Exhibit No.___(MCD-4T)
Docket Nos. UE/110876/UG-110877UE-120436/UG-120437
Witness: Michael C. Deen

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant,	Docket No. UE-110876
v.	Docket No. UG-110877
AVISTA CORPORATION d/b/a AVISTA UTILITIES, Respondent.	Docket No. UE-120436
	Docket No. UG-120437
	(consolidated)

RESPONSIVE & CROSS-ANSWERING TESTIMONY OF MICHAEL C. DEEN

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

REDACTED VERSION

September 19, 2012

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael C. Deen. I am a member of Regulatory & Cogeneration Services, Inc. ("RCS"), a utility rate and economic consulting firm. My business address is 900 Washington Street, Suite 780, Vancouver, Washington 98660.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.

A. I have been involved in the utility industry for about 6 years. During that time, I have served as an analyst and expert on a variety of matters including revenue requirement, cost-of-service, rate spread, and rate design, primarily regarding the Bonneville Power Administration and other utilities in the Pacific Northwest. I have testified before the Washington Utilities and Transportation Commission ("WUTC") in proceedings related to Puget Sound Energy, Avista, and PacifiCorp. A further description of my educational background and work experience can be found in Exhibit ___ (MCD-2), filed in Docket Nos. UE-110876/UG110877, which were consolidated into this docket.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am testifying on behalf of the Industrial Customers of Northwest Utilities ("ICNU"). ICNU is a non-profit trade association whose members are large industrial customers served by local distribution utilities throughout the Pacific Northwest, including Avista Utilities ("Avista" or the "Company"). I previously provided testimony regarding decoupling issues in Docket Nos. UE-110876/UG-110877.

Q. WHAT TOPICS WILL YOUR TESTIMONY ADDRESS?

A. This testimony will address a number of topics including certain power supply cost assumptions, the Company's proposed changes to the Energy Recovery Mechanism

("ERM") Retail Revenue Credit calculation and to the structure of the ERM, as well as ICNU's cost-of-service analysis and rate spread and design recommendations. Additionally, this testimony will contain ICNU's cross-answering testimony on the consolidated issue of electric revenue decoupling for Avista.

Q. HOW IS THIS TESTIMONY ORGANIZED?

A. My testimony is organized into seven sections as follows: I) Introduction and Summary; II) Power Supply Issues; III) ERM Modifications; IV) Cost-of-Service Analysis; V) Rate Spread; VI) Schedule 25 Rate Design; and VII) Decoupling Cross-Answering Testimony.

Q. PLEASE BRIEFLY SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS ADDRESSED IN THIS TESTIMONY.

A. The following table provides a summary of ICNU's recommended revenue requirement adjustments in this proceeding. This table includes adjustments related to cost of capital sponsored by ICNU witness Michael Gorman, Exhibit No. __ (MPG-1T), and also testimony regarding the Company's proposed attrition adjustment by witness Jim Dittmer, Exhibit No. __ (JRD-10T) (co-sponsored with Public Counsel and Northwest Industrial Gas Users). All values are presented incorporating ICNU's recommended rate of return of 7.48%, per Exhibit No. ___(MPG-3). Additional description of these items and ICNU's other recommendations in this proceeding is provided below. Finally, a detailed revenue requirement summary is contained in Exhibit No. __ (MCD-5) associated with this testimony. ICNU may also adopt additional adjustments proposed by other parties in this proceeding.

