Exhibit No.__ (JSS-4T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-160228

DOCKET NO. UG-160229

REBUTTAL TESTIMONY OF

JENNIFER S. SMITH

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corporation.

A. My name is Jennifer S. Smith. I am employed by Avista Corporation as a Senior Regulatory Analyst in the State and Federal Regulation Department. My business address is 1411 East Mission, Spokane, Washington.

Q. Have you previously provided direct testimony in this Case?

A. Yes. My testimony and exhibits in this proceeding covered the overall methodology and results of the Company's electric and natural gas Modified Test Year Studies[1], and Cross Check Studies, which were prepared as a cross check for the attrition analysis presented by Company witness Ms. Andrews.

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

A. My testimony will explain the Company's updated Modified Test Year and Cross Check Studies for both electric and natural gas to reflect adjustments by parties with which the Company agrees, and additional adjustments for updates and corrections that have been identified through the discovery process. I will then address the specific adjustments proposed by the parties[2] in this case.

Q. Are you sponsoring any exhibits?

[1] In the Company's rebuttal testimony, the use of "Modified Test Year Study" is synonymous with the Company's previous use of "Pro Forma Study". The Company continues to describe specific adjustments within its Modified Test Year Study as Pro Forma Adjustments for consistency purposes within direct testimony and workpapers.

[2] I will refer to each of the non-Company parties in these Dockets as follows: the Staff of the Washington Utilities and Transportation Commission (Staff), the Public Counsel Unit of the Washington Office of Attorney General (Public Counsel), the Industrial Customers of Northwest Utilities (ICNU), the Northwest Industrial Gas Users (NWIGU), and The Energy Project.

A. Yes. I am sponsoring Exhibit Nos.__ (JSS-5) (Electric) and (JSS-6) (Natural Gas), which consist of worksheets showing the calculation of the updated Electric and Natural Gas Modified Test Year and Cross Check Studies, including each adjustment as proposed by the Company on rebuttal.

A table of contents for my testimony is as follows:

Description **Page**

II. AVISTA MODIFIED TEST YEAR UPDATED TO INCLUDE ADJUSTMENTS IDENTIFIED BY PARTIES AND AGREED TO BY THE COMPANY

Q. Avista accepted certain adjustments as proposed by Staff and Intervening Parties for purposes of its Modified Test Year Study. Please describe each of these adjustments.

A. Each adjustment agreed to and updated by Avista is included in Table No. 1 (Electric) and No. 2 (Natural gas) below, with a brief description of each adjustment following the table. Workpapers have been provided to show the details of the adjustments.

Table No. 1:

Electric Modified Test Year (000s of Dollars)				
		NOI	**Rate Base**	**Revenue Requirement**
Avista Original Filed Modified Test Year		**$ 100,468**	**$ 1,411,117**	**$ 11,843**
	Adjustments Identified by a Party and Agreed to by Avista			
A	Restate Property Tax	499	-	(805)
B	Restate Incentive Expense	(79)	-	127
C	Pro Forma Regulatory Amortization	853	-	(1,376)
D	Pro Forma Meter Deferral & Amortization	749	-	(1,209)
	Total Adjustments Identified by Parties and Agreed to by Avista	$ 2,022	$ -	$ (3,263)
Avista Updated Modified Test Year with Adjustments Agreed to by Avista		**$ 102,490**	**$ 1,411,117**	**$ 8,580**

Table No. 2:

Natural Gas Modified Test Year (000s of Dollars)						
		NOI		Rate Base		Revenue Requirement
Avista Original Filed Modified Test Year	**$**	**22,602**	**$**	**286,493**	**$**	**(1,151)**
Adjustments Identified by a Party and Agreed to by Avista						
A Restate Property Tax		106		-		(171)
B Restate Incentive Expense		(21)		-		34
Total Adjustments Identified by Parties and Agreed to by Avista	$	85	$	-	$	(137)
Avista Updated Modified Test Year with Adjustments Agreed to by Avista	**$**	**22,687**	**$**	**286,493**	**$**	**(1,288)**

A. Restate Property Tax (Electric & Natural Gas)

The Company updated its Restate Property Tax Adjustment to reflect the actual property tax payment that was made to the State of Washington in April 2016, impacting the 2015 restated period.

B. Restate Incentive (Electric & Natural Gas)

This adjustment updates non-executive officer test period expense to appropriately reflect only O&M expenses and adjusts the 6-year average payout for executive officers to reflect the O&M portion as discussed below, in Section V. D.

C. Pro Forma Regulatory Amortization (Electric)

This adjustment corrects regulatory amortization expense, where the Company inadvertently removed the expiring amortization portion of the BPA Parallel Capacity settlement in this adjustment, as well as in Adjustment 3.08 Pro Forma Revenue Normalization Adjustment, where this amortization is properly reflected.

D. <u>Pro Forma Meter Deferral & Amortization (Electric & Natural Gas)</u>

In conjunction with the Company's Advanced Metering Infrastructure (AMI) project, the Company included in its direct case an adjustment to reflect the removal of the estimated undepreciated value of the Company's existing electric distribution meters. This adjustment also included the recording of a regulatory asset to reflect the deferral of these meters and a proposed fifteen-year amortization of this deferred regulatory asset.

The Company has since removed this adjustment to reflect the Commission's decision in Order 01 in Docket No. UE-160100 received after the Company's filed case. Order 01 required, upon execution of a contract with a vendor and the Company moving forward with AMI, that the Company defer, in a regulatory asset account for later prudence determination and recovery, the remaining net book value of its existing electric meters as the meters are removed from service. Based on the authorized recording of the regulatory asset per the WUTC, the deferred regulatory asset during the 2017 and January through June 2018 rate periods on an AMA basis is not expected to be material. The Company therefore, has removed the regulatory asset balance, and removed the impact on depreciation and amortization expense.

III. <u>AVISTA MODIFIED TEST YEAR UPDATED TO INCLUDE ADJUSTMENTS FOR MORE RECENT INFORMATION</u>

Q. Avista provided updated information and made adjustments to the Company's Original Modified Test Year. Please describe each of these adjustments.

A. Each adjustment, which has been updated by Avista is listed in Table No. 3 (Electric) and No. 4 (Natural gas), with an explanation of each following the tables. Workpapers have been provided to show the details of the adjustments.

