Exhibit No. ___T (KLE-2T)
Dockets UE-120436, et al.
Witness: Kenneth L. Elgin

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-120436/UG-120437** ***(consolidated)***
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-110876/UG-110877** ***(consolidated)***

TESTIMONY OF

Kenneth L. Elgin

STAFF OF WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Fair Rate of Return

September 19, 2012

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Kenneth L. Elgin. I am a senior financial analyst for the Washington Utilities & Transportation Commission. My business address is, Richard Hemstad Building, S. 1300 Evergreen Park Drive SW, Olympia, Washington 98504.

Q. Please summarize your educational background and professional experience.

A. I earned a B.A. degree in 1974 from University of Puget Sound and an M.B.A.in 1980 from Washington State University. I have been employed by the Commission in several different capacities since 1985. My experience is more fully described in Exhibit No. ___ (KLE-2).

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to provide the Commission with a recommendation for the fair rate of return (cost of capital) for Avista Utilities ("Avista" or "the Company").

II. COST OF CAPITAL SUMMARY

A. Staff's Cost of Capital Recommendation

Q. What is the overall cost of capital for the regulated operations of Avista?

A. The overall cost of capital for Avista regulated operations is 7.22 percent. The following table shows the capital structure and cost rates:

Component	Percent	Cost	Weighted Cost
Total debt	54.00	5.70%	3.08%
Common	46.00	9.00%	4.14%
Cost of Capital			7.22%

B. Comparing Staff and Company Recommendations

Q. Please compare your cost of capital determination with Avista's cost of capital proposal.

A. The Company proposes an overall cost of capital of 8.25 percent. The major differences between my recommendations and the Company's proposal are: 1) a return on equity ("ROE") of 9.00 percent compared to the Company's proposed 10.90 percent ROE; and 2) a capital structure with 46.00 percent equity compared to the Company's proposed hypothetical equity ratio of 48.40 percent.

There is a small difference in the proposed cost of debt. I calculate a cost of debt to the Company of 5.70 percent, compared to Avista's proposed 5.76 percent. This difference is due to: 1) the cost and amount of short-term debt; and 2) the costs and amounts of debt for Avista that will be issued in 2012. Exhibit No. ___ (KLE-4) contains all the adjustments supporting the cost of debt calculations.

My cost of capital recommendation is also consistent with Staff's position on decoupling in this case. The Commission's Decoupling Policy Statement recognizes correctly that customers should benefit from lower cost of capital due to decoupling. How a specific decoupling proposal actually impacts a utility's cash flows would need to be evaluated once it is adopted. If the Commission accepts a decoupling proposal, the Commission should reduce the equity ratio for ratemaking purposes to reflect the enhanced cash flow benefit decoupling confers on the Company. In future cases, I will need to evaluate the Company's financial position and make a specific recommendation based upon the actual performance of the utility under decoupling. There may be other means to reflect the reduced risk of decoupling on cost of capital.

III. BACKGROUND

Q. Please explain the context of the Commission's cost of capital determination for Avista in this proceeding.

A. This proceeding involves setting the rates for the regulated electric and natural gas utility operations of Avista Utilities in the State of Washington. Avista Utilities is the utility operating company wholly owned by Avista Corporation. Avista Corporation also owns Avista Capital, which contains all of Avista Corporation's unregulated activities.[1] When I use the term "Avista", I am referring to Avista Utilities.

[1] See Exhibit No. ___ (SLM-2), at 2.

This principle has particular application in this case. Capital costs have declined substantially. Consistent with the *Bluefield* and *Hope* decisions, the Commission should recognize that fact in determining the profit ratepayers should pay to Avista's owners through rates.

B. General Economic and Financial Conditions

Q. What economic and financial conditions are relevant to your estimate of Avista's cost of equity capital?

A. I rely upon current economic and financial conditions. Efficient markets assume current market conditions shape investor expectations and stock prices reflect those expectations. Stock prices reflect current opportunity costs, not past events.

Q. What is your general expectation regarding the impact of current financial conditions on investor expectations?

A. My general expectation is that the current macro-economic climate will continue in its present state through the rate year, 2013, at least. Furthermore, the current interest rate environment will continue to keep the cost of capital low.

C. Avista's Operations and Risks

Q. Please summarize Avista and its operations.

Q. In two recent contested rate cases involving PacifiCorp and Puget Sound Energy, the Commission rejected your recommendation to use a capital structure with 46 percent equity. Does that change your recommendation?

A. No. A 46 percent equity ratio is reasonable for Avista as it was in those two prior cases. It supports a BBB corporate credit rating for Avista Corporation, and it will enable Avista to attract capital on reasonable terms, consistent with *Bluefield* and *Hope*. No more is required.

In those rate cases I just cited, the Commission confirmed its safety and economy standard for determining an appropriate equity ratio. I applied that standard in this case. However, I note that in neither order did the Commission state that 46 percent equity was unsafe or uneconomic, or was otherwise inconsistent with Commission policy. I also note that in that PSE order, the Commission determined that a range of equity ratios would be consistent with its stated policy and stated that accepting the higher equity ratio would help address its alleged attrition.[40] That is not a factor here, because Staff is directly measuring attrition in this case.

Q. Through various witnesses, the Company contends that its proposed equity ratio is necessary to provide the Company access to capital markets to support its large capital requirements.[41] What is your response?

A. The facts do not support the Company's contention. As I have explained, Avista Corporation has successfully raised new debt on reasonable terms with a 46 percent

[40] *Utilities and Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 & UG-111049, Order 08 (May 7, 2012), at 21 ¶ 56.
[41] E.g., Thies, Exhibit No. ___ (MTT-1T), at 2, lines 8-16.