Table 1.
ICNU Integrated Revenue Requirement Adjustment Summary

Adjustment	WA RR Impact	ICNU Witness
Avista Filing	$41.0	N/A
Power Cost Update	($5.4)	Deen
WNP-3 Power Cost	($1.2)	Deen
REC Revenues	($1.2)	Deen
ERM Credit	($3.6)	Deen
Attrition Adjustment	($22.1)	Dittmer
Cost of Capital	($15.2)	Gorman
Total	**($7.7)**	**N/A**

- **Power Supply Issues.** ICNU has three separate adjustments to the Company's adjusted power supply cost (Company Adjustment 3.00), totaling approximately $7.8 million of reduction to the Washington revenue requirement. The changes collectively form the adjustment ICNU E 3.00.
    - **Power Cost Update.** This adjustment reflects updated power cost inputs provided by the Company in June and reduces the Washington revenue requirement by approximately $5.4 million.
    - **WNP-3 Power Cost.** This adjustment reverses the Company's antiquated practice of using mid-point settlement values for the cost of WNP-3 replacement power and uses actual costs, reducing the Washington revenue requirement by approximately $1.2 million.
    - **REC Revenues.** ICNU recommends making no pro-forma adjustment to 2011 REC sales under the Company's proposed REC revenue treatment. This results in a Washington revenue requirement reduction of approximately $1.2 million. Also, ICNU urges that procedural allowance be granted for parties to consider the implications of the Commission's recent Order 10 in Docket No. UE-100749 on the treatment of REC revenues in this proceeding.
- **ERM Modifications.** ICNU recommends that the Commission reject all of the Company's proposed modifications to the ERM. The Commission should specifically reject Avista's proposal to remove the current deadbands, sharing bands, collection/surcharge trigger as well as the proposed modification to the calculation of the Retail Revenue Credit.

- **Attrition Adjustment.** This adjustment reflects the revenue requirement impact of Mr. Dittmer's proposed treatment of the Company's attrition adjustment. ICNU and Public Counsel propose rejection of the Company's proposed attrition adjustment or alternate adjustment 4.00 through 4.03. ICNU and Public Counsel support the Company's restatement of 2011 capital (Adjustment 3.07) on condition of acceptance of revenue and tax normalizing adjustments PC E 2.12 and PC E 3.06.

- **Cost of Capital.** This adjustment reflects the revenue requirement impact of Mr. Gorman's proposed cost of capital. Mr. Gorman initially recommends a 9.4% return on equity ("ROE") and 7.48% over rate of return ("ROR") and a small adjustment to more accurately reflect Avista's capital structure, with further adjustments in the instance the Commission grants the Company an attrition adjustment.

- **Cost-of-Service.** ICNU recommends changes to the Company's peak demand allocation factors for production and distribution costs.

- **Rate Spread and Design.** ICNU supports the Company's equal percentage rate spread and recommends changes to the rate design for the three energy blocks in Schedule 25.

- **Revenue Decoupling.** ICNU continues to oppose NWEC's proposed decoupling mechanism for Avista that was consolidated into this proceeding from the last general rate case.

II. POWER SUPPLY ISSUES

Q. WHAT TOPICS WILL THIS SECTION OF TESTIMONY ADDRESS?

A. This section of testimony will address certain areas of the Company's proposed power supply costs. Specifically, it will address updates to power supply cost updates provided in response to discovery requests, WNP-3 settlement power cost assumptions, and the Company's assumed level of REC revenues included in base rates.

Q. HAVE YOU REVIEWED THE COMPANY'S PROPOSED POWER SUPPLY COSTS IN THIS PROCEEDING?

A. Yes. I have reviewed the Company's testimony, exhibits, and workpapers related to the proposed level of power supply cost, as well as a significant volume of data responses to data requests submitted by ICNU, Commission Staff, and other parties.

<u>Power Cost Update</u>

Q. ARE THE MARKET ASSUMPTIONS UNDERLYING THE POWER COSTS INITIAL FILING STILL APPLICABLE?

A. No. Since the Company's initial filing in April, there has been significant movement in the natural gas and electricity markets for delivery in the upcoming rate year. Also, through the normal course of business, the Company has continued to enter into natural gas and electricity contracts for the rate year. In response to Staff Data Request ("DR") 223, the Company provided a comprehensive market price and contract update on June 8, 2012. This response is attached as Exhibit No. __(MCD-6). Specifically the Company's updated power costs include "an updated three-month average natural gas prices and electric market prices, new short-term physical and financial contracts and an update to the Palouse Wind contract." These updates affect both the dispatch of resources in the AURORAxmp simulation as well as outside calculations such as the mark-to-market value of the Company's hedging transactions.