<u>Table No. 3:</u>

Electric Modified Test Year (000s of Dollars)				
		NOI	**Rate Base**	**Revenue Requirement**
Avista Updated Modified Test Year with Adjustments Agreed to by Avista		**$ 102,490**	**$ 1,411,117**	**$ 8,580**
Avista Updates to Modified Test Year without Agreement of Parties				
A	Cost of Debt and Rate of Return	2	-	888
B	Plant Held For Future Use	(8)	(862)	(92)
C	Restate Excise Taxes	(289)	-	466
D	Net Gains and Losses	7	-	(12)
E	Restate Debt Interest	184	-	(297)
F	Restate Incentive Expense	(1,203)	-	1,941
G	Pro Forma Power Supply	(1,057)	-	1,705
H	Pro Forma Employee Benefits	(1,649)	-	2,660
J	Pro Forma Property Tax	(99)	-	160
K	Pro Forma Capital - Incremental December 2015	(173)	3,302	686
L	Pro Forma 2016 Limited Capital Additions	(123)	(314)	179
Total Avista Updates to Modified Test Year without Agreement of Parties		$ (4,408)	$ 2,126	$ 8,285
Avista Updated Modified Test Year		**$ 98,082**	**$ 1,413,243**	**$ 16,866**

Table No. 4:

Natural Gas
Modified Test Year
(000s of Dollars)

		NOI	Rate Base	Revenue Requirement
Avista Updated Modified Test Year with Adjustments Agreed to by Avista		**$ 22,602**	**$ 286,493**	**$ (1,151)**
Avista Updates to Modified Test Year without Agreement of Parties				
A	Cost of Debt and Rate of Return	-	-	585
D	Net Gains and Losses	2	-	(3)
E	Restate Debt Interest	37	-	(60)
F	Restate Incentive Expense	(363)	-	586
H	Pro Forma Employee Benefits	(492)	-	387
I	Pro Forma Pipeline Safety Labor	29	-	(47)
J	Pro Forma Property Tax	(23)	-	37
K	Pro Forma Capital - Incremental December 2015	10	3,534	422
L	Pro Forma 2016 Limited Capital Additions	(36)	(4,953)	(550)
Total Avista Updates to Modified Test Year without Agreement of Parties		$ (836)	$ (1,419)	$ 1,357
Avista Updated Modified Test Year		**$ 21,766**	**$ 285,074**	**$ 206**

A. Cost of Debt and Rate of Return (Electric & Natural Gas)

This adjustment reflects an update to cost of debt from 5.51% to of 5.594%. In August 2016 Avista priced $175,000,000 First Mortgage Bonds due in 2051 (35 years), through a private placement offering with the bonds to be funded and issued in December 2016. Including the cost of hedges, the all-in rate is approximately 5.6% over the 35-year period.

B. Plant Held for Future Use (Electric)

This adjustment was updated to remove a piece of land from Plant Held for Future Use which was included in the original filing, that later was determined not to be needed for utility purposes.

C. Restate Excise Tax (Electric)

The Company discovered it had inadvertently understated its restated excise tax expense for 2015, by improperly removing Solar REC's paid to customers.

D. Net Gains and Losses (Electric & Natural Gas)

This adjustment corrects a classification error made on the net gains and losses adjustment.

E. Restate Debt Interest (Electric & Natural Gas)

This adjustment reflects the impact on test period results related to the change in the cost of debt as discussed in Section III. A. above. The change in cost of debt on all other rate base changes are reflected in their respective adjustments.

F. Restate Incentive (Electric & Natural Gas)

This adjustment updates non-executive officer test period expense to appropriately reflect only O&M expenses, and adjusts the 6-year average payout for executive officers to reflect the O&M portion only as discussed below, in Section IV. D.

G. Pro Forma Power Supply[3] (P/T Ratio) (Electric)

This adjustment reflects the impact on pro forma power supply expenses for the update to the Production/Transmission (P/T) Ratio.

H. Pro Forma Employee Benefits (Electric & Natural Gas)

This adjustment updates employee benefits expense to reflect current information as discussed below, in Section IV. G.

[3] Power supply updates are addressed by Company witnesses in Mr. Johnson and Mr. Kalich. These expenses will be updated in the November 2016 power supply update.

I. Pro Forma Pipeline Safety Labor (Natural Gas)

This adjustment reflects updates to include those employees that are currently employed by the Company for pipeline safety.

J. Pro Forma Property Tax (Electric & Natural Gas)

This adjustment updates the Company's Pro Forma Property Tax Adjustment to reflect the actual property tax payment that was made to the State of Washington in April 2016, as well as for updated information impacting the 2016 pro forma property tax expense.

K. Pro Forma Capital – Incremental December 2015 (Electric & Natural Gas)

This adjustment reflects actual 12-months ended December 2015 capital on an AMA basis, versus the original filing that included estimates for the last three months of 2015.

L. Pro Forma 2016 Limited Capital Additions (Electric & Natural Gas)

This adjustment reflects updates for actual transfers to plant for the January through May 2016 time period, which impacts both the 2017 and June 2018 AMA balances.

IV. STAFF AND INTERVENOR ADJUSTMENTS NOT INCLUDED BY AVISTA

Q. Staff, Public Counsel, and other intervenors proposed several adjustments, which the Company has not included within its studies. Please identify each of these adjustments and explain why Avista is rejecting their proposals.

A. The adjustments proposed by the parties, which have not been included by Avista, are identified in Table No. 5 below and then discussed in detail.

<u>Table No. 5:</u>

Staff & Intervenor Proposed Adjustments Rejected by Avista
A. Deferred Debits & Credits - Montana Riverbed Lease (Electric)
B. Plant Held for Future Use (Electric & Natural Gas)
C. Directors Fees (Electric & Natural Gas)
D. Restate Incentive Expense (Electric & Natural Gas)
E. Pro Forma Transmission Revenues and Expenses (Electric)
F. Pro Forma Labor Non-Executive (Electric & Natural Gas)
G. Pro Forma Employee Benefits (Electric & Natural Gas)
H. Pro Forma Property Tax (Electric & Natural Gas)
I. Pro Forma Capital Additions December 2015 AMA (Electric & Natural
J. Pro Forma 2016 Limited Capital Additions (Electric & Natural Gas)
K. O&M Offsets (Electric & Natural Gas)
L. Cross Check Adjustments (Electric & Natural Gas)

A. <u>Deferred Debits and Credits - Montana Riverbed Lease (Electric)</u>

Q. Washington Staff witness Ms. O'Connell[4] recommended that the Montana Riverbed Lease expenses included in the Company's case be removed, which results in a reduction in revenue requirement of $3,526,475. Does the Company agree with the recommendation proposed by Ms. O'Connell?

A. No, the Company does not agree with this proposal. Avista is required to make the scheduled lease payment in 2017 and beyond to the State of Montana. Avista will continue to incur this expense, until such time as the parties are able to reach agreement on any adjusted level

[4] Exhibit No. ECO-1T, page 11

for the remainder of the lease. Company witness Mr. Norwood's rebuttal testimony discusses this issue in further detail.

B. <u>Plant Held for Future Use (Electric & Natural Gas)</u>

Q. Staff witness Ms. O'Connell states that it is inappropriate for the Company to include purchases of land in FERC Account No. 105 – Plant Held for Future Use, due to inconsistencies with pertinent Code of Federal Regulations guidelines.[5] Do you agree?

