Exh. SLM-6T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-170485

DOCKET NO. UG-170486

REBUTTAL TESTIMONY OF

SCOTT L. MORRIS

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

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

A. My name is Scott L. Morris and I am employed as the Chairman of the Board and Chief Executive Officer of Avista Corporation (Company or Avista), at 1411 East Mission Avenue, Spokane, Washington.

Q. Have you filed direct testimony in this proceeding?

A. Yes. I have filed direct testimony in this case where I summarized the Company's proposal for a Three-Year Rate Plan. I explained why there is a continuing need for retail rate increases, not just for Avista, but for the electric and natural gas utility industry in general, as it repairs, replaces and upgrades its infrastructure. I also addressed our continuing capital investments, and how they are designed to accomplish three primary objectives: 1) provide safe, reliable service; 2) achieve high customer satisfaction; and 3) maintain a reasonable cost to customers. Finally, I briefly summarized the four ratemaking studies presented by Avista to demonstrate our need for electric and natural gas rate increases for the proposed Three-Year Rate Plan beginning May 1, 2018.

Q. What is the scope of your rebuttal testimony?

A. I will provide an overview of the Company's case, on rebuttal.[1] I will do this by addressing what I believe are the most critical issues of this case. Those issues include:

1. Should the Commission support a Three-Year Rate Plan as proposed by Avista and supported by Staff;

2. The level of capital additions that should be included in Year 1 of the Three-Year Rate Plan, and the methodology that should be used to determine that level;

[1] 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.

3. Whether a power supply adjustment has been properly supported by the Company and should be approved; and

4. Should the Commission support Avista's Long-Standing Interest Rate Hedging Program.

A table of contents for my testimony is as follows:

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Q. Are you sponsoring any exhibits that accompany your testimony?

A. No, I am not.

II. SUMMARY OF AVISTA'S ORIGINAL RATE REQUEST, REBUTTAL RATE REQUEST & THREE-YEAR RATE PLAN

Q. Would you please summarize the Company's electric and natural gas proposals included in its original filing?

A. Yes. The Company filed a Three-Year Rate Plan ("Rate Plan") as the framework for rate relief. This is what we understood to be a common objective of several parties – i.e., to break what the Commission has described as a nearly continuous cycle of rate filings by Avista over recent years.[2] Under the Rate Plan, Avista is proposing electric and natural gas revenue increases to occur May 1, 2018, May 1, 2019 and May 1, 2020. The electric and natural gas revenue increases originally proposed for the Rate Plan are shown in Table No. 1 below:

Table No. 1: Three-Year Rate Plan Summary – Original Filing

	Proposed Electric Revenue Increase	Proposed Natural Gas Revenue Increase
May 1, 2018	$61.4 million	$8.3 million
May 1, 2019	$14.0 million	$4.2 million
May 1, 2020	$14.4 million	$4.4 million

The Company's electric and natural gas requests were based on a proposed rate of return of 7.76%, with a common equity ratio of 50% and a 9.9% return on equity (ROE).

Q. What were the drivers of the Company's rate request filing?

A. Without repeating information contained in my original testimony, Exh. SLM-1T, the primary driver of the Company's rate request is the recovery of prudent and necessary capital expenditures. The other driver, on the electric side, was an increase in power supply costs.

[2] Docket Nos. UE-160228 and UG-160229, Order 06 at ¶6, fn. 5

Q. What is the Company's requested revenue requirement, <u>on rebuttal</u>?

A. Having reviewed the parties' testimony, as well as having incorporated other updated information discussed by Company witness Ms. Andrews that has occurred after the Company prepared its filing, Avista's revised revenue requirement is provided in Table No. 2 below:[3]

<u>Table No. 2: Three-Year Rate Plan Summary - Rebuttal</u>

	Proposed Electric Revenue Increase	Proposed Natural Gas Revenue Increase
May 1, 2018	$54.4 million	$6.6 million
May 1, 2019	$13.5 million	$3.7 million
May 1, 2020	$13.9 million	$3.8 million

Q. Has the Company modified its proposed cost of capital?

A. No. The Company's electric and natural gas requests continue to be based on a proposed rate of return of 7.76%, with a common equity ratio of 50% and a 9.9% return on equity (ROE).

Q. Is the Company continuing to support a Rate Plan as originally filed?

A. Yes, with one change. If the Commission approves an increase in overall power supply costs for Year 1 of the Rate Plan, Avista would agree to keep the resulting base level of power supply costs in effect for the entire term of the Rate Plan. Company witness Mr. Johnson discusses this further in his rebuttal testimony Exh. WGJ-6T.

Q. Does Staff support a Rate Plan?

[3] Company witness Mr. Ehrbar provides the rate spread of the Company's rebuttal revenue requirement, reflecting the agreed-upon rate spread included in the Settlement Stipulation filed on November 1, 2017.

A. Yes, Staff does support a Three-Year Rate Plan. Mr. Hancock states in lines 13-17, on p. 17 of Exh. CSH-1T:

> A multi-year rate plan will address the Commission's expressed concerns of breaking the pattern of annual rate filings. A properly designed rate plan would also share risks between customers and Avista, and incentivize the company to become more efficient in its operations, while providing for the opportunity to achieve the target rate of return.

Avista appreciates Staff's support of the Company's request for a Rate Plan in this case.

Q. What is the Company's response to other parties' concerns about a Three-Year Rate Plan expressed during the November 8, 2017 Public Hearing in Spokane, given the pending transaction between Avista and Hydro One?

A. In short, the purchase of Avista by Hydro One is not relevant to this case because the cost savings (net benefits) that will result, if the transaction is approved, have been identified and included as a portion of the proposed Rate Credit. Avista's decision to merge with Hydro One was driven by the unique partnership that is possible with Hydro One.[4] The merger with Hydro One will allow Avista and its customers to benefit from being part of a larger organization (the benefits of scale), while at the same time preserving local control of Avista and the retention of Avista's employees and management team, as well as its culture and its way of doing business. The transaction is not designed to target the elimination of jobs, or cost cutting that may lead to a deterioration of customer service, customer satisfaction, safety, reliability, or a lessening of charitable giving, economic development or innovation in the communities Avista serves.

[4] Docket No. U-170970, *Joint Application for an Order Authorizing Proposed Transaction*.

There will be some cost savings immediately following the closing of the transaction, such as reduced expenses associated with Avista no longer having publicly traded common stock, fewer non-employee members of the Avista Board of Directors, and other cost savings. These savings, however, will be covered by the proposed Rate Credit. Avista and Hydro One are proposing to flow through to Avista's electric and natural gas retail customers a Rate Credit beginning at the time the Proposed Transaction closes. Therefore, the costs which are currently embedded in either existing retail rates or the current rate case, which will be reduced as a direct result of the Proposed Transaction, will be immediately credited back to customers beginning at the time the Proposed Transaction closes, through the Rate Credit. Finally, Condition No. 18 to the Merger Agreement provides that Avista will file with the Commission on an annual basis a report detailing the actual cost savings that have occurred as a result of the transaction, if approved.