Natural gas prices in particular have declined significantly since the Company's initial filing. This response shows natural gas prices at the Company's modeled hubs ranging from [redacted] to [redacted] per dekatherm. This is significantly lower than the range of [redacted] to [redacted] per dekatherm in the Company's initial filing and tracks more closely with current prices for delivery in the rate year.

Q. WHAT IS ICNU'S RECOMMENDATION REGARDING THESE UPDATED POWER COSTS?

A. ICNU recommends that the Commission adopt the updates provided by the Company in response to Staff DR 223. These updates result in a decrease in Washington revenue requirement of approximately $5.4 million. The Company should also file a similar updated study in conjunction with its rebuttal filing.

<u>WNP-3 Power Costs</u>

Q. PLEASE DESCRIBE THE ISSUE OF WNP-3 REPLACEMENT POWER COSTS.

A. As a part owner of the incomplete WNP-3 nuclear facility, Avista reached a settlement agreement with BPA starting in 1987 for delivery of power to replace the output of the cancelled facility. This power is priced by BPA based on the average of the O&M costs of five proxy nuclear facilities. However, the price paid by Avista's customers in rates for this power is based on the mid-point between the minimum and maximum O&M proxy costs in any given year. This rate treatment is documented in the Company's workpapers.

Q. HOW HAS AVISTA'S RATE TREATMENT OF WNP-3 POWER COSTS FUNCTIONED OVER TIME RELATIVE TO ACTUAL COSTS?

A. As shown in Exhibit No. ___(MCD-7), Avista's rate treatment proved to be modestly beneficial to customers in the early years of the settlement but has shifted substantially in favor of the Company since approximately 1998. In fact, from 1998 through 2011, the Company has accrued approximately $19 million in net benefit on a system basis under the settlement rate treatment. This exhibit was prepared based on data received in response to ICNU DR 2.12 from the UE-110876 proceeding.

Q. WHAT IS ICNU'S RECOMMENDATION REGARDING THE RATE TREATMENT OF WNP-3 REPLACEMENT POWER COSTS IN THIS PROCEEDING?

A. ICNU believes that there is no reason to continue the settlement rate treatment at this time. Whatever benefits Avista's current rate treatment may have achieved are long since passed, and there is no reason not to simply use the actual, known, and measurable costs for this power. The Company has accrued substantial benefits over time and fairness, along with basic cost-based ratemaking principles, dictate that the Commission should abandon Avista's current treatment of the WNP-3 costs and simply use actuals.

Q. WHAT IS THE EFFECT OF ICNU'S RECOMMENDED ADJUSTMENT IN THIS PROCEEDING?

A. Using actual known and measurable costs for the WNP-3 replacement power in this proceeding would have the effect of lowering the Company's Washington revenue requirement in this proceeding by approximately $1.2 million.

<u>REC Revenues</u>

Q. WHAT IS THE COMPANY'S PROPOSED TREATMENT OF REC REVENUES IN THIS CASE?

A. The Company currently includes a pro-forma amount of REC revenues as an offset to other power supply costs in the rate year. As described in response to Public Counsel DR 164, this amounts to approximately $0.25 million of REC revenues attributed to Washington in base rates and is subject to the ERM along with power costs. This amount is based on the REC sales that the Company had made at the time of its filing for delivery in 2013.

Q. DOES ICNU AGREE WITH THIS TREATMENT?

A. No. There are a number of significant problems with the Company's proposed treatment. Potentially most significant of these is Order 10 in Docket No. UE-100749, which was issued very recently on August 23, 2012, giving guidance on the treatment and disposition of REC revenues to PacifiCorp. Additionally, even under the current ERM-based treatment of REC revenues, Avista's pro-forma adjustment significantly understates the REC revenues it will likely receive, and so should be rejected.