A. No. The Company purchased the land with plans to develop the property in the future and continues to plan to use this property to provide electric service to Avista customers. Accounting guidelines from the Code of Federal Regulations which describes the costs to be included in the Plant Held for Future Use (PHFU) account are as follows:

> A. This account shall include the original **<u>cost of electric plant</u>** (**<u>except land and land rights</u>**) owned and held for future use in electric service under a **<u>definite</u>** plan for such use to include: (1) Property acquired (except land and land rights) but never used by the utility in electric service, but held for such service under a **<u>definite</u>** plan, and (2) property (except land and land rights) previously held by the utility in service, but retired from such service and held pending its reuse in the future, under a **<u>definite</u>** plan, in electric service. (Emphasis Added)
>
> B. This account shall also include the original **<u>cost of land and land rights</u>** owned and held for future use in electric service under **<u>a plan</u>** for such use to include land and land rights: (1) Acquired but never used by the utility in electric service, but held for such service under **<u>a plan</u>**, and (2) previously held by the utility in service, but retired from such service and held pending its reuse in the future under **<u>a plan</u>**, in electric service.[6] (Emphasis Added)

[5] Exhibit No. ECO-1T, page 3

[6] 18 C.F.R. § 105. This section is included in Part 101 of Title 18, the Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to Provisions of the Federal Power Act.

The guidelines make a distinction between investment in "electric plant" (Section A) and investment in "land and land rights" (Section B). Section A, investment in the "cost of electric" plant requires a greater level of specificity or "definite" plans to be recorded in FERC Account No. 105 – Plant Held for Future Use. Whereas, Section B indicates "a plan" is required. Ms. O'Connell states that the Company has not developed "specific" plans for the use of this land for future use in electric service and therefore, and it is inappropriate to include this land in FERC Account No. 105. The CFR does not require "specific" plans, and the Company's general plans for this land meets the guidelines from the Code of Federal Regulations allowing the recording of this investment in FERC Account No. 105.

Q. Ms. O'Connell[7] and ICNU/NWIGU witness Mr. Mullins[8] reject Avista's proposal to include Plant Held for Future Use in rate base. Do you agree?

A. No. In the 1993 Puget Sound Energy case, Puget Sound Energy was allowed to maintain 73 parcels of land in rate base. The expected in-service dates identified for these parcels of land had a year listed between 1994 and 2021, a span of 28 years in the future. Until this case, Avista has not requested any PHFU be included in rate base as the investment has been relatively small. In this proceeding, Avista has requested to include 4 parcels of land that are planned to be developed by 2026. Generally, Avista does not prepare a detailed plan for each site until approximately two years prior to the beginning of construction. It would be costly to develop and update multiple detailed plans when equipment and technologies change, especially given that the CFR does not require detailed or "specific" plans.

[7] Exhibit No. ECO-1T, page 5
[8] Exhibit No. BGM-1CT, page 37

C. <u>Director's Fees (Electric & Natural Gas)</u>

Q. ICNU and NWIGU witness Mr. Mullins[9] proposed to restate the level of director's fees to a 50%/50% sharing between shareholders and ratepayers, resulting in a decrease in revenue requirement for electric and natural gas of approximately $347,000 and $100,000, respectively. Do you agree with Mr. Mullins' proposed modification?

A. No. Directors fees are part of the overall compensation package offered to attract and retain qualified Directors and should be allocated similar to other compensation items. In Order No. 10 from Docket Nos. UE-090134 and UG-090135, in reference to Director and Officer (D&O) insurance as part of the total compensation package, the Commission stated:

> D&O insurance is a benefit that <u>is part of the compensation package offered to attract and retain qualified officers and directors. Accordingly, it makes sense to split the costs in the same manner we require other elements of their compensation to be shared.</u> Based on the formula currently used to allocate officer compensation between ratepayers and shareholders, this results in 90 percent of the costs being included for recovery in rates. (emphasis added) (See page 56, paragraph 137)

The Commission has identified that D&O insurance is part of the compensation package and recommended a split similar to that of officer compensation. Director Fees represent another component of the same compensation package and should be allocated in a way similar to other compensation components.

It is not reasonable to arbitrarily disallow a large portion of these costs on the basis that shareholders should bear a share of these expenses. These are costs incurred in the ordinary course of business that cannot be avoided. Directors must be reasonably compensated, in order for them to serve. No party has otherwise challenged the actual level of compensation; they simply want to

[9] Exhibit No. BGM-1CT, page 43-44

remove 50% of it from rates. The Company, as a publicly-traded company must be able to attract and retain a qualified board of directors to provide required oversight and independent guidance. The Company does not have the option to refuse to incur these costs, any more than it does to refuse to pay its taxes or provide salaries to its employees; all are costs of doing business.

Q. Did the Company provide support for its 97% utility / 3% non-utility split for Director Fees?

A. Yes. The Company provided an estimate of the time spent on utility and non-utility operations based on each Director's actual experience. In the aggregate, the most recent survey completed in November 2015, showed a 97% / 3% split between utility and non-utility operations.

D. Restate Incentive Expense (Electric & Natural Gas)

Q. Staff makes three adjustments to the Company's Restating Incentive Adjustment. Does the Company agree with these adjustments?

A. Yes, the Company agrees with two of the three adjustments. The first corrects the non-executive officer test period expense to appropriately reflect only O&M expenses. The second corrects the 6-year average payout for executive officers to reflect the O&M portion only. Staff and the Company worked closely during the discovery phase to develop a method for calculating the incentive adjustment which is more transparent, and easier to understand, for all parties. The first two adjustments are a result of those discussions. In doing so, the Company and Staff, updated the adjustment and are in agreement on the first two issues.

The Company does not, however, agree with the third adjustment which restates the incentive expense to reflect 2015 test period levels adjusted for a six-year average ending December 2015. Staff bases this adjustment on the definition of a restating adjustment. In her testimony, Ms. Cheesman states: "because the Company attempts to adjust *test period* incentive expenses with projected 2016 O&M labor expenses, Avista's proposed adjustment more closely resembles a pro forma adjustment rather than a restating adjustment".[10] For this reason, Ms. Cheesman removed the effects the 2016 wage increase has on the incentive adjustment because it is included as a "restating" adjustment, rather than a "pro-forma" adjustment.

In our incentive adjustment, which we labeled "restating" adjustment, we did two things. We applied a historical six year average in order to smooth out year-to-year variations in expense, and updated incentive compensation to reflect the incentive for 2016. Incentive compensation is calculated on a percentage basis applied to labor expenses and is therefore appropriate to match the 2016 incentive expense with 2016 labor expense.

Q. Is it appropriate for Staff to make this change to the adjustment solely because Avista termed it as a restating adjustment?

