Avista Corp.
1411 East Mission PO Box 3727
Spokane, Washington 99220-3727
Telephone 509-489-0500
Toll Free 800-727-9170

AVISTA Corp.

January 18, 2008

Oregon Public Utility Commission
Attn: Filing Center
550 Capitol St. NE, Suite # 215
Salem, OR 97308-2148

RE: Avista Utilities (Dkt. No. UG 171/Advice No. 07-10-G)/Claimed Violation of ORS 756.040

Dear Filing Center,

On October, 15, 2007, Avista Utilities (Avista) filed Advice No. 07-10-G concurrently with the filing of its tax report for 2006 in Docket UG 171, pursuant to ORS 757.267 and 757.268 and OAR 860-022-0041. Avista's tax report for 2006 reflects a difference between taxes authorized to be collected in rates and taxes paid of $1.1 million. Under SB 408, this difference plus interest, would be refunded through an automatic adjustment clause (AAC).

This letter is meant to advise the Commission and all parties in UG 171 that Avista, for the reasons discussed below, claims that a rate adjustment in connection with its tax report for 2006 will violate ORS 756.040. Consideration of such a claim is expressly allowed by OAR 860-022-0041(10). Accordingly, Avista will put at issue in the contested proceedings in UG 171 whether it should have to refund <u>any</u> amounts, in connection with its tax report for 2006, notwithstanding its filing of a tariff reflecting a $1.1 million refund. This is consistent with Staff's recognition in its January 9, 2008 Memorandum that "the numbers in this AAC [automatic adjustment clause] are subject to revision when the Commission issues its final order in this docket on April 11 of this year." Therefore, the implementation of tariffs on January 22, 2008 establishing AACs and using numbers derived from tariffs filed by the utilities in December 2007, should not be construed as a waiver of Avista's position in litigation that no refunds are appropriate.

OAR 860-022-0041(10) (Annual Tax Reports and Automatic Adjustment Clauses Relation to Utility Taxes) provides for relief where there has been a demonstration that the AAC may violate the "fair and reasonable" rate provisions of ORS 756.040:

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

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

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

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

> ORS 756.040 General powers. (1)... In respect thereof the commission shall make use of the jurisdiction and powers of the office to protect such customers, and the public generally, from unjust and unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates. The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates. Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both for operating expenses of the public utility or telecommunications utility and for capital costs of the utility, with a return to the equity holder that is:
>
> (a) Commensurate with the return on investments in other enterprises having corresponding risks; and
>
> (b) Sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.
>
> (2) – (3) [omitted]

The imposition of a $1.37 million dollar refund (including interest) would clearly violate ORS 756.040, based on an earnings review for Avista using its results of operations report for the 2006 tax year. Avista filed its calendar year 2006 earnings review report with the OPUC on April 30, 2007. Excerpts from that report, together with OPUC Staff's review memo, are attached. The earnings report shows Avista earned a rate of return (ROR) of 6.26% for its Oregon operations, for the calendar year 2006. The 2006 results include an accrual (expense) of $1.3 million related to an estimated SB 408 refund. The report also shows a return on equity (ROE) of only 4.75%. The 4.75% is well below any measure of what would be considered to be a return on equity that is "commensurate with the return on investments in other enterprises having corresponding risks." The range of ROE recommendations, by all parties, in general rate cases is well above this result. Moreover, any recommendation for Avista to <u>further</u> increase the SB 408 refund would cause the ROE to be even lower, e.g., increasing the refund for 2006 by $500,000 would increase the total from $1.37 million to $1.98 million (including interest) and would result in an ROE of 3.59%. The table below provides a summary comparison of these ROEs:

Based on 2006 Earnings Report Filed with the OPUC

Authorized ROE	10.25%
Actual 2006 ROE (Including $1.3 million SB 408 refund)	4.75%
ROE with Addl. 2006 SB 408 Refund of $500,000	3.59%

An additional perspective on the SB 408 refund, would be to view the earnings impact to the Company solely related to the SB 408 refund. Avista's earnings opportunity, based on a 10.25% return on equity, is $3.9 million per year after tax.[1] A refund recommendation equal to $1.98 million, as discussed above, would result in an after-tax impact of $1.29 million, which is fully one-third of Avista's earnings of $3.9 million. The resulting ROE would be 6.87%, which, again, is well below any measure of a reasonable return to shareholders.

