on
17 to observe, at page 16, that:

18 ORS 756.040 thus limits utilities' exposure to rate reductions,
19 regardless of how the Commission exercises its discretion in
20 the application of the expression "properly attributed." In other
21 words, chapter 845 addresses the tax component of rates.
22 ORS 756.040 deals more broadly with the Commission's
23 obligation to set rates at or above the constitutional floor.
24

1 ORS 756.040 provides, in part, that rates are fair and reasonable if the
2 rates provide a return to the equity holder that is “commensurate with the
3 return on investments in other enterprises having corresponding risks.”

4 ORS 756.040 General powers. (1)... In respect thereof the
5 commission shall make use of the jurisdiction and powers of
6 the office to protect such customers, and the public generally,
7 from unjust and unreasonable exactions and practices and to
8 obtain for them adequate service at fair and reasonable rates.
9 The commission shall balance the interests of the utility
10 investor and the consumer in establishing fair and reasonable
11 rates. Rates are fair and reasonable for the purposes of this
12 subsection if the rates provide adequate revenue both for
13 operating expenses of the public utility or telecommunications
14 utility and for capital costs of the utility, with a return to the
15 equity holder that is:

- 16 (a) Commensurate with the return on investments in other
17 enterprises having corresponding risks; and
18 (b) Sufficient to ensure confidence in the financial integrity
19 of the utility, allowing the utility to maintain its credit and attract
20 capital.
21 (2) – (3) [omitted]
22

23 My understanding as an economist and financial analyst is that this
24 Commission should not order refunds if the effect is to deny Avista an
25 opportunity to earn a fair ROE that meets the *Hope* and *Bluefield* tests. My
26 testimony demonstrates that the effect of the refunds under the tax
27 adjustment clause would result in an ROE that clearly fails these tests.

28 **Q. HOW DOES NOT ALLOWING AVISTA AN ACTUAL OPPORTUNITY TO**
29 **EARN ITS COST OF CAPITAL RESULT IN TAKING VALUE FROM**
30 **INVESTORS?**

31 A. Not allowing the Company an opportunity to earn a sufficient return is
32 the economic equivalent of taking the capital of existing investors. In real
33 world capital markets, investors have many competing places to put their

1 money. If the money that is dedicated to utility service does not have an
2 opportunity to earn a return commensurate with that available from
3 alternatives of equivalent risk in the capital markets, investors are not being
4 adequately compensated for the use of their money. Since the capital
5 dedicated to utility service cannot be withdrawn once it is committed to public
6 service, its economic value to investors is reduced if it is not earning a fair
7 return commensurate with alternative investments on the open market.⁴ This
8 reduction in economic value constitutes a taking of investors' capital by the
9 governmental authority setting rates.

10 It is possible to observe how inadequate returns reduce economic
11 value in the marketplace. Consider a bond issued by a risky entity.
12 Generally the bond is sold to the public at close to face value (\$1000) and
13 can be traded in the market. Whoever owns the bond will receive the coupon
14 payments over the life of the bond and receive the \$1000 principal repayment
15 at maturity. As the level of interest rates vary or the risk of the cash flow
16 promised from the issuer of the bond change, so will the market value of the
17 bond. If the risk increases that the promised payments will not be made in
18 full, the value of the bond drops in the capital market. Only by lowering the
19 price that investors must pay for the bond can the expected return be made
20 competitive with other opportunities in the capital markets. For the investor

⁴ Individual owners of utility bonds and stocks can sell their claims on future cash flows to other investors, but they cannot withdraw the underlying capital from the utility. The government will not allow capital that is invested in utility rate base to be withdrawn. Therefore, the governmental authority having control over the rates must be set them as to allow that capital to earn of return that is competitive with the earnings available other opportunities of commensurate risk. Failing to allow such a return constitutes a taking of the economic value of the capital already dedicated to public utility service.

1 who owns the bond, the economic value of their investment is reduced as the
2 market price declines. Similarly, capital that is dedicated to public service in
3 the rate base of Avista has its value affected by the risks and prospects of the
4 Company relative to other opportunities in the capital market. Since the
5 money invested in Avista's rate base cannot be withdrawn, the effect of not
6 having an opportunity to earn returns commensurate with the underlying risk
7 causes the economic value of its investment to fall. This reduction in value
8 due to an inadequate opportunity to earn a return commensurate with risk is
9 the economic equivalent of the government taking value from the private
10 property of investors without compensation. When a utility suffers
11 confiscation, it is difficult to induce new investors to provide capital when the
12 utility needs to raise money to provide its customers with safe, reliable, and
13 adequate service. The end result is that investors lose, and ultimately
14 customers and the community also lose.