A. No. The end result of making both adjustments matches incentive compensation with the labor adjustment, and more accurately reflects what incentive compensation will be in the rate year.

E. <u>Pro Forma Transmission Revenue and Expenses (Electric)</u>

Q. On pages 5 through 8 of Staff witness Mr. Gomez's direct testimony[11], Staff rejects the Company's use of a three-year average in calculating a portion of its wheeling revenues during the rate period, and proposes the use of a five-year average. Does the Company agree with this proposal?

A. No. As noted by Company witness Mr. Cox, the Company has in the past used a five-year average for projecting BPA borderline wheeling revenue, but is proposing to use a three-

[10] Exhibit No. MC-1T, page 6:19, page 7:1-2
[11] Exhibit No. DCG-1T, page 5-8

year average (2013 – 2015) in order to be consistent with the three-year average used in all other instances where the Company projects transmission revenues that are based upon variable customer load figures. [12]/[13]

Additionally, a five-year history may be too long to properly reflect more recent actual load growth or system changes. A three-year history for BPA network service is similar to what is used by OASIS Non-Firm and Short-Term Firm Transmission Service, where a three-year history is understood to strike an appropriate balance between capturing an average over time, while also recognizing more recent changes for the system.

Q. Did other parties have proposed adjustments to Transmission Revenues?

A. Yes. ICNU proposed updates to the revenues associated with Transmission Wheeling (Low Voltage) and Transmission Wheeling (Ancillary Services). These updates would reflect new rates resulting from Avista's filings with FERC that occurred subsequent to the date of Avista's direct filed case. ICNU's proposal would result in a reduction to Washington electric expense of $586,000 (revenue requirement of $945,000).

Q. Does the Company agree with ICNU's proposed adjustment to update the Transmission Wheeling revenues for both Low Voltage and Ancillary Services?

A. Yes. The Company agrees that the new rates will be in effect in the rate year. However, the Company is proposing to reflect these updated rates in the November 2016 Power Supply update, along with all other known transmission revenue and expense changes. Considered

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[12] Exhibit No. BAC-1T, Page 9, line 13

[13] In Exhibit No. DCG-1T, page 7, lines 7-9, Mr. Gomez makes a reference to WAC 480-07-510(3)(i), which states that if there is a change in methodologies for adjustments, where a calculation has previously been approved by the Commission, the Company must also present a work paper showing both calculations. The Company did not provide both calculations for a three-year and five-year average in its direct filing, however, the calculation has now been prepared, and the impact of using a three-year average vs. a five-year average increases the Company's filed revenue requirement by $8,000, and is shown in a supporting work paper.

individually, the revenue requirement of the Transmission Wheeling Low Voltage and Ancillary Services components would be $505,000 and $440,000, respectively, for a total of $945,000.

F. <u>Pro Forma Labor Non-Executive (Electric & Natural Gas)</u>

Q. With the exception of only a decrease in full time equivalents ("FTE") related to Pipeline Safety, did Staff have any issues with the Company's Modified Test Year and labor adjustments?

A. No. The Company's labor adjustments were made in accordance with the guidelines set forth by this Commission for pro forma wage increases.

Q. Staff's labor adjustment reflects a decrease of three positions related to the Company's natural gas Pipeline Safety Project. Do you agree with this adjustment?

A. No. The natural gas Inspector position was filled in June of 2016 and the Damage Prevention Administrator position was filled in August 2016. The expense of these positions were included in the Company's Modified Test Year and will be serving customers in the rate year. The final position, Pipeline Safety Planning Manager, is currently being filled by an existing employee as part of a year-long developmental opportunity rotation and may or may not be filled by a new employee during 2017. For this reason, the Company has removed this position from the adjustment for a reduction in natural gas expense of $45,000 and revenue requirement of $47,000.

Q. ICNU Witness Mr. Mullins proposes to reduce Avista's labor expense because he asserts more labor costs will be capitalized in the rate year, resulting in a decrease in revenue requirement for electric and natural gas of approximately $881,000 and $262,000, respectively. Did Mr. Mullins provide any evidence to support his claim?

A. No, he did not. Mr. Mullins even states that "it is difficult to predict how changing levels of capitalization might impact labor expense precisely in the rate period"[14] (emphasis added). The basis for the labor adjustment is 2015 test period labor expense, adjusted to annualize the 2015 approved labor increases, approved increases in effect in 2016 for non-union and union employees, and approved union increases for 2017 in accordance with contract terms.

G. Pro Forma Employee Benefits (Electric & Natural Gas)

Q. Staff recommends using actual recorded retirement and medical benefit expense for year ending 2015, resulting in a decrease in revenue requirement for electric and natural gas of approximately $195,000 and $57,000, respectively. Does the Company agree with this adjustment?

A. No. The Company updated post-retirement medical and pension expense in May 2016 based on information provided by its compensation consultant, Towers Watson. Previously, the Commission has allowed the most recent actuarial report available in the record to be utilized as the basis for the adjustment. As noted in the most recent Pacific Power & Light Company rate case (UE-152253), Order No. 12:

> "…Thus, we continue our past practice and accept the adjustment proposed by Public Counsel to base these costs on the most recent actuarial report available in the record for the 2016 plan year.." (emphasis added).[15]

The Company's Modified Test Year and Cross Check Studies reflect the most recent actuarial data.

[14] Exhibit No. BGM-1CT, p 42:11-12
[15] UE-152253, Order No. 12, p 62 para 188

Q. In addition to the updates to the benefit adjustment for pension and post-retirement medical, have any other updates been incorporated into the Benefit Adjustment?

A. Yes. We have updated our benefits adjustment to reflect actual medical claims expense for 2016 and the most recent medical premium cost estimate for 2017 received from our medical underwriter. The net impact of the post-retirement medical, pension, and medical premiums result in increases to Washington electric and natural gas revenue requirements of approximately $2,660,000 and $796,000, respectively.

In addition, the premium estimates provided by our independent consultant, Mercer, show an increase for 2017 of $3,000,000 from $26,000,000 to $29,000,000 (system) resulting in increases to Washington electric and natural gas revenue requirements of approximately $856,000 and $257,000, respectively.

Q. Please describe the role medical benefits plays within the Company's overall compensation package.

A. Avista sponsors a self-funded plan that provides various levels of coverage for medical, dental and vision as a portion of a carefully balanced total compensation and benefits package. This also includes base salaries, performance-based award programs, and retirement benefits that are competitive in the marketplace as benchmarked against other similar-sized companies in regional and national markets. To aid in benchmarking our medical plan, Avista participates in a comprehensive benefit study, BENEVAL, performed by an independent actuarial company, Towers Watson. Similar to direct compensation, the Company generally targets the level of benefits it offers to be within +/- 15% of the market median. The various components within the medical plan (co-pays, deductibles, premium sharing, etc.) are also evaluated in order to maintain an appropriate level of medical benefits, relative to the overall benefits and compensation package.