Avista will provide further support for these assertions in its testimony in UG 171, to be filed on February 13, 2008, and would not object to the filing of brief surrebuttal testimony by Staff and intervenors addressing this particular issue.

Sincerely,

David Meyer
Vice President, Chief Counsel for Regulatory & Governmental Affairs

Enclosures

c: See attached service list

[1] Rate base of $79 million x 48.25% equity x 10.25% ROE equals $3.9 million (see Page 2 of Attachment).

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have served Avista Utilities (Dkt. No. UG 171/Advice No. 07-10-G)/Claimed Violation of ORS 756.040, by mailing a copy thereof or by electronic mail where paper service has been waived, to the following:

W	**CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP**	
	EDWARD A FINKLEA **(C)**	1001 SW 5TH - STE 2000 PORTLAND OR 97204 efinklea@cablehuston.com
	CHAD M STOKES **(C)**	1001 SW 5TH - STE 2000 PORTLAND OR 97204 cstokes@cablehuston.com
	CITIZENS' UTILITY BOARD OF OREGON	
	LOWREY BROWN **(C) (HC)** UTILITY ANALYST	610 SW BROADWAY - STE 308 PORTLAND OR 97205 lowrey@oregoncub.org
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	DANIEL W MEEK ATTORNEY AT LAW	
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	DEPARTMENT OF JUSTICE	
	JASON W JONES **(C) (HC)** ASSISTANT ATTORNEY GENERAL	REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 jason.w.jones@state.or.us
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W	**NORTHWEST INDUSTRIAL GAS USERS**	
	PAULA E PYRON EXECUTIVE DIRECTOR	4113 WOLF BERRY CT LAKE OSWEGO OR 97035-1827 ppyron@nwigu.org

Dated at Spokane, Washington this 18th day of January 2008.

Patty Olsness

Patty Olsness
Rates Coordinator

Avista Corp.
1411 East Mission PO Box 3727
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Toll Free 800-727-9170

AVISTA
Corp.

April 30, 2007

Ms. Judy Johnson
Program Manager
Rates & Tariffs
Oregon Public Utility Commission
550 Capitol St. NE
Salem, OR 97310-1380

RE: Avista Corp., Oregon Division Results of Operations

Dear Ms. Johnson:

The enclosed filing is a combined earnings report meant to satisfy the reporting requirements associated with the UM-903 investigation (associated Order 99-272), AR-357 Rulemaking (associated Order 99-284) as well as the standard Oregon annual reporting requirements. For UM-903 purposes, Avista makes no adjustment to normalize for weather, per the stipulation approved by Order No. 98-543.

Please see the attached report for the twelve months ended December 31, 2006, along with accompanying workpapers, for the Oregon division of Avista Corp. Following are the results:

	Per UM-903	Annual Report After All Type I	Annual Report After Type II
Rate of Return	6.26%	6.77%	6.88%
Implied Return on Equity	4.75%	5.80%	6.03%

If you have any questions concerning this information, please call me at (509) 495-8601.