15 **Q. HOW DO CUSTOMERS BENEFIT BY ENHANCING THE UTILITY'S**
16 **FINANCIAL FLEXIBILITY?**

17 A. While providing an ROE that is sufficient to maintain Avista's ability to
18 attract capital, even in times of financial and market stress, is consistent with
19 the economic requirements embodied in the U.S. Supreme Court's *Hope* and
20 *Bluefield* decisions, it is also in customers' best interests. Ultimately, it is
21 customers and the service area economy that enjoy the benefits that come
22 from ensuring that the utility has the financial wherewithal to take whatever
23 actions are required to ensure reliable service. By the same token,

1 customers also bear a significant burden when the ability of the utility to
2 attract necessary capital is impaired and service quality is compromised.

3 **Q. WHAT ROLE DOES REGULATION PLAY IN ENSURING THAT AVISTA**
4 **HAS ACCESS TO CAPITAL UNDER REASONABLE TERMS AND ON A**
5 **SUSTAINABLE BASIS?**

6 A. Investors recognize that constructive regulation is a key ingredient in
7 supporting utility credit ratings and financial integrity, particularly during times
8 of adverse conditions. Fitch Ratings, Inc. ("Fitch"), a bond rating agency that
9 rates Avista's bonds, noted that "Fitch is concerned that the recent rapid
10 escalation in the cost of capital will not be reflected on a timely basis in utility
11 rates."⁵ On May 19, 2009, Fitch announced that it had increased Avista's
12 "Issuer Rating" from BB+ to BBB-.⁶

13 Moody's has emphasized the need for regulatory support "in an era of
14 broadly rising costs," noting that as cost pressures have escalated for electric
15 utilities, so too has the importance of timely recovery through the regulatory
16 process and the risks associated with regulatory lag.⁷ S&P concluded "the
17 quality of regulation is at the forefront of our analysis of utility
18 creditworthiness,"⁸ and recently observed that its risk analysis focuses on the
19 utility's ability to consistently earn a reasonable return:

⁵ Fitch Ratings Ltd., "U.S. Utilities, Power and Gas 2009 Outlook," *Global Power North America Special Report* (Dec. 22, 2008).

⁶ "Fitch Upgrades Avista Corp's IDR "BBB-"; Outlook Stable", Fitch Ratings (May 19, 2009). Ratings below BBB- are not investment grade and are considered in the "junk" category

⁷ Moody's Investors Service, "Regulatory Pressures Increase For U.S. Electric Utilities," *Special Comment* (March 2007).

⁸ Standard & Poor's Corporation, "Assessing U.S. Utility Regulatory Environments," *RatingsDirect* (Nov. 7, 2008).

1 Notably, the analysis does not revolve around “authorized”
2 returns, but rather on actual earned returns. We note the
3 many examples of utilities with healthy authorized returns that,
4 we believe, have no meaningful expectation of actually earning
5 that return because of rate case lag, expense disallowances,
6 etc.⁹

7 Avista's senior credit ratings remain at the very bottom of the
8 investment grade scale. In a recent report by S&P ranking U.S. regulated
9 utilities from strongest to weakest, Avista was ranked 161 out of the total 175
10 companies with investment grade credit ratings.¹⁰ In other words, only 14
11 companies in the utility industry with investment grade ratings have a credit
12 profile weaker than Avista's.

13 **Q. HOW DOES THE ROE FOR AVISTA UNDER THE REFUND SCENARIOS**
14 **COMPARE TO THE FAIR ROE UNDER THE HOPE AND BLUEFIELD**
15 **STANDARDS?**

16 A. The ROE's ranging from negative to less than 4 percent fall far short of
17 any reasonable definition of a fair ROE. Avista's current authorized return on
18 equity in Oregon is 10.0%. Avista will be requesting an 11.0% ROE in a rate
19 filing soon to be made with this Commission.¹¹ I have been involved in
20 hundreds of rate cases and other regulatory proceedings since 1975. I
21 cannot recall any witness (whether Company, Staff or intervener) in any case
22 involving an investor-owned utility recommending a fair ROE even as low as
23 6 percent, and certainly not at levels produced by the income tax refund in

⁹ *Id.*

¹⁰ Standard & Poor's Corporation, “Issuer Ranking: U.S. Regulated Electric Utilities, Strongest To Weakest,” *RatingsDirect* (Mar. 31, 2009).