Q. Please provide an overview of how medical premiums for the Company are set.

A. Medical premiums[16] for the Company are set annually by an independent consultant, Mercer.[17] Premiums are based on utilization, which is the pattern of use or intensity of services used for a particular timeframe, and medical trend, which is the projected increase in the cost to treat patients from one year to the next. This includes costs related to type of medical services, such as outpatient procedures, professional services such as office visits, physical therapy and emergency room visits, prescription drugs, and medical equipment, among other things. The following factors are taken into consideration in the development of medical trends:

- Population Profile – the number and composition of participating employees (such as single/family, age, etc.).
- Projected Medical and Prescription Costs – the increase in unit cost for a given medical service or treatments, the mix and intensity of differing types of service, new treatments/therapy/technology.
- Laws and Regulation – changes and associated costs, such as those required as part of the Affordable Care Act.

The premium estimate, based on a combination of utilization and medical trend, is the basis for the medical cost estimate provided by Mercer. The following illustration shows the change in overall premiums for the period 2010-2016 for Avista:[18]

[16] In this context, "premium" is defined as total medical costs including both the Company and employee contribution.
[17] Mercer is currently the world's largest human resources consulting firm, with more than 20,500 employees, based in more than 40 countries and operates internationally in more than 130 countries.
[18] There was no premium change for Avista in 2012.

Illustration No. 1:

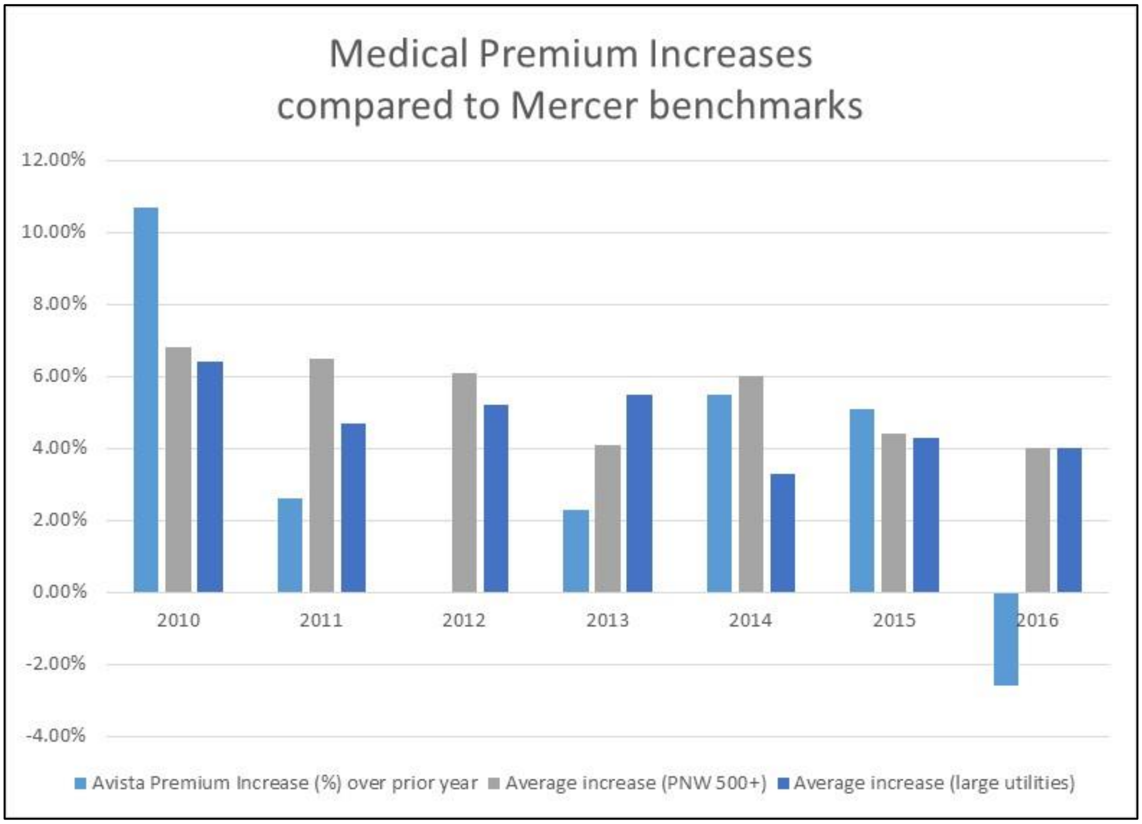


Illustration No. 1 indicates Avista's cumulative overall average premium increase from 2010-2016 is approximately 24%, with an average annual increase of approximately 3%. For comparison purposes, our peers in the Pacific Northwest 500 Utilities Sector (PNW 500+) and Large Utilities Sector have experienced cumulative 2010-2016 overall average premium increases of 38% (6% per year) and 33% (5% per year), respectively.

Therefore, for this recent historical period, the annual increases in Avista's medical costs have been well below those of the other companies in the bar chart above.

Actual medical expense will vary from premium cost estimates based on variations in plan utilization and actual components in medical trend. For the past several years, actual expense has been approximately <u>10-15%</u> less than our premium cost estimates, resulting in lower costs for the

Company and our customers. Some reasons could include the effects of the Company's wellness programs, the severity of flu season in a given year, the level of acute or chronic illness, or for a variety of other reasons.

Q. Have actual claims continued to be lower than premium estimates in 2016?

A. No, they have not. Whereas in previous years we have incurred a level of expense lower than premium cost estimates, during 2016 actual claims have exceeded this estimate. This has resulted in an increase <u>in expense</u> between 2015 and 2016 of approximately $5 million (system).

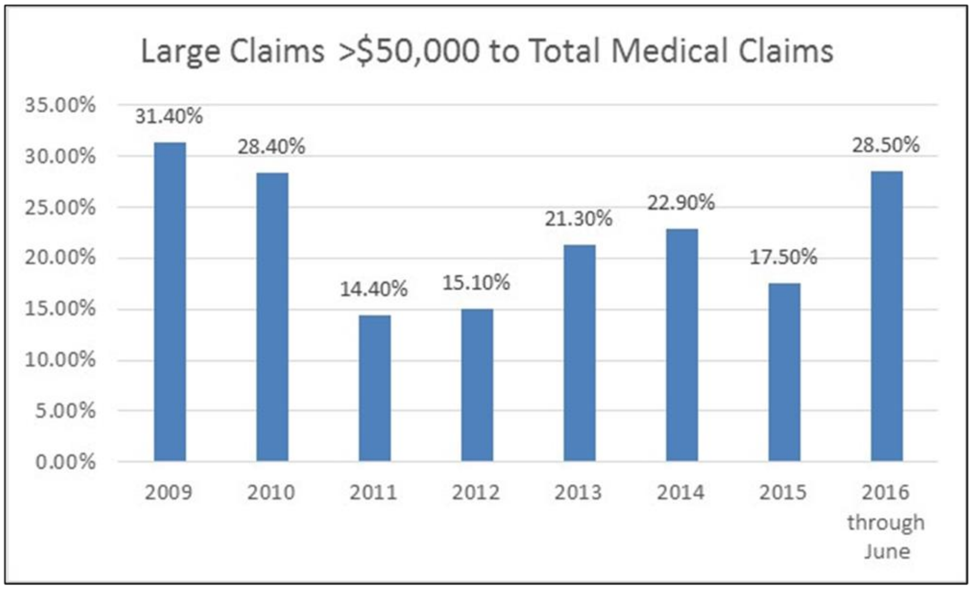
The primary factors which contributed to this increase are as follows:

1. Large Claimants. The primary contributor to this increase are large claimants, coupled with increases in unit costs and utilization. Large claimants are responsible for approximately 28.5% of the total claims for the year.[19]

   Illustration No. 2 shows the amount of claims greater than $50,000 from 2009-June 2016.

[19] Large claim percentages above 25% are considered outside of the norm by Mercer underwriters.

<u>Illustration No. 2:</u>



2. Medical and Prescription Costs. The Company has experienced slight increases in medical costs and services, but with significant increases in prescription drug costs.

3. Additional participants. New participants in the plan for 2016 have elected to include spouse and children.

4. Utilization and Population Profile. In addition to increase in the size of claims, the rate of use has increased during 2016. A key contributor to this is our population profile which is comprised of a high percentage of family participants as well as older age demographics. At Avista, the average participant family size is approximately 2.9 versus 2.1 for all participants within the Premera Blue Cross Network[20], and our average plan participant is age 46.

Q. Premium estimates for 2017 indicate a cost increase above those realized in 2016 of approximately $3,000,000 (system). What are the primary factors contributing to this increase?

[20] Premera provides health care services to approximately 2.0 million people in Washington State.

A. Mercer's underwriters estimate premium costs will rise approximately 16% in 2017 based on medical trend (including prescription drugs) and rate of utilization. The factors remain fairly similar to those driving the increase in expense for 2016:

1. Large Claimants. Many of the large claimants in 2016 will likely continue incurring similar expenses into 2017. Due to the number and seriousness of their conditions.[21] Although actual utilization cannot be predicted exactly, it is common for these types of medical needs to extend over multiple years.

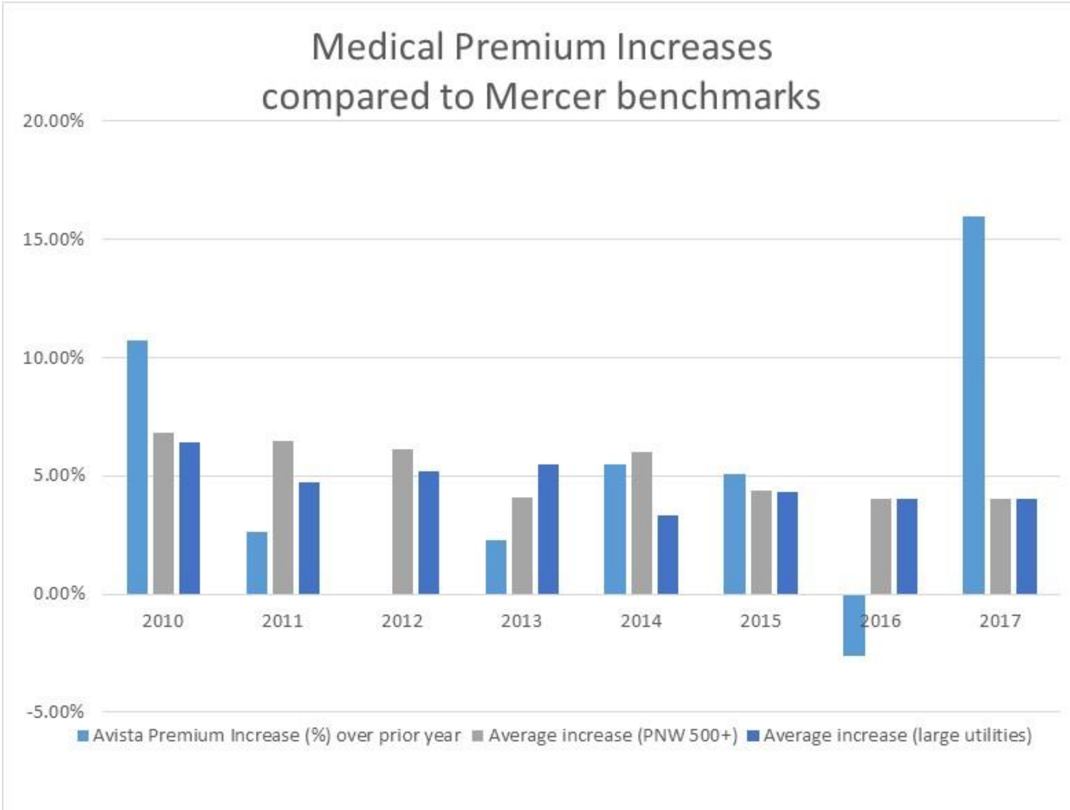
2. Medical and Prescription Cost. According to Mercer, the 6% trend in medical costs for 2016 will continue into 2017. Prescription drug cost trend, however, is anticipated to double from an increase of 6% in 2016 to 12% in 2017.

3. Utilization. The rate of overall utilization continues to grow due in part to our population profile and age demographic of employees.

Illustration No. 3 below shows the same information provided earlier in Illustration No. 1, only updated with the 2017 premium increase. For comparison purposes, if we assume a 4% increase for our peers for 2017 (consistent with Mercer's estimate of 4% for 2016), updated with Avista's 2017 increase average premium, our average premium increase for 2010 to 2017 is 5%, consistent with our peers.

[21] Through August of 2016, there are 4 large claims which have exceeded $250,000 each. Avista has an insurance policy with an annual stop-loss limit of $250,000 per person.

<u>Illustration No. 3:</u>



Mercer expects 2016 to be 4% nationally

Q. What is the impact of the changes discussed above for Washington customers?

A. The table No. 6 below summarizes the increase in expense for both 2016 and 2017 for System and Washington Electric and Washington Natural Gas from what was originally included in this case.