Q. How do the Company's original and rebuttal revenue requirements compare to Commission Staff's over the Rate Plan?

A. Illustration Nos. 1 and 2 below provide a summary of Avista's original revenue requirement request, Staff's proposed revenue requirement, and Avista's revenue requirement, on rebuttal.

Illustration No. 1: Electric Revenue Requirement[5]

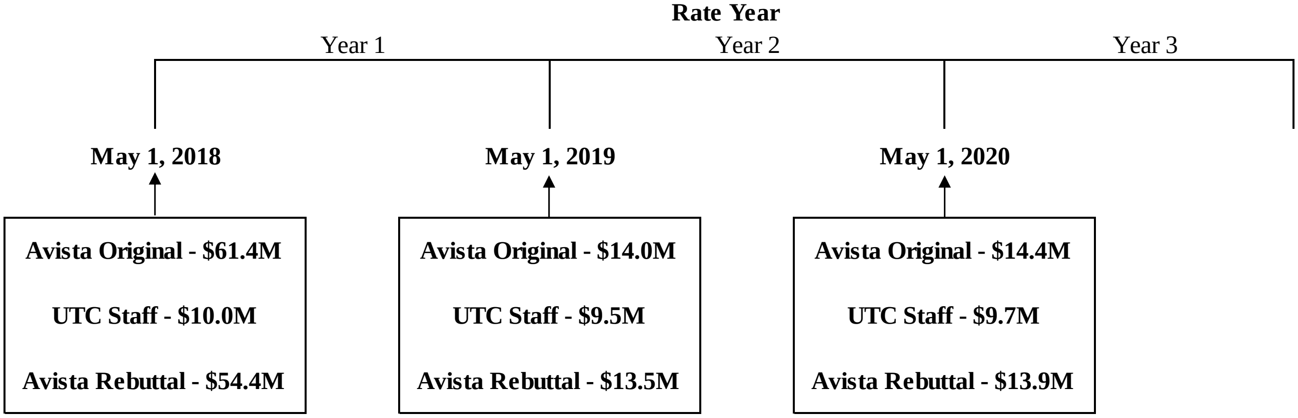
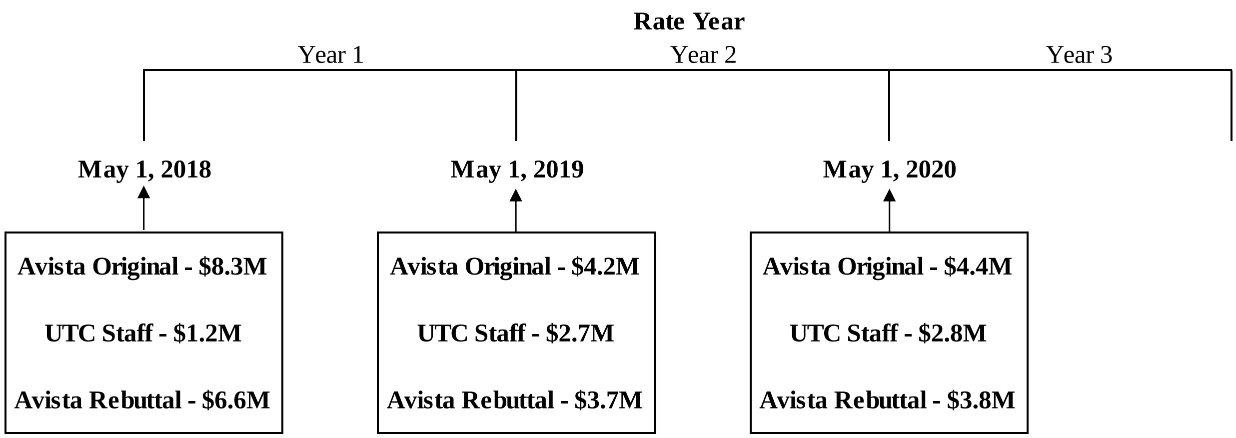


Illustration No. 2: Natural Gas Revenue Requirement[6]



Q. Please provide additional information regarding the differences between Avista's proposed Year 1 electric and natural gas revenue requirements and that of Staff.

[5] Public Counsel supports an increase of $7.5 million, ICNU supports an increase of $0.2 million in 2018, and neither support a Rate Plan. The Energy Project did not perform a revenue requirement study.
[6] Public Counsel supports an increase of $1.6 million, NWIGU supports a decrease of $0.5 million for 2018, and neither support a Rate Plan. The Energy Project did not perform a revenue requirement study.

A. Ms. Andrews' in Exh. EMA-10T identifies the primary differences between Avista and Staff's electric and natural gas revenue requirement positions for Year 1, which are summarized in Table No. 3 below.

Table No. 3

Line:	Reconcilation of Avista Rebuttal versus Staff Revenue Requirement - Year 1 (000s)			Electric	Natural Gas	
		Electric	Nat. Gas			
1	**Staff Filed**			**$ 10,034**	**$ 1,107**	
2	Power Supply			$ 16,609	-	See Company witnesses Kalich / Johnson
	Miscellaneous Contested Adjustments:			$ 1,690	$ 234	See Andrews
3	Working Capital	$ (75)	$ 234			
4	Pro Forma Property Tax (1)	$ 694	-			
5	MT SB #363 Hydro Fee	$ 1,071	-			
6	Net Capital Adjustments			$ 12,632	$ 2,547	See Company witnesses Schuh & Andrews
7	Cost of Capital			$ 13,422	$ 2,742	See Company witnesses Thies / McKenzie
8	**Avista Rebuttal**			**$ 54,387**	**$ 6,630**	

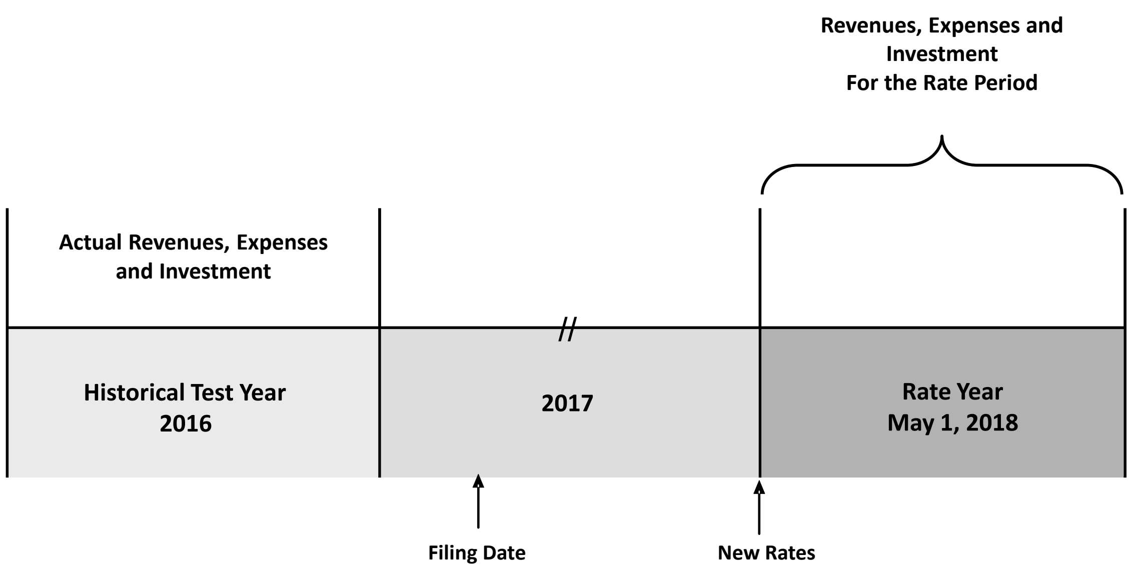
(1) Avista believes Staff errorred in its calculation of its electric pro forma property tax adjustment. Once corrected, Avista and Staff would agree.