Q. PLEASE ADDRESS THE IMPLICATIONS OF THE COMMISSION'S RECENTLY ISSUED ORDER.

A. ICNU's analysis of the implications of the REC Order in UE-100749 is not complete. However, the Commission did make several determinations that are very pertinent to Avista's treatment of REC revenues in this proceeding.

Of central importance are two of the Commission's findings. First, the Commission ordered that "The actual proceeds from the sale of Renewable Energy Credits should be returned to ratepayers in the form of a credit on each customer's bill." Re PacifiCorp, Docket No. UE-100749, Order 10 ¶65. Second, the Commission stated that RECS "are comparable to, and should be treated the same as, utility property with respect to disposition of sale proceeds." Order 10 ¶70. This latter point is significant, in that the Commission ordered the treatment of REC revenues to be made outside of the normal ratemaking process. The Commission ordered the parties to work to either submit joint or individual proposals to create a mechanism for crediting actual REC revenues that conforms to the Commission's guidance.

Given the very recent nature of the order, ICNU has not had the opportunity to craft such a proposed mechanism in this proceeding. However, the principles and guidance in that order are equally applicable to Avista this proceeding. ICNU recommends that procedural allowance be made for all parties to consider the application Commission guidance provided in UE-100749 to Avista's treatment of REC revenues in this proceeding.

Q. PLEASE EXPLAIN HOW AVISTA'S PROPOSED REC REVENUE ADJUSTMENT IS INACURATE, EVEN UNDER THE CURRENT ERM-BASED TREATMENT.

A. Leaving aside the implications of the UE-100749 Order, ICNU does not agree with Avista's proposed treatment of REC revenues in this case. By removing actual 2011 sales, including only REC sales made at the time of the initial filing, Avista is very likely to understate significantly the amount of REC revenues actually received during the test year.

Based on the workpapers of William Johnson, Avista has only included $0.38 million of REC revenues on a system basis, but actually achieved sales of approximately $2.2 million during 2011. Although historical sales have been volatile, based on the Company's response to Staff DR 18, the Company had achieved sales of approximately [redacted] through the first quarter of 2012, indicating that the Company was on pace to achieve extremely similar (and slightly higher) sales during 2012.

Based on this pattern, ICNU recommends that there be no pro-forma adjustment to the 2011 sales amount in this case. Removing this adjustment would result in approximately a $1.2 million reduction to the Washington revenue requirement in this case. This value is derived by subtracting the Company's included $378,000 in REC sales from the 2011 value of $2.2 million on a system basis and then adjusting for the Washington allocation factor and for revenue sensitive items.

Q. PLEASE SUMMARIZE ICNU'S RECOMMENDATIONS REGARDING REC REVENUES AT THIS TIME.

A. If the Commission does not choose to address the implications of Order 10 in UE 100749 in this proceeding, and permits Avista to continue passing REC revenues through the ERM, ICNU recommends that no pro-forma adjustment be made to 2011 actual REC sales in this case. As described above, this treatment would result in a $1.2 million reduction in the Washington revenue requirement relative to Avista's filed case.

However, ICNU notes that the recent Order 10 in Docket No. UE-100749 appears extremely relevant to the disposition of REC revenues by Avista in this case. ICNU urges that procedural accommodation be made for parties to work together and/or individually provide further analysis of that Order's implications in this proceeding.

III. ERM MODIFICATIONS

Q. WHAT CHANGES IS THE COMPANY PROPOSING TO THE ERM IN THIS PROCEEDING?

A. The Company is proposing a variety of changes to the ERM. Structurally, the Company is proposing to eliminate the current deadband and sharing band structure and move entirely to a 90% customer to 10% company cost sharing and also to replace the current accrual "trigger" amount with an annual mechanism. Additionally, the Company is proposing to change the method for calculating the retail revenue credit to allow the Company to collect more revenue.