Sincerely,

Liz M. Andrews

Liz M. Andrews
Manager, Revenue Requirements

Enclosures

c: Deborah Martin
Scott Morris
Kelly Norwood

AVISTA UTILITIES

Oregon

Twelve Months Ending December 31, 2006

		Per Results Reports	Earnings Test Adjustments (fr/ Table II)	Earnings Test Results UM-903	Weather Normalization Sales/Purch	Total Type I Results	Total Type II Adjustments (fr/ Table III)	Earnings Test Incl. Type II Adj.
		A	B	C	D	E	F	G
	OPERATING REVENUES							
1	Total General Business	$122,020,382	0	$122,020,382	$3,377,617	$125,397,999	0	$125,397,999
2	Transportation	2,557,931	0	2,557,931	0	2,557,931	0	2,557,931
3	Other	44,299,516	0	44,299,516	0	44,299,516	(4,320,495)	39,979,021
4	Total Operating Revenues	168,877,829	0	168,877,829	3,377,617	172,255,446	(4,320,495)	167,934,951
	OPERATING EXPENSES							
5	Gas Purchased	134,179,033	0	134,179,033	2,618,997	136,798,030	(4,478,796)	132,319,234
6	Operations & Maintenance	8,681,970	226,585	8,908,555	17,668	8,926,223	12,667	8,938,890
7	Administrative & General	5,847,285	(262,650)	5,584,635	10,062	5,594,697	0	5,594,697
8	Taxes Other Than Income	6,751,127	(1,636)	6,749,491	67,032	6,816,523	0	6,816,523
9	Depreciation & Amortization	6,837,883	0	6,837,883	0	6,837,883	0	6,837,883
10	Total Operating Expenses	162,297,298	(37,701)	162,259,597	2,713,759	164,973,356	(4,466,129)	160,507,227
11	OPERATING INCOME BEFORE INCOME TAX	6,580,531	37,701	6,618,232	663,858	7,282,090	145,634	7,427,724
	INCOME TAXES							
12	Current Federal Income Taxes	2,721,182	12,451	2,733,633	217,015	2,950,648	47,608	2,998,256
13	Deferred Federal Income Taxes	(1,366,215)	0	(1,366,215)	0	(1,366,215)	0	(1,366,215)
14	State Income Taxes	302,688	2,515	305,203	43,815	349,018	9,612	358,630
15	Total Income Taxes	1,657,655	14,966	1,672,621	260,830	1,933,451	57,220	1,990,671
16	NET OPERATING INCOME	$4,922,876	$22,735	$4,945,611	$403,028	$5,348,639	$88,414	$5,437,053
	AVERAGE RATE BASE							
17	Utility Plant in Service	$174,441,339	(10,137)	$174,431,202	$0	$174,431,202	0	$174,431,202
18	Less: Accumulated Depreciation & Amortization	77,662,756	0	77,662,756	0	77,662,756	0	77,662,756
19	Net Utility Plant	96,778,583	(10,137)	96,768,446	0	96,768,446	0	96,768,446
20	Accumulated Deferred Income Taxes	(18,736,028)	0	(18,736,028)	0	(18,736,028)	0	(18,736,028)
21	Inventory and Other	970,421	0	970,421	0	970,421	0	970,421
22	TOTAL AVERAGE RATE BASE	$79,012,976	($10,137)	$79,002,839	$0	$79,002,839	$0	$79,002,839
23	RATE OF RETURN	6.23%		6.26%		6.77%		6.88%
24	IMPLIED RETURN ON EQUITY	4.68%		4.75%		5.80%		6.03%

UM-903 Earnings Test Calculation

25	EARNINGS THRESHOLD - Return on Equity	12.49% (1)
26	EQUITY EARNINGS AT THRESHOLD RATE	$4,761,047
27	EQUITY EARNINGS ACTUAL	$1,810,646
28	100% OF NOI EXCEEDING THRESHOLD	($2,950,401)
29	100% OF REVENUE EXCEEDING THRESHOLD	($5,000,106)
30		
32	33% REVENUE ADJ DUE TO SPRING REVIEW ( ) = Under Threshold	($1,650,035)
33		
34	Conversion factor	0.590068

AVISTA COST OF CAPITAL

	Capital Structure (2)	Cost (3)	Weighted Cost
Long-Term Debt	44.29%	7.74%	3.43%
Preferred Securities	5.67%	7.20%	0.41%
Preferred Stock	1.79%	7.39%	0.13%
Common Equity	48.25%	10.25%	4.95%
Total	100.00%		8.92%

Type I: Adjustments for uncollectible estimate, debt synchronization, salaries, incentives, dues, franchise

Type II: Adjustment for Union wages, Gas Cost Incentive

(1) Earnings Threshhold: calculated as the sum of 10.25% authorized ROE, plus 200 basis points (per Order 05-1053), plus 20% of any change in the risk free rate for the 12-month calendar year (per Order 04-203).

(2) Current Authorized Capital Structure per Order No. 03-570.

(3) Cost as of Twelve Months Ending December 31, 2006.