¹¹ I will be filing testimony supporting the requested ROE in this soon-to-be filed case.

1 this case. Indeed, investors are requiring just under 5 percent to invest in 30-
2 year U.S. Treasury bonds, backed by the full faith and credit of the national
3 government with its power to tax and print money.¹² Similarly, the average
4 yield on utility bonds rated Baa bonds (the same rating as Avista) averaged
5 7.76% in May 2009.¹³ The equity in Avista has no maturity and is junior to the
6 claim of debt against assets and earnings. Hence the required fair return on
7 Avista equity would far exceed the observed yield on bonds of the same
8 rating as Avista's.

9 **Q. HOW DO THE ROE'S RESULTING FROM THE REFUND COMPARE TO**
10 **THE FAIR ROE'S BEING FOUND BY STATE REGULATORY**
11 **COMMISSIONS?**

12 A. The firm Regulatory Research Associates ("RRA") publishes a survey
13 of regulatory decisions. RRA reported that the average determination of a fair
14 ROE for gas utilities in 2008 was 10.37% and 10.24% for the first quarter of
15 2009.¹⁴ The lowest allowed ROE for a gas utility in the first quarter of 2009
16 was 10.05% for New England Gas in Massachusetts.¹⁵ The lowest allowed
17 fair ROE for a gas utility in the two years from January 2007 through
18 December 2008 was 9.50% for Arkansas Western Gas in Arkansas.¹⁶ As for
19 electric utilities, the 2008 average was fair ROE determination was 10.46%
20 and for the first quarter of 2009 the average ROE found to be fair was

¹² www.finance.yahoo.com (visited June 8, 2009).

¹³ <http://credittrends.moodys.com> (visited June 3, 2009).

¹⁴ Regulatory Research Associates, "Major Rate Case Decisions—January-March 2009" (April 2, 2009) p.1.

¹⁵ *Id.*, p. 4.

¹⁶ Regulatory Research Associates "Major Rate Case Decisions—January 2007-December 2008 Supplemental Study (January 12, 2009) p. 8.

1 10.24%.¹⁷ Significantly, RRA indicated that if the 8.75% allowed ROE for
2 United Illuminating Company in Connecticut is removed, the national average
3 ROE determination for the first quarter of 2009 was 10.48%.¹⁸ It speaks
4 volumes that RRA felt that the 8.75% was out of line and it was meaningful to
5 compute a national average without that low ROE.¹⁹ By this national
6 comparison, the ROE resulting from the income tax adjustment refund in this
7 case would be extremely out of line with the findings of state commissions on
8 the fair ROE. This is particularly true because, by objective measures like
9 bond ratings, Avista is more risky than the average gas or electric utility in the
10 U.S.

11 **Q. WHAT IS YOUR CONCLUSION REGARDING WHETHER AVISTA'S ROE**
12 **AFTER REFUNDS FROM THE INCOME TAX ADJUSTMENT CLAUSE**
13 **WOULD RESULT IN CONFISCATION?**

14 A. By any objective measure an ROE for Avista ranging from negative to
15 less than 4 percent would fall well short of any concept of a fair ROE²⁰. A
16 return so low would be less than investors could earn on alternatives with less
17 risk. It would not allow Avista to attract capital on reasonable terms and
18 would not maintain Avista's financial integrity. The ROE resulting from the

¹⁷ Regulatory Research Associates, "Major Rate Case Decisions—January-March 2009" (April 2, 2009) p.1.

¹⁸ Ibid.

¹⁹ I was an expert witness for United Illuminating Company in this case (Docket No. 08-07-04) before the Connecticut Department of Utility Control. There were economic circumstances surrounding this case that render it not a usable benchmark for fair ROE.

²⁰ It is not necessary for the Commission to determine, in this case, what an absolute ROE threshold for confiscation would be; that will depend on the unique circumstances of each utility at the time. Rather, it is enough to establish that the demonstrated ROE's with any refund do not meet any reasonable definition of a fair ROE.

1 refunds would be far below any recommended or allowed fair ROE in my
2 experience, and also well short of any allowed return by any state regulatory
3 agency on any electric or gas utility in the country over the last two years.
4 Just as Avista has finally been able to build its financial strength to emerge
5 from junk bond status, such a negative regulatory decision would be a big
6 step in the wrong direction, and contrary to the interests of Avista's customers
7 in Oregon and the communities it serves.