<u>Table No. 6:</u>

Summary of Medical Cost Estimates (that exceed what was reflected in filing)			
Year	**System**	**WA Electric**	**WA Natural Gas**
2016	$ 4,800,000	$ 1,306,338	$ 391,098
2017	$ 3,000,000	$ 816,461	$ 244,437

Q. What measures has the Company previously implemented to keep medical costs down?

A. Avista encourages employees to take responsibility for their health care by offering various wellness programs, biometric screening, health risk assessment tools, discounted gym memberships and on-site exercise classes and facility. To keep office visit costs down, we offer access to phone or web-based 24/7 telemedicine services and an on-site clinic. We have limited our exposure to large claims through an insurance policy with annual stop-loss limits of $250,000 per person. When employees do require medical care for catastrophic conditions, we have a case management program managed by a third-party administrator to help manage these costs. To keep prescription drug costs down, we have contracted with specialty pharmacies who help participants determine the most economic treatment options. In addition, the Company has made the following changes to the medical plan offered to employees:

- For employees hired or rehired on or after January 1, 2014, upon retirement the Company no longer provides a contribution towards his or her medical premiums. The Company will provide access to the retiree medical plan, but the retiree will pay the full cost of premiums upon retirement.

- Manage Utilization of Specialty Drugs – We review measures to lower the cost of prescription drugs including requiring prior authorization, implementing step therapy.

- Beginning January 1, 2020, the method for calculating health insurance premiums for non-union retirees under age 65 and active Company employees will be updated. Revisions will result in separate health insurance premium calculations for each group.

Q. What steps is Avista taking going forward to mitigate cost increases?

A. Beginning in 2017, Avista will offer a self-insured High Deductible Health Plan (HDHP) in addition to the current self-insured plan. The HDHP requires plan participants to pay all costs of medical care up to defined deductible limits. This plan will enforce the message to participants to manage their own health with an array of tools to assist them in becoming better consumers. The Company is also working closely with Mercer to evaluate and develop alternative strategies to reduce and/or maintain medical costs going forward, including:

- Plan Review – thorough review of plan metrics to evaluate any potential plan inefficiencies and target disease-management programs.
- Consideration of narrow or custom provider networks – Seeking out the best quality, highest value hospital or physician group may result in lower unit costs and better long-term outcomes. The trade-off of less choice for plan participants will need to be weighed against the financial returns these networks offer.

In summary, the Company is taking proactive steps to reduce premium increases in the coming years, which we believe will help to offset some of the increases in medical expense.

Q. Please summarize the changes in medical expense from 2015 to 2016.

A. After a prolonged period of experiencing actual claims expense lower than premium cost estimates, in 2016 Avista began to exceed those estimates. This trend is expected to continue into 2017. The factors contributing to this increase are primarily due to utilization rates, large claims, price increases and our population profile. That said, our premium rates and medical trend rates continue to be reasonable in relation to what other companies have been experiencing. In an effort to keep medical cost increases to a minimum, we have already made changes to our plan effective January 1, 2014, will offer new options to employees in 2017, and will continue to work with our underwriter to determine additional steps to be taken.

H. <u>Pro Forma Property Tax (Electric & Natural Gas)</u>

Q. Staff proposed modifications to the filed Pro Forma Property Tax Adjustment. Did Staff include all updated information in their proposal?

A. No. Staff witness Ms. Huang reduced the Pro Forma Property Tax amount by approximately $38,000 electric and increased Natural Gas expense by approximately $35,000.[22]

The Company has provided updates through the process of the case, with the latest update being included in August of 2016. This update included the impact of the revised restated property tax adjustment, as well as the inclusion of the updated production transmission (P/T) ratio. Had Staff used the information provided in the most recent update, we assume her adjustment would have been an increase of $154,000 electric and $36,000 to natural gas.

I. Pro Forma Capital Additions December 2015 AMA (Electric & Natural Gas)

Q. ICNU and NWIGU rejected the Company's pro forma adjustment to include rate base for capital investment as of year-end December 31, 2015 on an AMA basis.[23] Does the Company agree with the proposals of these parties?

A. No. Ms. Schuh specifically addresses the adjustments related to capital additions proposed by ICNU and NWIGU and why their adjustments do not fairly state costs and rate base for the rate period.[24]

J. Pro Forma 2016 Limited Capital Additions (Electric & Natural Gas)

Q. Staff, ICNU and NWIGU rejected the Company's inclusion of 2016 Limited Capital Additions adjustment and each proposed different adjustments.[25] Does the Company agree with the proposals of these parties?

[22] Exhibit No. JH-1T, page 21
[23] Exhibit No. BGM-1CT, page 36
[24] Exhibit No. KKS-8T, page 8
[25] Exhibit No. BGM-1CT, page 36

A. No. Ms. Schuh specifically addresses the adjustments related to capital additions proposed by Staff, ICNU and NWIGU why their adjustments do not fairly state costs and rate base for the rate period.[26]

K. O&M Offsets (Electric & Natural Gas)

Q. Do you agree with Staff's proposed modifications to the Company's O&M Offset adjustment?

A. No. Ms. Schuh explains within her testimony the level of capital additions expected to be added in its Modified Test Year Pro Forma Capital adjustments.[27] It is appropriate to include the O&M Offsets related to these capital projects as they represent a benefit to rate payers and reflect the actual reductions in O&M costs to be experienced during the rate period. Because the Company does not agree with the removal of certain capital costs from its Pro Forma Capital adjustments, it does not agree with the removal of O&M Offsets related to those projects.

L. Cross Check Adjustments (Electric & Natural Gas)

Q. Staff, ICNU and NWIGU did not specifically address the Cross Check Adjustments, but proposed to remove them. Do you agree with the removal of the Cross Check adjustments?

A. No. The purpose of these adjustments is to provide final cross check balances used to compare with the Company's Attrition Studies; our proposed revenue increases, however are derived directly from our attrition analyses. In addition, they are also used for the purpose of preparing the cost of service studies presented by Company witness, Ms. Knox and Mr. Miller.

[26] Exhibit No. KKS-8T, page 8
[27] Exhibit No. KKS-1T, page 37

V. AVISTA UPDATED CROSS CHECK STUDIES

Q. Beyond the Modified Test Year reflecting updated adjustments, have you also prepared an update to Cross Check Study?

A. Yes. The NOI, rate base and revenue requirement impact for each of the adjustments to the Cross Check Studies has been provided below in Table Nos. 7 (electric) and 8 (natural gas), with a description of each adjustment following. Workpapers have been provided for each of these adjustments.