TABLE II

AVISTA UTILITIES

Oregon
Type I Adjustments
Twelve Months Ending December 31, 2006

		Uncollectible Expense Adj.	Salaries & Wages Adj.	Incentive Pay Adj.	Memberships & Dues Adj.	Remove Franchise True-ups	Restate Debt Interest	Total Type I Adjustments
		(1a)	(1b)	(1c)	(1d)	(1e)	(1f)	
	OPERATING REVENUES							
1	Total General Business							$0
2	Transportation							0
3	Other							0
4	Total Operating Revenues	0	0	0	0	0	0	0
	OPERATING EXPENSES							
5	Gas Purchased							0
6	Operations & Maintenance	237,577	(10,992)					226,585
7	Administrative & General		(8,716)	(223,102)	(30,832)			(262,650)
8	Taxes Other Than Income					(1,636)		(1,636)
9	Depreciation & Amortization							0
10	Total Operating Expenses	237,577	(19,708)	(223,102)	(30,832)	(1,636)	0	(37,701)
11	OPERATING INCOME BEFORE INCOME TAX	(237,577)	19,708	223,102	30,832	1,636	0	37,701
	INCOME TAXES							
12	Current Federal Income Taxes	(77,664)	6,442	72,932	10,079	535	127	12,451
13	Deferred Federal Income Taxes	0	0	0	0	0	0	0
14	State Income Taxes	(15,680)	1,301	14,725	2,035	108	26	2,515
15	Total Income Taxes	(93,344)	7,743	87,657	12,114	643	153	14,966
16	NET OPERATING INCOME	($144,233)	$11,965	$135,445	$18,718	$993	($153)	$22,735
	AVERAGE RATE BASE							
17	Utility Plant in Service		$ (10,137)					(10,137)
18	Less: Accumulated Depreciation & Amortizatior							0
19	Net Utility Plant	0	(10,137)	0	0	0	0	(10,137)
20	Accumulated Deferred Income Taxes							0
21	Inventory and Other							0
22	TOTAL AVERAGE RATE BASE	0	(10,137)	0	0	0	0	(10,137)

TABLE III

AVISTA UTILITIES

Oregon

Type II Adjustments

Twelve Months Ending December 31, 2006

		Union Wage Adjustment	Gas Cost Adjustment		Total Type II Adjustments
		(2a)	(2b)	(2c)	
	OPERATING REVENUES				
1	Total General Business				$0
2	Transportation				0
3	Other		$ (4,320,495)		(4,320,495)
4	Total Operating Revenues	0	(4,320,495)	0	(4,320,495)
	OPERATING EXPENSES				
5	Gas Purchased		(4,478,796)		(4,478,796)
6	Operations & Maintenance	12,667			12,667
7	Administrative & General				0
8	Taxes Other Than Income				0
9	Depreciation & Amortization				0
10	Total Operating Expenses	12,667	(4,478,796)	0	(4,466,129)
11	OPERATING INCOME BEFORE INCOME TAX	(12,667)	158,301	0	145,634
	INCOME TAXES				
12	Current Federal Income Taxes	(4,141)	51,749	0	47,608
13	Deferred Federal Income Taxes	0	0	0	0
14	State Income Taxes	(836)	10,448	0	9,612
15	Total Income Taxes	(4,977)	62,197	0	57,220
16	NET OPERATING INCOME	($7,690)	$96,104	$0	$88,414
	AVERAGE RATE BASE				
17	Utility Plant in Service				$0
18	Less: Accumulated Depreciation & Amortization				0
19	Net Utility Plant	0	0	0	0
20	Accumulated Deferred Income Taxes				0
21	Inventory and Other				0
22	TOTAL AVERAGE RATE BASE	0	0	0	$0

ITEM NO. CA4

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 10, 2007

REGULAR ____ **CONSENT** _X_ **EFFECTIVE DATE** _____N/A_____

DATE: June 25, 2007

TO: Public Utility Commission

FROM: Carla Owings

THROUGH: Lee Sparling, Ed Busch and Judy Johnson

SUBJECT: AVISTA CORPORATION: (Docket No. UM 903/AR 357) 2007 Spring Earnings Review.

STAFF RECOMMENDATION:

Staff recommends there be no earnings shared by Avista Corporation due to Avista's earnings through December 31, 2006, falling below the earnings threshold established in UM 903.