8 **Q. DOES THIS CONCLUDE YOUR PRE-FILED DIRECT TESTIMONY?**

9 A. Yes.

**PUBLIC UTILITY COMMISSION
OF
OREGON**

**UG 171 (1)
Phase II**

AVISTA EXHIBIT 500

**Direct Testimony of Jeanne Pluth
On Behalf of
Avista Corporation
In the Matter of Avista's
SB 408 2007 Tax Report**

June 15, 2009

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, BUSINESS ADDRESS**
2 **AND QUALIFICATIONS.**

3 A. My name is Jeanne M. Pluth. I am employed by Avista Corporation as
4 Senior Regulatory Analyst in the State and Federal Regulation Department.
5 My business address is 1411 East Mission Avenue, Spokane, Washington
6 99220. I am a 1986 graduate of Eastern Washington University with a
7 Bachelor of Arts Degree in Business Administration, majoring in Accounting.
8 In 1987, I passed the Certified Public Accountant exam, earning my CPA
9 License in April 1988. I worked for McFarland & Alton, CPAs from 1991 to
10 1997, before joining the Company in April 2001. I worked at Advantage IQ, a
11 subsidiary of Avista, before transferring to the Utility in December 2004. I
12 served in the Projects and Fixed Assets section of the Finance Department
13 before I was hired into the State and Federal Regulation Department as a
14 Regulatory Analyst in November 2006. I have attended several utility
15 accounting and ratemaking training courses.

16 **Q. WHAT IS THE SCOPE OF YOUR TESTIMONY IN THIS PROCEEDING?**

17 A. My testimony and exhibits in this proceeding will generally cover
18 accounting and financial data in support of the Company's claim, filed on May
19 5, 2009, that implementation of the automatic adjustment clause (AAC),
20 resulting in a refund of \$2.4 million to customers, would result in confiscatory
21 rates in violation of ORS 756.040, which requires that rates be just,
22 reasonable, and sufficient. I will provide an analysis of the results under both

1 the prior rule and the new Temporary Rule, as each defines the earning
2 review period, and will quantify the impacts on the Company's earnings.

3 **Q. WILL YOU DEFINE THE TWO PERIODS THAT YOUR TESTIMONY WILL**
4 **ADDRESS?**

5 A. Yes. The prior rule defined the earnings review period as the
6 applicable tax year, which will be referred to as the "2007 tax year" in my
7 testimony. The new Temporary Rule defined the earnings review period as
8 the period during which the AAC would be in effect, which is the period June
9 1, 2009 through May 31, 2010, for the 2007 tax year, and will be referred to
10 as the "refund period" in my testimony.

11 **Q. ARE YOU SPONSORING ANY EXHIBITS TO BE INTRODUCED IN THIS**
12 **PROCEEDING?**

13 A. Yes. I am sponsoring Exhibit Nos. 501 and 502. Exhibit 501 consists
14 of a worksheet, which shows actual annual earnings test operating results,
15 rate base for the Company's Oregon jurisdiction, and the Company's
16 calculation of the return on equity (ROE) for the 2007 tax year. Exhibit 502
17 consists of a worksheet, which shows forecasted operating results, rate base
18 and ROE for the refund period.

19 **ANALYSIS OF RESULTS UNDER THE PRIOR RULE**

20 **Q. WOULD YOU PLEASE SUMMARIZE EXHIBIT 501?**

21 A. Yes. The exhibit provides net operating income, rate base and the
22 computed return on equity (ROE) for the 2007 tax year, for three scenarios:
23 (1) Per the earnings test, adjusted for the average capital structure and debt

1 costs; (2) Adjusted to remove the 2007 SB 408 accrual; and (3) Adjusted to
2 include the impact of the SB 408 tax refund, including interest.

3 **Q. WHAT IS THE ROE UNDER EACH SCENARIO?**

4 A. The actual ROE per the earnings test results was -0.37%. By
5 removing the \$2.38 million accrual for SB 408, the ROE would have been
6 3.17%. The ROE drops to -0.44% with the accrual of the \$1.98 million 2007
7 SB 408 refund, plus interest.

