

## DECISION MEMORANDUM

**TO: COMMISSIONER KJELLANDER  
COMMISSIONER SMITH  
COMMISSIONER HANSEN  
COMMISSION SECRETARY  
COMMISSION STAFF  
LEGAL**

**FROM: SCOTT WOODBURY**

**DATE: APRIL 16, 2004**

**RE: CASE NO. AVU-E-04-2 (Avista)  
SALE OF SKOOKUMCHUCK HYDROELECTRIC PLANT  
EWG DETERMINATION**

On February 23, 2004, Avista Corporation (Avista; Company) filed an Application with the Idaho Public Utilities Commission (Commission) regarding the proposed sale by Avista of its ownership interest in the Skookumchuck dam, hydroelectric plant and related facilities (Skookumchuck). Skookumchuck is a 1-megawatt (MW) generation facility located in the vicinity of Centralia, Washington on property adjacent to the Centralia Power Plant, a large coal-fired generating facility. Skookumchuck is co-owned by Avista Corporation, PacifiCorp, Public Utility District No. 1 of Snohomish County, Puget Sound Energy, Inc., City of Tacoma, City of Seattle, and Public Utility District No. of Grays Harbor County (collectively the "Owners").

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

### **Purchase and Sale Agreement**

Avista has entered into a Purchase and Sale Agreement to sell its interest in the Skookumchuck hydroelectric plant to 2677588 Washington, LLC, a Limited Liability Company formed by TransAlta USA, Inc. (TransAlta). Washington LLC intends to operate

Skookumchuck as an Exempt Wholesale Generator (EWG) within the meaning of Section 32 of the Public Utility Holding Company Act of 1935 (PUHCA).

Washington LLC is a Washington Limited Liability Company and a direct wholly-owned subsidiary of TransAlta. TransAlta is the indirect owner of the Centralia Power Plant and the Centralia Coal Mine. In 2000, the Owners sold the Centralia Power Plant to a direct wholly-owned subsidiary of TransAlta, TECWA Power, Inc., and PacifiCorp sold the Centralia coal mine to another direct wholly-owned subsidiary of TransAlta, TECWA Fuel, Inc. TransAlta Centralia Generation LLC, a direct wholly-owned subsidiary of TECWA Power, Inc., owns and operates the Centralia Power Plant as an EWG.

Skookumchuck is a small earth-filled dam and hydroelectric generating plant located in the vicinity of Centralia, Washington on property adjacent to the Centralia Power Plant. The Skookumchuck Dam was constructed in 1973 as a water storage facility for the Centralia Power Plant. In 1991, a generating plant with a capacity of approximately 1 MW was installed at the dam. The project was granted an exemption from licensing as a hydropower facility by the Federal Energy Regulatory Commission (FERC) pursuant to 16 U.S.C. § 2705(d), which allows exemptions for facilities less than 5 MW. The project is, however, subject to dam safety regulations by the FERC.

Avista proposes to sell and transfer to Washington LLC the dam, powerhouse, water rights, land, easements and other assets of Skookumchuck, including certain fixtures, contracts and other rights. The sale and transfer of Skookumchuck is governed by the Skookumchuck Facilities Purchase and Sale Agreement between the Owners and Washington LLC, dated November 25, 2003, ("Sale Agreement"), which is included in Appendix 1 to the Application.

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

Avista is informed that the new owner/operator will continue operation of the Project to provide cooling water supply to the Centralia Power Plant and to produce power from Skookumchuck either as an EWG or as a Qualifying Facility under the Public Utility Regulatory Policies Act of 1978. None of the electrical output of Skookumchuck will be used to serve Avista's retail customers, except perhaps indirectly through the wholesale power markets.