Q. Do you believe that Staff's proposed revenue requirement for electric and natural gas service provide the Company with the opportunity to earn its allowed return in the rate effective periods?

A. No, I do not. The revenue requirement for Year 1 was developed through a pro forming process of the 2016 historic test period. Years 2 and 3 were built on the use of a revenue growth factor, or "K factor", as previously employed by the Commission to set rates for Puget Sound Energy (PSE). Both the Company and Staff used the pro formed Rate Year 1 (May 1, 2018) as the starting point for Years 2 and 3, and built off of that. Because of that, it becomes all the more important to get the pro forming process for the first year right, because everything escalates from there. Get it wrong, and the problem compounds itself, with even greater revenue requirement deficiencies in Years 2 and 3.

As Ms. Andrews describes in more detail in her rebuttal testimony (Exh. EMA-10T), the proposed revenue increases supported by Staff (and to a greater degree ICNU, NWIGU and Public Counsel) will not provide the Company with a reasonable opportunity to earn its allowed rate of return. The reason is quite simple – the combination of revenue, expense, and investment will not be in general alignment. Illustration No. 3 below generally illustrates the objective of ratemaking, which is to properly match the level of revenue, expense, and rate base for the year rates are in effect.

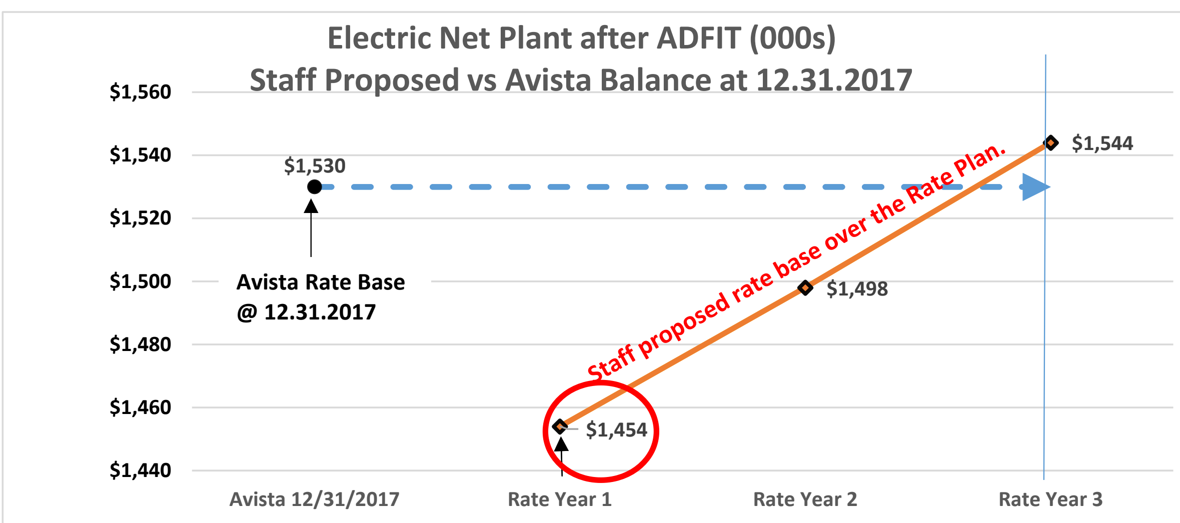
<u>Illustration No. 3: Ratemaking Objective</u>



Ratemaking's objective is to properly "match" the revenues, expenses and rate base that will exist during the period new rates are in effect. This so-called "matching" principle has long been recognized as a hallmark of successful regulation. If ratemaking is to achieve its goal, revenues, expenses and investment for the rate period (in this case May 1, 2018 – April 30, 2019) must be in alignment or "matched." Stated differently, if the Commission were to only use levels of rate base reflected in the 2016 historical test year (as shown above), and if it were to make extremely selective pro forma adjustments to rate base reaching out into 2017 as Staff has done, the end result would still not reflect levels of rate base that will be in service during the "rate year" of May 1, 2018 – April 30, 2019. As such, there will not be a proper "matching" of revenues, expenses and investments for the rate year. With the major driver of the Company's general rate case being related to capital (rate base), the substantial difference between the level of rate base supported by the Company, and that of Staff, does not allow for the proper matching.

Illustration No. 4, excerpted from Ms. Andrews' rebuttal testimony (Exh. EMA-10T), shows that the level of Washington electric rate base at December 31, 2017, if the Commission were to accept Staff's case, would not be reflected in rates <u>until Year 3</u> of the Rate Plan (i.e., May 1, 2020):

<u>Illustration No. 4: Staff's Net Plant Compared to Avista's at December 31, 2017</u>



Q. What would be the combined Washington return on equity ("ROE") for Avista using Staff's and the other parties' proposed revenue requirements?

A. As discussed by Ms. Andrews in Exh. EMA-10T, Staff's proposed revenue requirement for electric and natural gas would result in earned ROEs of 8.1% and 8.0%, respectively for 2018. For Public Counsel and ICNU/NWIGU, their proposed electric revenue requirements would result in ROEs of 7.8% and 7.2%, respectively, with natural gas results at 8.1% and 7.5%, respectively. These results reflect a reduction of between 140 to 230 basis points below that currently authorized (9.5%).

Q. But isn't it the viewpoint of Staff that this lag in cost recovery is an inevitable part of utility ratemaking?

A. Yes. Mr. Hancock, who provides an overview of regulatory lag in his testimony, states that "regulatory lag exists for administrative reasons; it is an unavoidable business reality for a regulated utility and its regulator."[7] The biggest issue, from the Company's perspective, is <u>how much regulatory lag is enough</u>.

Q. What do you mean by that?

A. Avista in its original filing <u>did not</u> propose a revenue requirement that attempted to eliminate all regulatory lag. As I discussed earlier, Avista included capital projects through 2017, and did not otherwise seek to include in its Year 1 revenue requirement capital recovery for projects in January–April 2018 (the period before rates go into effect), or any capital in the actual May 1, 2018 rate year. Avista will absorb those costs – i.e., regulatory lag. However, the level of capital included by Staff in their revenue requirement is so deficient

[7] Exh. CSH-1T, p. 7, ll. 6-7.

and would result in so much "lag", that Avista would not be able to cut capital and expenses enough to be able to have a reasonable opportunity to earn its allowed return.