8 **Q. HAS THE DATA IN THIS EXHIBIT BEEN REVIEWED BY THE OTHER**
9 **PARTIES IN THIS DOCKET?**

10 A. Yes. The parties had previously reviewed the data and other
11 assumptions surrounding the derivation of the -0.44% return on equity and
12 agreed that it accurately reflected the impact on Avista's 2007 return on
13 equity, were it to refund the agreed-upon level of \$1.98 million plus interest.

14 **ANALYSIS OF RESULTS UNDER THE TEMPORARY RULE**

15 **Q. PLEASE EXPLAIN HOW THE COMPANY DEVELOPED THE**
16 **FORECASTED OPERATING RESULTS FOR THE REFUND PERIOD.**

17 A. Forecasted operating results preparation began with 2008 earnings
18 test results (the historical accounting information for the twelve months ended
19 December 31, 2008, adjusted for standard earnings test adjustments,
20 including a weather normalization adjustment), which had been reviewed by
21 Commission Staff. Then, several adjustments were made to restate the 2008
22 actual results for known, measurable and anticipated events to the forecasted
23 refund period.

1 **Q. WOULD YOU PLEASE SUMMARIZE EXHIBIT 502?**

2 A. Yes. Exhibit 502 begins with actual operating results and rate base for
3 2008 in column (A). Numerous adjustments, described in detail below, were
4 made in columns (B) through (N), to derive the forecasted results of
5 operations for the refund period, prior to any SB 408 refund [Column (O)].
6 Column (P), entitled SB 408 Refund (2007), presents the impact of refunding
7 \$2.38 million to customers (\$1.98 million refund plus \$0.40 million interest).
8 The final column, column (Q), entitled Restated Total, reflects the forecasted
9 operating results during the refund period, including the refund to customers
10 for the 2007 SB 408.

11 **Q. WHAT IS THE FORECASTED ROE FOR THE REFUND PERIOD?**

12 A. The forecasted ROE excluding any SB 408 refund is 5.94%. The ROE
13 drops to 3.78% with the accrual of the \$1.98 million 2007 SB 408 refund, plus
14 interest.

15 **Q. WOULD YOU PLEASE EXPLAIN EACH OF THE COLUMNS IN THE**
16 **EXHIBIT, THE REASON FOR THE ADJUSTMENT AND ITS EFFECT ON**
17 **REFUND PERIOD STATE OF OREGON NET OPERATING INCOME**
18 **AND/OR RATE BASE?**

19 A. Yes. The first adjustment, column (B) , entitled **Earnings Test**
20 **Adjustments**, includes all standard adjustments from our annual normalized
21 earnings reporting to the Commission, including adjustments for
22 Memberships and Dues, Salaries and Wages, Incentive Pay, Eliminate
23 Revenue Pass-Through, Uncollectible Expense, Miscellaneous, and Remove

1 Senate Bill 408 Accrual (for prior periods). These adjustments were audited
2 by Commission Staff during the annual earnings test review.

3 Column (C), entitled **Earnings Test Results UM-903**, is the subtotal of
4 the previous two columns.

5 Column (D), entitled **Weather Normalization Sales/Purchases**,
6 normalizes weather sensitive natural gas therm sales by eliminating the effect
7 of temperature deviations above or below historical normals. This adjustment
8 restates revenue and natural gas cost to reflect the change in therm sales if
9 weather had been normal based upon energy rates and the authorized
10 weighted average cost of gas in effect during the year. The adjustment
11 reflects a winter season consisting of October through June and historical
12 normals computed on a twenty-five year rolling average per the settlement in
13 Docket No. UG-181 (Order No. 08-185). This adjustment decreases Oregon
14 net operating income by \$1,032,793.

15 Column (E), entitled **Total Including Type I Results**, is a subtotal of
16 columns (C) and (D).

17 Column (F), entitled **Restate Debt Interest**, restates debt interest on
18 the 2008 results using the Company's forecasted weighted average cost of
19 debt and forecasted capital structure at December 31, 2009, and applied to
20 Oregon's 2008 level of rate base to produce an adjusted level of tax
21 deductible interest expense. The 2008 earnings test had used the actual
22 debt costs at December 31, 2008 and the authorized capital structure
23 approved in Docket No. UG-181. The state and federal income tax effect of

1 the restated level of interest decreases Oregon net operating income by
2 \$51,920.