## **EWG Determinations**

To qualify as an EWG, the owner/operator must be engaged exclusively in the business of owning or operating an “eligible facility” and selling electric energy at wholesale. If the costs of a generation facility were included in the rates of a regulated utility on October 24, 1992 (the date of enactment of Section 32 of PUHCA), then in order for the facility to be considered an “eligible facility,” every state Commission having jurisdiction over such rates must specifically determine that allowing the facility to become an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate state law. 15 U.S.C. § 79z-5a(c). Thus, the Commission and each of Avista’s other state regulatory commissions, must make these determinations regarding Avista’s sale and transfer of Skookumchuck.

## **Benefits of Transaction**

Avista proposes to transfer its interest in Skookumchuck to Washington LLC because the sale is a lower cost option than continuing to invest in and operate and maintain Skookumchuck.

Skookumchuck has an electrical capacity of 1 MW, but because it is operated for purposes of supplying cooling water to the Centralia Power Plant, Avista states that it has relatively low energy output. The Company contends that the sale will not harm the public interest because competitive markets will be unaffected by the sale. Over the last eight years, the average annual production of Skookumchuck has been 3,013 MWh. Skookumchuck’s bus-bar cost in fiscal year 2003 (12 months ending March 31, 2003) was approximately \$255 per MWh. The facility is interconnected with the distribution system of Puget Sound Energy, Inc. (PSE) and historically all of the power from Skookumchuck has been sold to PSE.

As one of the owners of Skookumchuck, Avista must pay its proportionate share of the costs. Net plant related to Avista’s share of its investment in Skookumchuck is included in the Company’s rate base. The Company contends that customers will not be harmed if the project is sold because the cost of power generated from Skookumchuck substantially exceeds the projected cost of market power. Hence, the Company’s revenue requirement will be lower as a result of the sale of Skookumchuck.

The proposed transaction eliminates the risk that Avista will be required to fund its share of future expenditures for ensuring the structural integrity of the Skookumchuck Dam. Avista contends that the benefits from the proposed sale outweigh the risks of rising costs of

continuing to own and operate Skookumchuck. Continued operation of Skookumchuck as a hydroelectric project, the Company contends, would be uneconomic, and such operation would not be in the public interest.

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

Because Skookumchuck assets are located in the State of Washington, Avista contends that Idaho's property transfer statute, *Idaho Code* § 61-328, is not applicable to the contemplated sale. Should the Commission, however, decide to exercise its authority over the proposed sale, Avista requests that the Commission approve the sale.

#### **Proposed Ratemaking Treatment**

Avista projects that the sale of Skookumchuck will result in a small after-tax gain. The Idaho jurisdictional share (33.01%) of the after-tax gain is projected to be approximately \$216,000. Avista proposes to allocate the after-tax Skookumchuck gain between jurisdictions and between ratepayers and shareholders in the same manner that Avista's after-tax gain on the sale of the Centralia Power Plant was allocated in Case No. AVU-E-99-6. Applying the depreciation reserve method (the ratio of accumulated depreciation to gross plant) of 69.70% for allocating proceeds to ratepayers set forth in the Order approving the sale of the Centralia Power Plant to the estimated Idaho share of the Skookumchuck after-tax gain of approximately \$216,000 yields an allocation to ratepayers of approximately \$151,000 and an allocation to shareholders of approximately \$65,000. The calculation and allocation of the estimated gain is attached as Exhibit No. 1 to the testimony of Ronald R. Peterson.

Avista is proposing that the estimated portion of the Skookumchuck after-tax gain allocated to ratepayers of approximately \$151,000 be deferred and added to the deferred gain on the Centralia Power Plant which is currently being passed on to ratepayers through a rate credit on Schedule 65 – Temporary Rate Adjustment.

### **Timing of Approval**

The new owner/operator of Skookumchuck, the Company contends, cannot process its EWG application with the FERC until all of the Company's regulatory commissions have made the three determinations required by Section 32 of PUHCA. Accordingly, Avista requests that the Commission process its Application expeditiously.