Q. How much "regulatory lag" would Avista face if the Commission adopted Staff's revenue requirements?

A. Ms. Andrews in Exh. EMA-10T explains that Staff's recommended level of rate base for Year 1 would result in a combined electric and natural gas rate base regulatory lag of over $100 million annually over Washington's Three-Year Rate Plan, and an annual combined revenue loss of between $21 million and $25 million. This goes well beyond merely providing an incentive to better manage costs; it cuts into the very marrow of cost recovery for prudent plant additions. In doing so, it precludes the Company from any reasonable opportunity to earn its authorized rate of return. I will discuss in the next section of my testimony the amount of regulatory lag that Avista will absorb, even under its own proposals on rebuttal.

III. STAFF'S PRO FORMA CAPITAL ADJUSTMENTS WOEFULLY UNDERSTATE THE LEVEL OF PLANT-IN-SERVICE PRIOR TO THE START OF THE MAY 1, 2018 RATE YEAR

Q. Please explain how Staff arrived at its level of capital additions included in Year 1 of the Rate Plan.?

A. As Company witnesses Schuh (Exh. KKS-3T) and Andrews (Exh. EMA-10T) discuss on rebuttal, for Year 1 of the Rate Plan, Staff began with end-of-period results for 2016, and did only very limited pro forming of capital additions in 2017, capturing only 7 out of 121 projects that will be in service and used and useful in 2017 – i.e., before the start of the

May 1, 2018 rate year.[8] Staff only selected the 7 projects for inclusion based on its application of a "threshold" of 0.5% of net plant, thereby excluding any projects less than $8.6 million for electric and $1.7 million for natural gas.[9] To make matters worse, for the 7 projects selected, Staff only included transfers to plant through August 2017,[10] thereby leaving a substantial portion of 2017 rate base associated with just those 7 projects on the "cutting room floor" (by not going through December 2017).

Ms. Schuh and Ms. Andrews go on to observe that the Company, in its initial filing, provided extensive documentation for each of the 121 projects[11], including detailed business cases explaining the need for each, the timing and the cost. In short, all of the information necessary for Staff and parties to begin their audit process was provided in the Company's filing in May 2017. And yet, Staff only selected 7 projects to be included during the five months prior to the filing of its testimony – leaving 114 projects and $232.6 million (gross plant) of plant increases in 2017 unaccounted for – all of which are necessary in the ordinary course of business.

Ms. Schuh's testimony notes that this "threshold" of 0.5% of net plant is arbitrary and was simply drawn from an unrelated "budget" rule requiring the filing of annual budget reports (WAC 480-140-040).[12] It was never meant to provide the final answer for ratemaking,

[8] As explained by Ms. Andrews, at p. 9, footnote 10 of Exh. EMA-10T, Staff and Avista disagree on the inclusion of depreciation expense within the 2016 AMA to EOP adjustment. Staff excludes depreciation expense, whereas Avista includes depreciation expense to reflect recovery of (return of) the rate base additions from 2016 AMA to EOP, not just the return on those additions (as proposed by Staff). Because this depreciation expense is excluded in Year 1, there is no opportunity to recover it in Years 2 and 3. The resulting impact of Staff excluding the annualized depreciation expense within its 2016 AMA to EOP adjustment is approximately $4.0 million for electric and $767,000 for natural gas, annually.
[9] Exh. KBS-1T, p. 19, ll. 22-23.
[10] Exh. KBS-1T, p. 18, l. 8.
[11] Exh. HLR-6, Exh. JMK-2, Exh. SJK-4.
[12] Exh. KBS-1T, p. 18, ll. 11-12.

but it has become such.[13] Furthermore, although the use of this "threshold" was employed by the Staff in the Company's prior rate cases (over its objection), it only served as the starting point for Staff's analysis in those prior cases - not the ending point as is the case here. In the prior cases, after using this "threshold", Staff determined that it did not produce reasonable results and added an attrition adjustment to the pro formed historic test period.

Q. Was Staff's application of the 0.5% threshold applied in the same manner for Avista as utilized in Puget Sound Energy's most recent general rate case?

A. As explained by Ms. Schuh, not only did Staff employ an arbitrary threshold of 0.5% of net plant, but it did so in a manner entirely inconsistent with the way it applied the threshold in the ongoing Puget Sound Energy rate case.[14] In that case, Staff witness Wright filed testimony that acknowledged that, unless the "threshold" was applied to net plant on a "functional basis" (i.e., 0.5% of net plant applied to each category of generation, transmission, distribution, and, general plant respectively) it would not produce reasonable results.[15] A mere three months after Mr. Wright filed that testimony on behalf of Staff, Staff witness Scanlan in this case ignored such an approach altogether and applied the threshold calculation to all plant in the aggregate. Each approach produces profoundly different results. Staff's application of their "threshold" to all aggregated plant produces an $8.7 million "threshold" for electric and

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[13] The Commission, in Docket No. UE-150204 and UG-150205, did not state that the "threshold" in WAC 480-140-040 should be used for all future cases; rather, the Commission states that it was appropriate in that case. To that end, the Commission stated in Order 06, at ¶82 in Docket Nos. UE-160228 and UG-160229 (Avista's 2016 general rate case) that it has "… not established bright-line standards governing the timing or the number of adjustments that can be accepted in a given case, and **has not established a minimum size for pro forma adjustments** to be recognized." (emphasis added)

[14] Docket No. UE-170033 and UG-170034.