Table No. 7:

Electric
Cross Check Study
(000s of Dollars)

		NOI	Rate Base	Revenue Requirement
	Avista Updated Modified Test Year	**$ 98,082**	**$ 1,413,243**	**$ 16,866**
	Avista Updates to 2017 Cross Check Study			
	Cross Check Adjustments as Originally Filed			
	Cross Check Labor Non-Exec	(422)	-	-
	Cross Check Information Tech Service Expense	(1,213)	-	-
	Cross Check Insurance Expense	(49)	-	-
	Updates to Originally Filed Cross Check Adjustments			
A	Cost of Debt and Rate of Return	-	-	26,750
B	Cross Check Capital Addition 2016 AMA	(2,426)	18,626	(839)
C	Cross Check Capital Addition 2017 AMA	(4,828)	69,028	1,412
D	Cross Check 2017 AMI Capital & Expense	(1,674)	8,792	(1,875)
E	Cross Check Property Taxes	(920)	-	184
F	Cross Check Employee Benefits	(530)	-	856
H	Reconcile 2017 Cross Check to Attrition	1,788	(42,711)	(3,251)
	Total Avista Updates to 2017 Cross Check Study	**$ (10,275)**	**$ 53,735**	**$ 23,236**
	Total Avista Modified Test and 2017 Cross Check Study	**$ 87,807**	**$ 1,466,978**	**$ 40,101**
	Avista Updates to 2018 Cross Check Study			
	Cross Check Adjustments as Originally Filed			
	Cross Check Power Supply Adjustment	(1,836)	-	-
	Cross Check Labor Non-Exec	(504)	-	-
	Cross Check Transmission Rev/Exp Adj	(127)	-	-
	Cross Check Insurance Expense	(43)	-	-
	Cross Check Information Tech/Serv Exp	(255)	-	-
	Updates to Originally Filed Cross Check Adjustments			
A	Cost of Debt and Rate of Return	-	-	10,355
G	Cross Check Planned Capital Additions 2018 AMA	(2,220)	(2,449)	174
H	Cross Check 2018 AMI Capital & Expense	(1,776)	15,183	727
I	Reconcile 2018 Cross Check to Attrition	1,786	7,109	(771)
	Total Avista Updates to 2018 Cross Check Study (And Incremental January to June 2018 Increase)	**$ (4,976)**	**$ 19,843**	**$ 10,485**
	Total 2018 Cross Check Study	**$ 82,831**	**$ 1,486,821**	**$ 50,586**

Table No. 8:

Natural Gas Cross Check Study (000s of Dollars)		NOI		Rate Base		Revenue Requirement
Avista Updated Modified Test Year	**$**	**21,851**	**$**	**285,074**	**$**	**69**
Avista Updates to 2017 Cross Check Study						
Cross Check Adjustments as Originally Filed						
Cross Check Labor Non-Exec		(108)		-		-
Cross Check Information Tech Service Expense		(298)		-		-
Cross Check Insurance Expense		(14)		-		-
Updates to Originally Filed Cross Check Adjustments						
A Cost of Debt and Rate of Return		-		-		4,950
B Cross Check Capital Add 2016 AMA		(547)		4,970		(200)
C Cross Check Capital Add 2017 AMA		(1,234)		10,172		529
D Cross Check 2017 AMI Capital & Expense		(482)		3,034		(1,022)
E Cross Check Property Tax Exp		(136)		-		(51)
F Cross Check Employee Benefits		(159)		-		257
I Reconcile 2017 Cross Check to Attrition		(792)		(3,836)		3,394
Total Avista Updates to 2017 Cross Check Study	**$**	**(3,770)**	**$**	**14,340**	**$**	**7,857**
Total Avista Modified Test and 2017 Cross Check Study	**$**	**18,081**	**$**	**299,414**	**$**	**7,926**
Avista Updates to 2018 Cross Check Study						
Cross Check Adjustments as Originally Filed						
Cross Check Labor Non-Exec		(150)		-		-
Cross Check Regulatory Amortizations		351		-		-
Cross Check Insurance Expense		(12)		-		-
Cross Check Information Tech/Serv Exp		(66)		-		-
Updates to Originally Filed Cross Check Adjustments						
A Cost of Debt and Rate of Return		-		-		2,546
K Cross Check Planned Capital Add 2018 AMA		(565)		(1,397)		92
L Cross Check 2018 AMI Capital & Expense		(631)		6,053		(1,596)
N Reconcile 2018 Cross Check to Attrition		579		1,301		494
Total Avista Updates to 2018 Cross Check Study (And Incremental January to June 2018 Increase)	**$**	**(495)**	**$**	**5,957**	**$**	**1,536**
Total 2018 Cross Check Study	**$**	**17,586**	**$**	**305,371**	**$**	**9,462**

A. Cost of Debt and Rate of Return (Electric & Natural Gas)

As noted above in Section III. A., the Company updated the Cost of Debt from 5.51% to of 5.59%, which impacts debt interest on all rate base items, as well as rate of return.

B. Cross Check Capital Addition 2016 AMA (Electric & Natural Gas)

This adjustment reflects updates for actual transfers to plant for the January through May 2016 time period and also updates the expected transfers for June through December 2016, which impacts both the 2017 and June 2018 AMA balances.

C. Cross Check Capital Addition 2017 AMA (Electric & Natural Gas)

This adjustment reflects the impact of the updates to the Capital Addition 2016 AMA adjustments above, in part B.

D. Cross Check 2017 AMI Capital & Expense (Electric & Natural Gas)

This adjustment reflects updates for the timing of transfers to plant in the 2017 time period, which impacts both the 2017 and June 2018 AMA balances. See Company witness, Ms. Schuh for further discussion of this timing.

E. Cross Check 2017 Property Tax (Electric & Natural Gas)

This update includes the impact of the revised restated property tax adjustment, as well as the inclusion of the updated production transmission (P/T) ratio impacting 2017 expenses.

F. Cross Check Employee Benefits (Electric & Natural Gas)

This adjustment reflects updates to reflect actual medical claims expense for 2016 and the most recent medical premium cost estimate for 2017 received from our medical underwriter Section III. G.

G. Cross Check Planned Capital Additions 2018 AMA (Electric & Natural Gas)

This adjustment reflects updates for actual transfers to plant for the January through May 2016 time period, which impacts both the 2017 and June 2018 AMA balances.

H. Cross Check 2018 AMI Capital & Expense (Electric & Natural Gas)

This adjustment reflects updates for the timing of transfers to plant in 2017, which impacts both the 2017 and June 2018 AMA balances. See Company witness, Ms. Schuh for further discussion of this timing.

I. Reconcile 2017 Cross Check to Attrition (Electric & Natural Gas)

The updated adjustment records a decrease in electric expense of $3,413,000 and an increase in natural gas expense of $1,159,000. This update also decreases net rate base by $42,711,000 electric, and $3,836,000 natural gas. This adjustment is necessary to reconcile with the total level of attrition deficiency as determined by the Company's updated Attrition Studies sponsored by Ms. Andrews.

J. Reconcile 2018 Cross Check to Attrition (Electric & Natural Gas)

The updated adjustment records a decrease in expense of $2,638,000 electric and $871,000 natural gas. This update also increases net rate base by $7,109,000 electric and $1,301,000 natural gas. This adjustment is necessary to reconcile with the total level of attrition deficiency as determined by the Company's updated Attrition Studies sponsored by Ms. Andrews.

Q. Does this conclude your rebuttal testimony?

A. Yes.