Q. PLEASE DESCRIBE THE COMPANY'S RATIONALE FOR ITS PROPOSED CHANGES TO THE DEADBAND AND SHARING BAND.

A. The Company argues that it experiences substantial power supply cost variability in the form of hydro conditions, fuel, and purchased power expense over which it has essentially no control. The Company further argues that its Purchased Gas Adjustment mechanism ("PGA") has no sharing bands, utilities in other states have power cost adjustment mechanisms without deadbands, and that elimination of the deadbands will reduce the impact of setting rates at the "wrong" level through the normal rate case process. Finally, the Company argues that their proposed change would be viewed favorably by the financial community and perhaps take financial stress off the Company.

Q. ARE THESE ARGUMENTS PERSUASIVE?

A. No. At a basic level, the Company has not demonstrated a need to move away from the current deadband and sharing structure in the ERM. The Commission has made it clear that a deadband and sharing mechanisms of the nature already in place in the ERM are essential in balancing risk to the Company with consumer protection. The Commission has repeatedly found that deadbands and sharing mechanisms of the type included in the ERM are important mechanisms both for balancing risk between consumers and the Company, as well as creating an incentive for the Company to actively manage power costs at the lowest reasonable level. The Commission has already fully considered the structure of the ERM deadbands and sharing levels in the context of the Company's operational profile and financial condition, as well as risks already allocated through the normalized ratemaking process. These conditions are inherently different from both the Company's natural gas supply and the various utilities' mechanisms from other states with no deadbands cited by the Company.

In fact, the Commission has already explicitly rejected the exact change proposed by the Company on this basis. In Docket No. UE-050684, the Commission rejected a power cost adjustment mechanism proposed by PacifiCorp which included only 90/10 customer and Company cost sharing and no deadbands in part because, "The 90/10 sharing band and the absence of a deadband do not adequately balance risks and benefits between shareholders and ratepayers." Re PacifiCorp, UE-050684, Order 04 ¶99.

It is unsurprising that financial rating agencies would view the Company's current deadbands and sharing structure "negatively," given that the analysis provided by those agencies is exclusively focused on the perspective of potential shareholders. It would be greater cause for concern if financial rating agencies did *not* recognize the ERM was balanced in its risk sharing between consumers and the Company. Also notably, the Company has not proposed a benefit to consumers in the form of lower capital costs if its proposed changes are adopted and more risk is shifted to customers.

Finally, the Company did not complain during the many years of high power costs in which balances in favor of the Company accrued. It would be inequitable to change the mechanism now that we are seeing lower power costs in the market-place.

Q. PLEASE DISCUSS THE COMPANY'S PROPOSED CHANGE FROM THE CURRENT ACCRUAL TRIGGER TO AN AUTOMATIC ANNUAL ADJUSTMENT MECHANISM.

A. The ERM adjustment trigger is currently set to 10 percent of the base level of revenue of approved by the Commission in the most recent general rate case (presently about $45 million). The Company argues that an automatic annual adjustment would result in smaller rebates or surcharges and also more closely align adjustments with the time when utility costs and revenues are incurred.

Q. PLEASE RESPOND.

A. ICNU does not believe the Company's proposed change is necessary or well supported. In general, the goal of matching costs and revenues to the time period in which they are incurred must be balanced with the benefits of rate stability for customers. Further, the fact that the Company is already filing nearly annual general rate cases does not support the need for an additional, automatic adjustment to power costs. As shown in the response to Staff DR 265, attached as Exhibit No. __(MCD-8), Avista has been granted electric rate increases nine times by the Commission since 2001. ICNU believes that the current trigger mechanism is functioning adequately at the time.

Q. PLEASE DESCRIBE THE COMPANY'S PROPOSED CHANGE TO THE RETAIL REVENUE ADJUSTMENT WITHIN THE ERM.

A. As described in the testimony of William G. Johnson, Exhibit No. ___ (WGJ-1T), starting on page 20, the retail revenue credit is a mechanism within the ERM that is designed to prevent customers from being under or over charged through the ERM due to changes in power expenses related to changes in retail load. The adjustment rate is currently based on the full (fixed and variable) costs of production and transmission authorized in the Company's last general rate case.