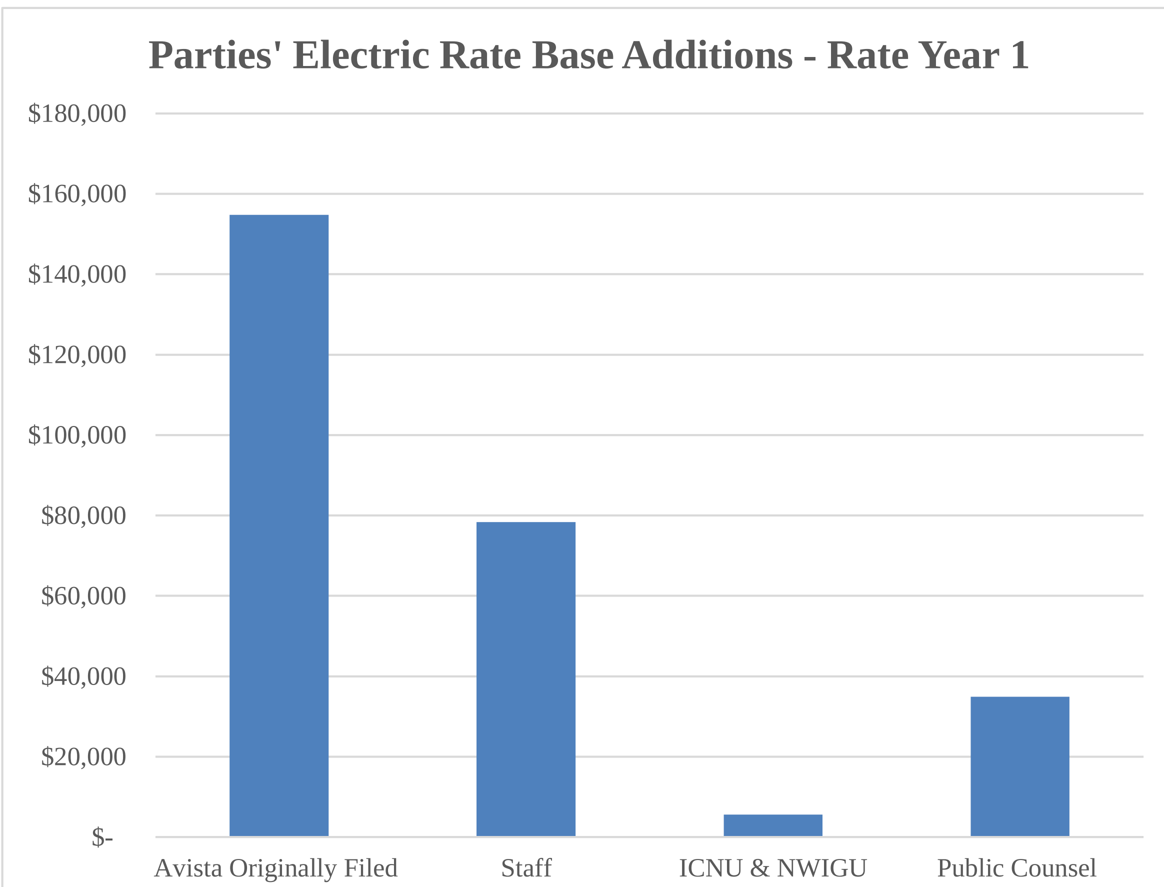
[15] Id., Exh. ECW-1T, p. 7, ll. 3-6: "Staff found smaller adjustments that would otherwise be reasonable, such as Distribution plant adjustments, would not be captured if the threshold were only applied to gross rate base. Therefore, Staff refined the standard in this case, applying the one-half of one percent threshold to **net utility plant in service by category** instead of rate base. **Staff believes the refinement will allow a better review of plant adjustments in this and future, rate cases."** *(Emphasis added)*

a $1.7 million "threshold" for natural gas service, thereby excluding the vast majority of plant-in-service for audit purposes.

Q. What level of Rate Base did Staff and the other parties propose, as compared to what Avista proposed in its initial filing?

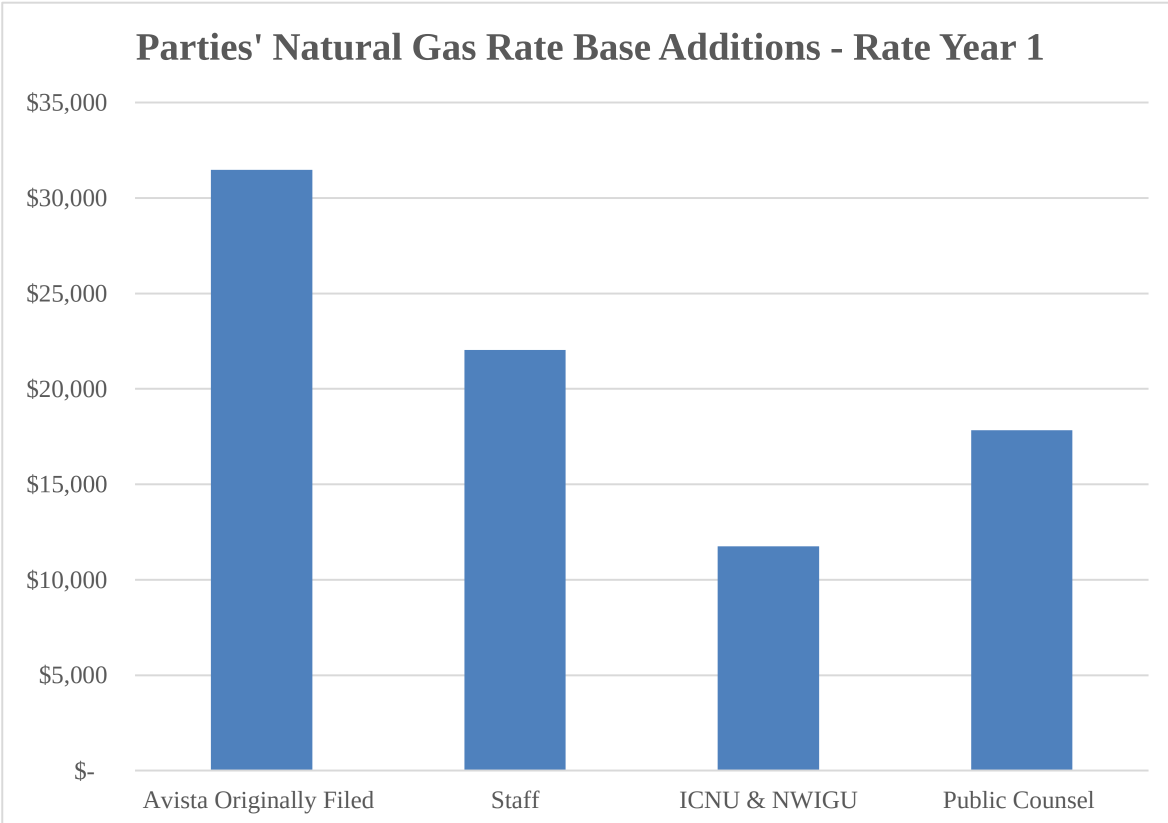
A. Illustration Nos. 5 and 6 below, taken from Ms. Schuh's rebuttal testimony, provides a comparison of electric and natural gas net plant after ADFIT ("rate base") additions for 2017, as well as an adjustment to end-of-period 2016 balances, as proposed by the Company and other parties, as used for the start of the first rate year effective May 1, 2018.[16]

<u>Illustration No. 5: Electric</u>



[16] Avista and Staff included an end-of-period 2016 adjustment, while ICNU/NWIGU and Public Counsel did not. The sources for these balances are as follows, for electric and natural gas, respectively: Avista—Exh. EMA-3 and Exh. EMA-7; Staff—Exh. JH-2 and Exh. JH-3; ICNU/NWIGU—Exh. BGM-3 and Exh. BGM-4; and Public Counsel—Exh. MEG-11 and Exh. MEG-12.

Illustration No. 6: Natural Gas



These illustrations show that the rate base adjustments, as supported by the other parties, fall well below the level of plant-in-service that will be in place and serving customers during the first year of the Rate Plan. They also illustrate why the Company does not agree with the use of an arbitrary "threshold" to limit the number of pro forma projects included in the revenue requirement, as well as limiting the dollar amount of those few capital projects by using a cut-off point of August 31, 2017, as proposed by Staff.