3 Column (G), entitled **2008 EOP Rate Base Adjustment**, restates 2008
4 results from an average of monthly averages (AMA) basis to and end of
5 period basis. In addition, this adjustment includes the debt interest impact of
6 the adjustment to rate base. This adjustment increases Oregon net operating
7 income by \$204,961 and increases rate base by \$14,751,573.

8 Column (H), **Refund Period Revenue Adjustment**, restates revenue
9 to the amount expected from forecasted loads and customers for the refund
10 period at the current rates effective November 1, 2008. The weighted
11 average cost of gas and amortization of prior gas costs and demand side
12 management costs approved in the November 1, 2008 Purchased Gas
13 Adjustment (PGA) are reflected in the pro forma revenue. PGA tracked gas
14 costs have been restated to match the commodity, demand, and
15 amortizations included in the pro forma revenue. This adjustment also
16 eliminates the Senate Bill 408 refund amount returned to customers during
17 2008 and the related credit to amortization expense (for the 2006 tax year
18 refund). This adjustment increases Oregon net operating income by
19 \$1,155,205.

20 Column (I), **Remove SB 408 2008 Accrual**, removes the 2008 accrual
21 for the estimated 2008 Oregon SB 408 refund. This adjustment increases
22 Oregon net operating income by \$942,500.

1 Column (J), **10% Gas Costs Deferral Adjustment**, reflects the 10%
2 amount of non-deferred Purchase Gas Costs that are expected to benefit
3 earnings during the period June 1, 2009 through October 31, 2009. The
4 weighted average cost of natural gas will be reset on November 1, 2009 in
5 the annual PGA filing. This adjustment increases Oregon net operating
6 income by \$475,177.

7 Column (K), **2009 Capital Adjustment**, pro forms in capital cost,
8 depreciation and property taxes associated with forecasted capital projects.
9 This adjustment includes all projects expected to be completed and
10 transferred to plant-in-service by December 31, 2009. The capital costs have
11 been averaged for their appropriate pro forma period with the associated
12 depreciation expense and property tax, as well as the appropriate
13 accumulated depreciation and deferred income tax rate base offsets. In
14 addition, this adjustment brings forward the accumulated depreciation and
15 DFIT for all plant in service at December 31, 2008. In addition, this
16 adjustment also includes the debt interest impact of the adjustment to rate
17 base. This adjustment decreases Oregon net operating income by \$182,135
18 and increases rate base by \$14,090,929.

19 Column (L), **Labor and O&M Costs Adjustment**, brings 2008 test
20 period wages and other operations and maintenance costs forward to refund
21 period levels. Wages were adjusted to actual March 1, 2009 labor rates and
22 resulted in increased expense of \$214,852. Other O&M costs were increased
23 to reflect projected costs through the refund period and resulted in increased

1 expense of \$448,000. This adjustment decreases Oregon net operating
2 income by \$402,418.

3 Column (M), **GRC Projected Revenue Adjustment**, pro forms \$3.5
4 million of general rate case rate relief for the final three months of the refund
5 period (i.e. March 1, 2010 through May 31, 2010). This adjustment assumes
6 that the Commission will award 100% of the \$14.2 million rate relief
7 requested in our soon-to-be filed general rate case and assumes that new
8 rates will become effective March 1, 2010. This adjustment increases
9 Oregon net operating income by \$2,073,912.

10 The adjustment in column (N), **SIT-FIT**, adjusts Oregon state income
11 tax expense and federal income tax expense applicable to Oregon gas utility
12 operations. Avista Corporation files a consolidated federal income tax return
13 for an affiliated group that includes electric utility operations in Washington
14 and Idaho, gas utility operations in Oregon, Washington, and Idaho, and non-
15 utility subsidiary operations.

16 Federal income tax expense is determined for Oregon gas utility
17 operations on a stand-alone basis, or, in other words, based on the income
18 generated by Oregon gas operations. The (\$202,293) adjustment to current
19 federal income tax expense relates to the federal income tax impact of the
20 adjustment to Oregon state income tax. The \$250,723 adjustment to deferred
21 federal income tax relates to correcting a deferred tax expense item that was
22 correctly assigned to Oregon gas operations, but was inadvertently
23 overstated.

1 The level of Oregon state income tax was also calculated on a stand-
2 alone basis, since this is the method used to determine taxes paid in Senate
3 Bill 408 filings. Oregon stand-alone taxable income before state income tax
4 was multiplied by the state statutory rate of 6.6% to determine the amount of
5 Oregon state income tax. The adjustment to Oregon state income amounts
6 to an increase of \$577,980.