The Company is proposing to change the calculation of the adjustment to include only the energy classified portion of production and transmission costs. The rationale for this change is that it will allow the Company to recover additional revenue from load growth to offset the costs associated with increased capital investment between rate cases. The effect of the change would be to reduce the adjustment rate from $50.59 per MWh to $33.29 per MWh. On a revenue requirement basis, the Company is proposing Adjustment 4.04 – Retail Revenue Credit, which would increase the Washington revenue requirement by approximately $3.6 million in this case.

Q. DOES ICNU SUPPORT THE COMPANY'S PROPOSED CHANGE?

A. No. The Company's proposed change amounts to a one-sided attempt to obtain additional revenues to address the issues related to regulatory lag which it is already proposing to address through its attrition adjustment. Further, it is unclear how regulatory lag is present, since Avista is filing newly annual rate cases. The ERM is not the appropriate context to address any potential regulatory lag issues and is duplicative with other proposals in this proceeding. Further, any change to the retail revenue adjustment methodology should take place solely within the ERM and not affect base rates. On this basis, the Commission should reject the proposed change to adjustment methodology and also reject the Company's Adjustment 4.04.

Q. PLEASE SUMMARIZE ICNU'S POSITION REGARDING THE COMPANY'S PROPOSED MODIFICATIONS TO THE ERM.

A. For the reasons outlined above, the Commission should reject all of the Company's proposed changes to the structure of the ERM and also the proposed adjustment regarding the retail revenue adjustment. As an alternative, if the Commission believes the ERM is not serving its original purpose to balance power cost risk between the

Company and consumers along with providing administrative simplicity, ICNU recommends that the ERM be discontinued on the basis that the Company has been filing nearly annual rate cases to adjust power costs for over a decade.

IV. COST-OF-SERVICE ANALYSIS

Q. HAVE YOU REVIEWED THE COST-OF-SERVICE ANALYSIS PRESENTED BY THE COMPANY IN THIS PROCEEDING?

A. Yes. I have reviewed the Company's cost-of-service study presented in the testimony, exhibits, and workpapers of Company witness Tara Knox.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSED METHODOLOGY?

A. No. Specifically, I strongly disagree with the Company's demand allocation factors used in the study.

Q. HOW HAS AVISTA CALCULATED THE PEAK DEMANDS USED IN ITS COST OF SERVICE STUDY?

A. Avista's study uses two basic demand (or peak) allocation factors for specific cost assignments: class system coincident demands for generation and transmission costs and class non-coincident demands for distribution costs. For each of these demands, Avista derives the class value from all 12 months of a year ("12CP" and "12NCP"). Using this average value dramatically understates the demand level of certain classes. Giving each and every month equal weighting ignores the fundamental driver of new generation, transmission or distribution development. The need and scaling of these facilities is determined by the peak demands placed on the facility. Including other irrelevant demands in the derivation of the class value simply causes a shift in cost responsibility to other classes in the cost study. This latter point can be appreciated by reviewing the following table containing the 12NCP data used by Avista for Schedule 1 to allocate distribution demand costs.

Table 2 Monthly Peaks for Sch. 1 (MW)		
Month	**NCP**	**Percent of Maximum**
Jan	612	100%
Feb	587	96%
Mar	581	95%
Apr	514	84%
May	514	84%
Jun	441	72%
Jul	397	65%
Aug	474	77%
Sep	517	85%
Oct	391	64%
Nov	418	68%
Dec	582	95%
Avg.	**502**	
Max	**612**	

Most of the months have demands substantially below the winter peak value that occurs in January. While distribution facilities typically have both a summer and winter capacity rating, the difference is far less than the 36% gap indicated in the table above. Thus, the inclusion of these lower load months substantially understates the distribution demand-related cost of serving this class.

The following table compares Avista's 12NCP demands with the class 1NCP demands that I derived from Avista's data. To more accurately assess distribution demand cost responsibility, I recommend that the ICNU class NCP values in Table 3 be used in the cost of service study.