IV. <u>THE COMPANY'S REBUTTAL POSITION MAKES USE OF A "FUNCTIONALIZED" APPROACH FOR ESTABLISHING A THRESHOLD FOR AUDIT PURPOSES</u>

Q. What is the Company proposing on rebuttal, in an effort to find a common ground with Staff?

A. In order to find common ground, on rebuttal, the Company has revised its requested revenue requirement for May 1, 2018 downward from $61.4 million to $54.4 million for electric, and from $8.3 million to $6.6 million for natural gas. The Company arrived at this lower level, in part, by using Staff witness Mr. Cooper's approach in the ongoing PSE case in arriving at a "threshold" on a "functionalized" basis (as discussed by Ms. Schuh in Exh. KKS-3T). Using this methodology, Avista has included 36 out of 121 projects that will be in service in 2017, based on <u>actual transfers to plant</u> (i.e., plant that is in-service and used and useful) through <u>October 2017</u>.[17]

This approach, all else being equal, adds $62.5 million of pro formed electric rate base and $16.5 million of pro formed natural gas rate base for 2017, producing a corresponding increase in electric revenue requirement of $11.6 million and for natural gas $3.2 million over Staff's $1.8 million (electric) and $1.3 million (natural gas) revenue requirement. Illustration Nos. 7 and 8 provides a similar comparison as Illustration Nos. 5 & 6, only including Avista's rebuttal level of rate base:

[17] Company witnesses Mr. Kinney, Ms. Rosentrater, and Mr. Kensok provide further information related to the projects that have been included using the Company's "functionalized threshold" methodology.

Illustration No. 7:

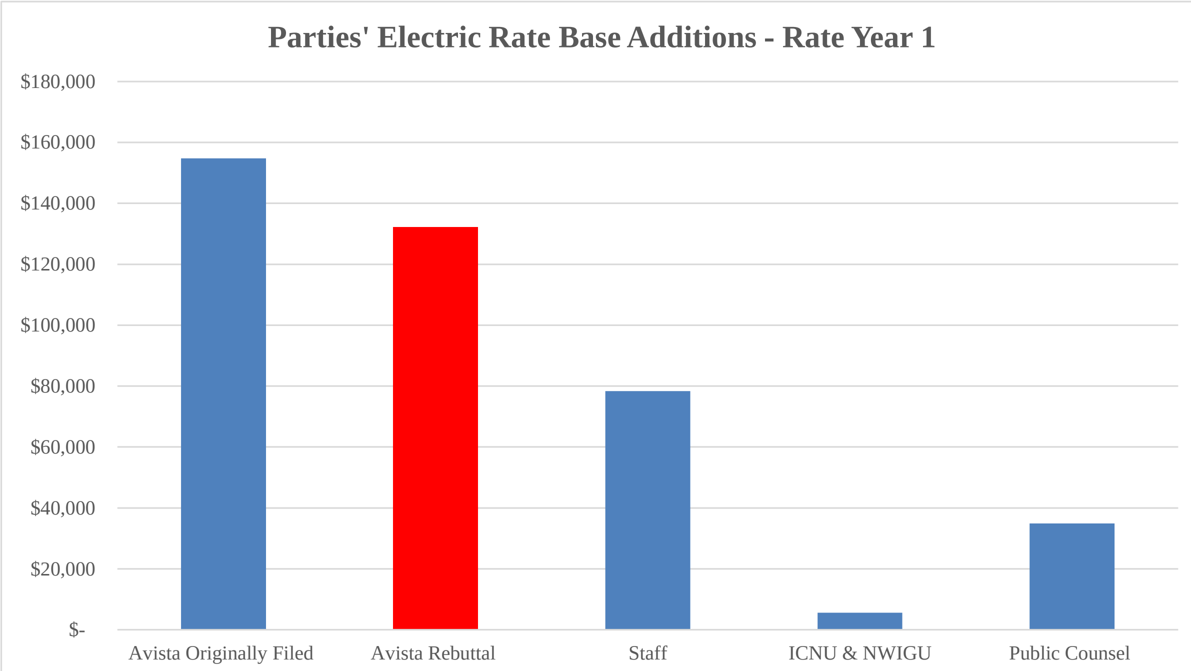
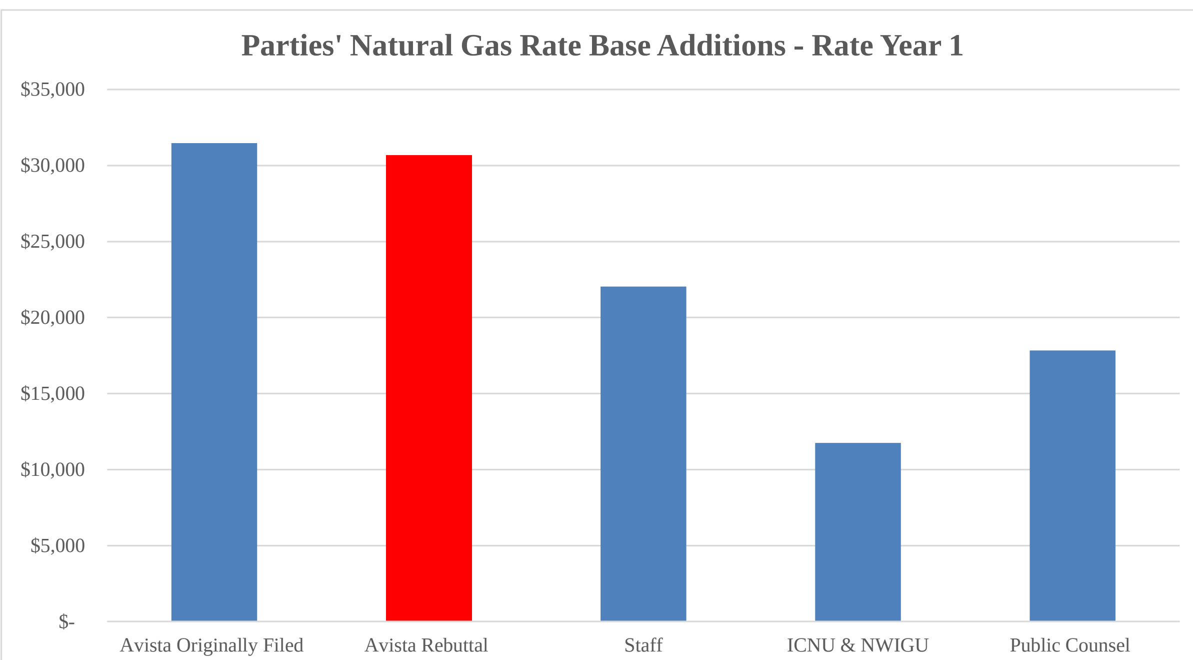


Illustration No. 8:



Q. In Avista's efforts to find "common ground", how much ratebase has it still <u>excluded</u> from its May 1, 2018 revenue requirement?