7 The net impact to Oregon net operating income for federal and state
8 income taxes is a reduction of \$626,410.

9 Column (O), entitled **Adjusted Total**, is a subtotal of columns (E)
10 through (N), and represents the forecasted results of operations for the refund
11 period, prior to any SB 408 refund.

12 Column (P), **SB 408 Refund (2007) Adjustment**, reflects the 2007 SB
13 408 refund to customers, including interest. This adjustment reduces Oregon
14 net operating income by \$1,546,920.

15 The final column, column (Q), entitled **Restated Total**, is the total of
16 columns (O) and (P) and reflects the forecasted operating results during the
17 refund period, including the refund to customers for the 2007 SB 408.

18 **Q. DOES THIS CONCLUDE YOUR PRE-FILED TESTIMONY?**

19 A. Yes.

**PUBLIC UTILITY COMMISSION
OF
OREGON**

**UG 171 (1)
Phase II**

AVISTA EXHIBIT 501

**Exhibit of Jeanne Pluth
On Behalf of
Avista Corporation
In the Matter of Avista's
SB 408 2007 Tax Report**

June 15, 2009

Avista Corporation
Oregon Gas
Impact of SB 408 on Return on Equity
2007

AVERAGE 2007 CAPITAL STRUCTURE

Line No.	Per Earnings Test Results	Remove SB 408 Accruals in 2007	Adjusted	Include 2007 Tax Report Amount Incl Interest	Adjusted
1	Net operating income	\$3,438,175	\$3,438,175		\$3,438,175
2	Remove SB 408 accrual in 2007		\$2,338,488		2,338,488
3	Remove associated DFIT		-818,471		-818,471
4	Include 2007 tax report amount		0	-\$2,379,877	-2,379,877
5	Include associated DFIT		0	832,957	832,957
6	Adjusted net operating income	\$3,438,175	\$1,520,017	-\$1,546,920	\$3,411,272
7	Debt return requirement	3,576,415	3,576,415		3,576,415
8	Preferred stock requirement	21,299	21,299		21,299
9	Net income available for common	-\$159,539	\$1,360,478		-\$186,442
10	Equity return percentage	-0.18%	1.53%		-0.21%
11	Equity component of capital structure	48.25%	48.25%		48.25%
12	Implied return on equity	-0.37%	3.17%		-0.44%
13	Rate base	\$88,744,795	\$88,744,795		\$88,744,795
14	Weighted cost of debt & pref. trust	4.030%	4.030%		4.030%
15	Debt return requirement	\$3,576,415	\$3,576,415		\$3,576,415
16	Weighted cost of preferred stock	0.024%	0.024%		0.024%
17	Preferred stock requirement	\$21,299	\$21,299		\$21,299

	Capital Structure	Cost	Weighted Cost
18	Long-Term Debt	47.46%	7.74%
19	Preferred Securities	4.97%	7.19%
20	Preferred Stock	0.64%	3.70%
21	Common Equity	46.93%	10.25%
22	Total	100.00%	8.864%

**PUBLIC UTILITY COMMISSION
OF
OREGON**

**UG 171 (1)
Phase II**

AVISTA EXHIBIT 502

**Exhibit of Jeanne Pluth
On Behalf of
Avista Corporation
In the Matter of Avista's
SB 408 2007 Tax Report**

June 15, 2009

**Avista Utilities
Oregon Jurisdiction**

UG 171(1) Phase II
Avista / 502
Pluth

Calculation of Return on Equity Results during Refund Period under "Temporary Administrative Rule" per Order No. 09-135

[June 1, 2009 - May 31, 2010]