### **Appendices to Application**

Attached to the Company's Application are the following Appendices:

- (1) The Skookumchuck Facilities Purchase and Sale Agreement;
- (2) The Skookumchuck Dam Management Agreement; and
- (3) The prefiled direct testimony of Ronald R. Peterson, Avista Vice President of Energy Resources and Optimization describing the proposed sale and the reasons for the sale; the request for Commission EWG determinations; the proposed ratemaking treatment of the sale including the allocation of the gain between ratepayers and shareholders; and the Company's proposal that the ratepayers' share of the after-tax gain be added to the balance of the deferred gain on the Centralia Power Plant, which is currently being passed on to ratepayers.

On March 10, 2004, the Commission issued Notices of Application and Modified Procedure in Case No. AVU-E-04-2. The deadline for filing written comments was April 1, 2004. Comments were filed by Commission Staff and an interested party. The commenting party questions the wisdom of selling off power generating facilities to gain short-term profits at a time when more regional power is needed. The party suggests that the Commission require Avista to show how the utility intends to replace the power generating capacity of Skookumchuck before it is allowed to abandon the facility. If a utility can sell off small facilities today, what will they try to sell off next, he queries?

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

Based on Staff's review of the Idaho Code, Staff represents that it has discovered no Idaho laws that address the issues raised by Avista's request, and none prohibit or limit the authority of Washington, LLC as an EWG to operate Skookumchuck as a wholesale facility. Staff notes further that although the project is located in Washington, the transaction complies with the intent and meets the standards of *Idaho Code* § 61-328. In compliance therewith, Staff represents:

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

Staff agrees with the Company's contention that the benefits from the proposed sale outweigh the risks of rising costs of continuing to invest in and operate and maintain Skookumchuck. . . . The cost of power generated from Skookumchuck substantially exceeds the projected cost of market power. The proposed transaction eliminates the risk that the Company will be required to fund its share of expenditures for ensuring the continued structural integrity of the Skookumchuck dam. Skookumchuck has an electrical capacity of only 1 MW and is operated for principal purposes of supplying cooling water to the adjacent Centralia power plant. As a result, Skookumchuck has a relatively low energy output and a very low capacity factor. Finally, the project no longer represents a "core business" asset to Avista or any of the current Owners because the Owners no longer have an ownership interest in the Centralia Steam plant.

Staff agrees with Avista's contention that Avista's ratepayers will not be harmed by the sale and that continued operation of Skookumchuck by Avista would be uneconomic and not in the public interest.

Avista projects that the sale of Skookumchuck will result in a small after-tax gain. The Idaho jurisdictional share (33.01%) of the after-tax gain is projected to be approximately \$216,000. Avista proposes to allocate the after-tax Skookumchuck gain between jurisdictions and between ratepayers and shareholders in the same manner that Avista's after-tax gain on the sale of the Centralia power plant was allocated in Case No. AVU-E-99-6. Avista is proposing that the estimated portion of the Skookumchuck after-tax gain allocated to ratepayers be deferred

and added to the deferred gain on the Centralia power plant which is currently being passed on to ratepayers through a rate credit on Schedule 65 – Temporary Rate Adjustment. Staff concurs with the Company-proposed ratemaking treatment and recommends that Avista be directed to file the final accounting entries associated with the sale within 45 days of closing. Any revenue requirement reduction from not operating the project will be reflected in Avista's results of operation. As such, Staff represents that this change should be reflected in the current Avista rate proceeding.

### **COMMISSION DECISION**

Avista requests a Commission Order requesting the sale of its minority ownership interest in Skookumchuck and seeks a Commission Order making certain public interest findings required in order for Skookumchuck to qualify as an exempt facility and for the new owner/operator to qualify as an exempt wholesale generator (EWG) under Section 32 of PUHCA, and seeks approval of proposed accounting treatment of the gain on the sale. Staff recommends that the Company's Application be approved and recommends that the Company be directed to file the final accounting entries associated with the sale within 45 days of closing. Does the Commission agree?

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Scott Woodbury

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