A. Utilizing Avista's "functionalized threshold" still leaves unaccounted for in rates, an additional <u>85 projects</u> and is approximately $23 million less in overall rate base than would be in service in 2017. It is only offered up by the Company as a way for the Commission to find a possible common ground between Staff and the Company. It also provides a "path" for the Commission that would be acceptable to the Company, albeit one that would mean that it would still experience "regulatory lag" in the recovery of nearly $100 million of capital additions over the three year period of the Rate Plan. The Company may need to address this by further examining its capital spending on projects it otherwise believes to be necessary.

Q. With this regulatory lag, why then does the Company continue to invest at a significant level in plant?

A. In short, the Company believes that the increased level of capital spending is necessary at this time and is supported by the various business units.[18] As Company witness Mr. Thies discusses in his direct and rebuttal testimonies, the Company's practice has actually been to constrain the level of capital investment each year, such that not all of the prioritized

[18] Avista's capital investments originate from the following six major "investment drivers":

1. Respond to customer requests for new service or service enhancements;
2. Meet our customers' expectations for quality and reliability of service;
3. Meet regulatory and other mandatory obligations;
4. Address system performance and capacity issues;
5. Replace infrastructure at the end of its useful life based on asset condition; and
6. Replace equipment that is damaged or fails, and support field operations.

An explanation of each of these drivers, as well as examples of specific capital projects under these drivers, was provided in the Infrastructure Investment Plan (Exh. SLM-3).

projects and programs[19] will be funded in a given year at the level requested. Avista believes that holding capital spending below the level requested accomplishes several important objectives, including:

- ***Promotes Innovation*** - Encourages ways to satisfy the identified investment needs in a manner that may identify potential cost savings, defer implementation, or other creative options or solutions.
- ***Balances Cost and Risk*** – Captures the customer benefits of deferring needed investments by prudently managing the cost consequences and risks associated with such deferrals.
- ***Efficiently Allocates Capital*** – Ensures that the highest-priority needs are adequately funded in the most efficient and effective way.
- ***Reduces Variability*** - Moderates the magnitude of year-to-year variability to avoid excessive rate impacts, and more efficiently optimizes the number and cost of personnel necessary to carry out the capital projects.

Avista currently has chosen to stabilize the level of annual capital spending at what can be described as a constrained level of $405 million, in an effort to accomplish the objectives described above. The dollar amount of capital projects requested by departments with the amounts approved by the Company is provided in Table No. 4 below. The dollar amounts for projects that were delayed (not approved) are also shown:

[19] "Project" refers to an individual investment for a specific period of time. "Programs" represent investments that address systemic needs that are ongoing with no recognized endpoint, such as the wood pole management program. For ease of reference, the term "capital project" will be used to represent both capital projects and capital programs.

Table No. 4: Capital Project Requests/Approvals[20]

Year	Requested	Approved	Delayed	% Capital Delayed
2012	$269	$250	$19	8%
2013	$320	$250	$70	28%
2014	$386	$331	$55	17%
2015	$404	$355	$49	14%
2016	$451	$375	$76	20%
2017	$461	$405	$56	14%
2018	$455	$405	$50	12%
2019	$531	$405	$126	31%
2020	$556	$405	$151	37%

Q. How much "regulatory lag" would Avista face if the Commission adopted Avista's revenue requirements on rebuttal?

A. As Ms. Andrews states, Avista, for its part on rebuttal, has essentially agreed to include a combined electric and natural gas rate base regulatory lag of $35 million to $50 million annually over the Rate Plan, and a revenue requirement loss of approximately $7 to $10 million annually. This compares to the regulatory lag of over $100 million **annually** of plant over the Rate Plan that would result from Staff's proposals. This would translate into an **annual** combined revenue loss of between $21 million and $25 million.

[20] From Exh. MTT-6T, Table No. 1.

V. PARTIES' CHALLENGES TO THE COMPANY'S POWER SUPPLY ADJUSTMENTS ARE UNFOUNDED

Q. How much of the Company's electric revenue requirement is accounted for by the Power Supply Adjustment in this case?

A. The Power Supply Adjustment (which also is used to establish the Energy Recovery Mechanism ("ERM") base) accounts for approximately $16 million of the Company's overall revenue requirement. It has not been adjusted since January 1, 2016, nearly 2.5 years prior to May 1, 2018, Year 1 of the Rate Plan. The Company sought to adjust it effective September 1, 2017 through its Power Cost Rate Adjustment, but the Commission denied the adjustment, believing it more important to address it in the overall context of this general rate case. Now is the time to do so.

As testified to by Company witnesses Kalich (Exh. CGK-4T) and Johnson (Exh. WGJ-6T), this Power Supply Adjustment has been an integral part of rate cases since at least 2003. The methodology, while refined over time based on suggestions of Staff and intervenors, has remained basically intact and has been consistently applied.

Q. Have Staff, ICNU or Public Counsel provided specific analyses or proposals to eliminate Avista's proposed power cost adjustment?

A. No. Neither Staff,[21] nor ICNU,[22] nor Public Counsel[23] have provided any empirically-based analysis to support removing entirely the Company's $16 million increase in pro forma power costs over the amount in current base rates. In fact, there is no fact-based evidence to support any specific reductions in expenses. They provide no alternative analysis

[21] See generally Exh. DCG-1T.
[22] See generally Exh. BGM-1T.
[23] See generally Exh. RSW-1T.

– i.e., nowhere for the Commission to land other than an outright rejection of the <u>entire</u> adjustment. Rather, they simply assume that, because Avista did not perfectly forecast costs during a period of rapidly falling expense, there must be something inherently or intentionally biased in its power cost modeling, and that this bias somehow offsets other undisputed power cost increases. The problem with this position, however, is that they have not performed any alternate empirical analysis whatsoever, choosing instead to lodge "scattershot" criticisms of the Company's model. They simply argue that Avista's entire proposed power cost adjustment should be eliminated.

As such, they leave the Commission with no place to go, other than accepting or rejecting outright the Company's analysis. That is unreasonable on its face, when we know that the Portland General Electric (PGE) contract expired in 2016, and is no longer providing $10.6 million in net ratepayer benefits (Washington share), and yet these non-existent benefits <u>continue</u> to be flowed through the ERM.[24]

Q. If the Company were to accept *<u>all</u>* of Mr. Gomez's adjustments to the Company's model used in its Power Supply Adjustment, what is the result?

A. As Mr. Kalich states in his rebuttal testimony Exh. CGK-4T, if one made the adjustments recommended by Staff witness Mr. Gomez, it would actually serve to *<u>increase</u>* total system power supply costs by ***$2.7 million***. The same could be said of Public Counsel witness Ms. Wilson; when she asked the Company to rerun the power supply model with her suggested inputs, it actually *<u>increased</u>* total system power supply costs by ***$5.6 million***.[25]

[24] Exh. WGJ-6T, p. 14.
[25] See Exh. CGK-5, p. 13.