		RESTATEING ADJUSTMENTS FOR THE REFUND PERIOD (JUNE 1, 2009 THROUGH MAY 31, 2010)														
		Twelve Months Ended December 31, 2008														
A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q
Per Reports	Earnings	Earnings	Weather	Total Including	Restate	2008 EOP	Refund Period	Remove	10% Gas	2009	Labor &	GRC	SIT-	Adjusted	SB 408	Restated
Results	Test	Test Results	Normalization	Type I	Debt	Rate Base	Revenue	SB 408	Costs Deferral	Capital	O&M Costs	Projected	FIT	Total	Refund	Total
Adjustments	UM-903	UM-903	Sales/Purch	Results	Interest	Adj	Adj	2008 Accrual	Adj	Adj	Adj.	Revenue	Adjustment	Total	(2007)	Total
1	138,127,860	-	128,122,860	(8,870,300)	119,252,560	-	1,977,183	-	-	-	-	3,521,600	-	124,701,343	-	124,701,343
2	2,391,049	-	2,391,049	-	2,391,049	-	18,156	-	-	-	-	-	-	2,409,205	-	2,409,205
3	67,984,820	-	67,984,820	-	67,984,820	-	(67,836,051)	-	-	-	-	-	-	148,769	-	148,769
4	198,498,729	-	198,498,729	(8,870,300)	189,628,429	-	(65,890,712)	-	-	-	-	3,521,600	-	127,259,317	-	127,259,317
OPERATING REVENUES																
5	161,530,160	-	161,530,160	(6,903,362)	154,626,798	-	(66,069,465)	-	(813,659)	-	8,161	-	-	87,751,835	-	87,751,835
6	11,052,994	239,662	11,292,656	(50,339)	11,242,317	-	(2,251,282)	-	-	-	607,165	19,985	-	9,618,185	-	9,618,185
7	7,005,583	(223,165)	6,782,418	(28,270)	6,754,148	-	6,200	-	-	-	47,526	11,223	-	6,819,097	-	6,819,097
8	4,582,832	519,792	5,102,624	(187,137)	4,915,487	-	41,041	-	-	314,457	-	74,295	-	5,345,280	-	5,345,280
9	4,516,874	2,156,743	6,673,617	(6,667,617)	6,666,000	-	479,968	(1,450,000)	-	481,209	-	105,504	-	6,178,794	2,379,877	8,558,671
10	188,682,443	2,693,032	191,375,475	(7,169,108)	184,206,367	-	(67,793,538)	(1,450,000)	(813,659)	795,666	662,852	105,504	-	115,713,191	2,379,877	118,093,068
OPERATING EXPENSES																
11	9,816,286	(2,693,032)	7,123,254	(1,701,192)	5,422,062	-	1,902,826	1,450,000	813,659	(795,666)	(662,852)	3,416,096	-	11,546,126	(2,379,877)	9,166,249
INCOME TAXES																
12	414,173	(175,424)	238,749	(556,120)	(317,371)	43,199	622,034	-	284,781	(516,192)	(216,686)	1,116,722	(202,293)	641,748	-	641,748
13	1,346,054	(754,860)	591,194	-	591,194	-	-	507,500	-	-	-	-	250,723	1,349,417	(832,957)	516,460
14	-	(35,417)	(35,417)	(112,279)	(147,696)	8,721	125,587	-	53,701	(97,339)	(43,748)	225,462	577,980	670,150	-	670,150
15	1,760,227	(965,701)	794,526	(668,399)	126,127	51,920	747,621	507,500	338,482	(613,531)	(260,434)	1,342,184	626,410	2,461,315	(832,957)	1,828,358
16	8,056,059	(1,727,331)	6,328,728	(1,032,793)	5,295,935	(51,920)	1,155,205	942,500	475,177	(182,135)	(402,418)	2,073,912	(626,410)	8,884,811	(1,546,920)	7,337,891
AVERAGE RATE BASE																
17	213,787,056	9,777	213,796,833	-	213,796,833	16,380,152	-	-	-	20,963,759	-	-	-	251,140,744	-	251,140,744
18	87,678,732	-	87,678,732	-	87,678,732	774,812	-	-	-	4,793,418	-	-	-	93,246,962	-	93,246,962
19	126,108,324	9,777	126,118,101	-	126,118,101	15,605,340	-	-	-	16,170,341	-	-	-	157,893,782	-	157,893,782
20	(19,232,070)	-	(19,232,070)	-	(19,232,070)	(2,755,553)	-	-	-	(2,079,412)	-	-	-	(24,067,035)	-	(24,067,035)
21	3,235,848	-	3,235,848	-	3,235,848	1,901,786	-	-	-	-	-	-	-	5,137,634	-	5,137,634
22	110,112,102	9,777	110,121,879	-	110,121,879	14,751,573	-	-	-	14,090,929	-	-	-	138,964,381	-	138,964,381
23	7.32%	-	5.75%	-	4.81%	-	-	-	-	-	-	-	-	6.39%	-	5.28%
24	7.72%	-	4.58%	-	2.70%	-	-	-	-	-	-	-	-	5.94%	-	3.78%

See Oregon SB 408 Adjustment Descriptions