DISCUSSION:

Commission Order Nos. 99-272 and 99-284 (Dockets UM 903 and AR 357) established the role and structure of earnings reviews for Purchased Gas Adjustment (PGA) for Oregon's three regulated natural gas distribution companies: Avista Corporation (Avista or Company), Cascade Natural Gas Corporation and Northwest Natural Gas Corporation. Beginning in 1999, these reviews were originally scheduled to sunset in 2002, but were extended twice, first in Commission Order No. 03-198 (Docket AR 449) and then again in Commission Order No. 07-019 (Docket AR 512) which extended the spring earnings review process through 2009.

The Commission adopted OAR 860-022-0070 along with a list of issues agreed upon by the parties in a Statement of Stipulated Issues. The Commission adopted various resolutions to apply to earnings reviews. These resolutions are summarized below:

- Relationship of Earnings Review to Purchased Gas Adjustment (PGA) Filings: Each spring a general earnings review will be held; a portion of revenues above a specified return on equity (ROE) level would be booked to a deferred account.

- Structure of Earnings Reviews: By May 1 each year, Local Distribution Companies (LDCs) will file results of operations for the 12 months ended the prior December 31. Staff will complete a review and distribute summary conclusions by June 10 to all parties. At the first regular public meeting in July, Staff will present the results of the earnings review for each LDC. If there are unresolved issues, a settlement conference will be held. If there are still outstanding issues, parties will file position statements by August 1 and the Commission would issue its decision on unresolved issues by August 15. Unless otherwise directed by the Commission, LDCs file annual gas cost tracking filings by August 31 for November 1 rate changes. These rate changes include amortization of credit amounts in the deferred account, if any, resulting from the spring earnings review.
- Effective Date of Rate Adjustment: Amount of revenues to be returned to customers will be booked to a deferred account, with interest beginning the previous January 1. The rate adjustment and amortization will be effective with the date of the subsequent base gas cost change.
- The ROE Earnings Threshold: For the spring 2007 review, Avista's earnings threshold was calculated as the sum of 10.25 percent (the ROE authorized for Avista by Commission Order No. 03-570) plus 200 basis points maximum authorized by Commission Order No. 05-1053 and an adjustment for inflation as specified in Order No. 04-203; resulting in a threshold of 12.49 percent.
- Earnings Sharing: If adjusted earnings are below the earnings threshold, there will be no rate adjustment. If adjusted earnings are above the earnings threshold, the amount of revenue in the test year representing 10 percent of the earnings exceeding the threshold level will be shared with customers.
- Earnings Adjustments: Results of operations reports will be adjusted for Type 1 adjustments set forth in Order No. 99-272 with the exception, however, of Avista. Avista made a one-time election not to include a weather normalization adjustment in its spring earnings review filings. On August 2, 2005, Avista filed Schedule 462, Purchased Gas Cost Adjustment Provision - Oregon, in Advice No. 05-02-G which was adopted by the Commission on August 16, 2005. As set forth in the tariff, beginning October 1, 2005, the company will defer 90 percent of the difference between its monthly actual and estimated commodity cost of gas. Since this sharing level is less than the 67/33 percentage sharing prescribed under OAR 860-022-0070(8), the company is subject to a fall earnings review, as well as the mandated spring earnings review. The purpose of the fall earnings review is to determine whether or not Avista should absorb any of its deferrals.

Avista's Earnings Review:

On May 1, 2007, Avista submitted its 2006 Results of Operations report for the 12 months ended December 31, 2006. The Company states that its report was developed in a manner consistent with Commission Order No. 99-272 and reflects adjustments appropriate to the Stipulated Agreement attached to Order 99-272. The Company further states that it makes no adjustment to normalize for weather per the stipulation approved in Commission Order No. 98-543.

The Company calculates its ROE as 4.75 percent prior to the application of its Type I and Type II adjustments pursuant to Avista's original one-time election not to include a weather normalization adjustment. The Company's ROE calculation falls below the threshold of 12.49 percent authorized by the Commission.

Staff has reviewed the Company's earnings report and concludes that the reported ROE is calculated accurately as represented by Avista. Because Avista's adjusted ROE is below the authorized threshold, there should be no sharing of earnings with customers.

As required by OAR 860-022-0070(6), Staff has submitted these findings to the parties in Docket No. UM 903. Staff received no comments.

PROPOSED COMMISSION MOTION:

There should be no earnings shared in this filing due to Avista Utilities' 2006 earnings falling below the earnings threshold established in UM 903.