Q. Did Mr. Gomez review the entire history of power supply costs and the ERM in his testimony?

A. No, he did not. Mr. Gomez purposefully selected years 2011 through 2016 for review, leaving out years 2003 through 2010.[26] As Mr. Johnson states, Mr. Gomez contends the Company retained $24.6 million of savings through biasing its rate case power cost forecast methodology to over-estimate future power costs. This is despite the fact that these power cost forecasts have been thoroughly reviewed in Avista's rate cases over the past 15 years (with subsequent ERM Annual Filings approved by the Commission). Through this process, the present forecasting model has been revised, refined, and approved by the Commission in many prior cases.

The ERM has been in place for 13 full years beginning in 2003. Over the entire period, power costs have been both higher and lower than the baseline (authorized) amount in base rates. As Mr. Johnson explains in Exh. WGJ-6T, for the first seven years the Company absorbed <u>$41.4</u> million in unrecovered power costs and customers paid $60.3 million in surcharges. Those were not good times for anyone.[27]

Power costs have decreased significantly since 2011, and the sharing bands in the ERM have allowed the Company to retain a portion of the overall reduction in power costs. Power costs have come down by a cumulative $133.1 million in the years 2012 through 2017 compared to the level of costs in 2011. This is unequivocally a favorable development and is very beneficial for customers. Of the total $133.1 million reduction in costs, <u>**customers have received $108.5 million**</u> (or 82%) in both base power supply cost reductions and ERM

[26] Exh. DGC-1T, p. 8, l. 8.
[27] Exh. WGJ-6T, p. 9.

rebates, and the **<u>Company has retained $24.6</u>** million (or 18%) through the sharing bands of the ERM. [28]

VI. <u>COMPANY WITNESS THIES, ON REBUTTAL, ADDRESSES CHALLENGES TO AVISTA'S LONG-STANDING INTEREST RATE HEDGING PROGRAM</u>

Q. Staff witness Mr. McGuire excluded the 2016 settlement of interest rate swaps from the Company's filed cost of debt. Do you agree?

A. No. As explained by Mr. Thies on behalf of the Company (Exh. MTT-6T), satisfactory resolution of the "interest rate hedging" issue raised by Staff is also of utmost importance. If Staff's position is adopted, it will cause Avista to expense <u>a $33.6 million write-off</u> of interest rate hedging loss <u>in 2018</u>. As Mr. Thies testifies, all interest rate hedges were conducted in accordance with an interest rate hedging program shared with Staff prior to its implementation in 2013, and consistently administered through time. No objections were raised then and none have been raised in any of the prior three general rate cases since then. Indeed, even though other Commissions' decisions are not determinative here in Washington, both Idaho and Oregon have reviewed Avista's Interest Rate Risk Management Plan and have accepted Avista's weighted average cost of debt, <u>including</u> the costs of the 2016 settled interest rate swaps. At the end of the day, the purpose of the hedging program was to decrease the impact of interest rate volatility experienced in customer rates, in much the same way as the Company engages in natural gas price hedging based on the consistent application of hedging policies over time.

[28] Exh. WGJ-6T, pp. 10-11.

Q. Staff witness Mr. McGuire states that Avista "operates its hedging practices in a manner inconsistent with Commission Policy."[29] Do you agree with this statement?

A. No. As Mr. Thies explains, Mr. McGuire's reference is to the Commission's Policy Statement that was issued on March 13, 2017 related to natural gas hedging.[30] Avista's Plan and the hedges that were settled in 2016 were in place prior to the adoption of the Commission Policy on natural gas hedging. The hedges were entered into during the period April 2013 through July 2016.

As explained further by Mr. Thies, Avista's plan is well designed and utilizes hedge ratios, hedge windows, rate triggers that factor in volatility, and on-going market analysis. Avista in fact 1) had a prudent interest rate risk management plan in place, 2) followed the Plan, 3) made reasonable hedging decisions factoring in changing interest rate environments and 4) appropriately managed interest rate risk for customers. No one likes that the hedges in question were out of the money, but one must remember why the Company is hedging to begin with. As stated on p. 2 in the Company's Interest Rate Risk Management Plan (Exh. MTT-3C), "The goal of Avista Corp's Interest Rate Risk Management Plan ('the Plan') is to maintain a competitive cost of capital while reducing cash flow volatility and the associated retail rate impacts related to future interest rate variability." The Company prudently executed on that plan, and therefore the costs associated with the interest rate hedges should be included in the Company's cost of debt.

[29] Exh. CRM-1T, p. 21, ll. 10
[30] Docket No. UG-132019, "Policy and Interpretive Statement on Local Distribution Companies' Natural Gas Hedging Practices."

VII. SUMMARY OF COMPANY WITNESSES

Q. Would you please provide a brief summary of the testimony of the other witnesses representing Avista in this proceeding?

A. Yes. Even though I have alluded to this testimony above, I will summarize their rebuttal testimony as follows:

Mr. Mark Thies, Senior Vice President, Chief Financial Officer and Treasurer, explains that the Company has followed its capital budgeting processes to establish an appropriate capital spending level that balances both the risks and consequences of not investing into the system. A 50% common equity ratio is appropriate, consistent with the Commission's ability to set a capital structure that can be hypothetical, and provides a reasonable balance between safety and economy. Further, the cost of debt as filed at 5.62% is the most appropriate cost of debt that should be used for the rate-effective period beginning May 1, 2018. Contrary to the assertions of Staff, he explains that the Company developed and followed an Interest Rate Risk Management Plan which we believe manages risk and reduces interest rate variability on the customers' behalf. Finally, he provides the Company's response to the impact of the Hydro One merger and proposed federal tax reform.

Mr. Adrien McKenzie, Vice President of Financial Concepts and Applications (FINCAP), Inc., responds to Staff and intervenor testimony concerning the fair return on equity (ROE) for Avista. Mr. McKenzie concludes that the cost of equity recommendations of Mr. Parcell (9.1%), Mr. Gorman (9.1%), and Mr. Garrett (7.0% and 9.0%) are simply too low and fail to reflect the risk perceptions and return requirements of real-world investors in the capital markets.

Ms. Elizabeth Andrews, Senior Manager of Revenue Requirements, explains that the Company's requests have been adjusted downward on rebuttal to reflect updated information and certain adjustments as proposed by Staff or other intervening parties. Next, she discusses that the drivers of the Company's need for rate relief relates to capital additions, and how the Company has reduced the level of capital included on rebuttal in an effort to find "common ground" on revenue requirement with Staff. Her testimony also speaks to the severe impact on the Company from regulatory lag, if rate year levels are not properly set, stressing the importance of setting sufficient rates in Rate Year 1, as the Company would not have an opportunity to file a new general rate case for the remaining two years of the Rate Plan following Rate Year 1.

She also discusses the Company's revised revenue growth factors (K-Factor) used during the Rate Plan to determine Rate Year 2 and 3 revenue increases, which reflects agreement, in part, with the revenue growth factors proposed by Staff. She provides an explanation of the adjustments included in the electric and natural gas rebuttal revenue requirements per the Company's revised study results, after reflecting corrections and updates that have been identified through the process of this case, as well as discusses the remaining contested adjustments. Finally, Ms. Andrews' provides Avista's response to ICNU and NWIGU's attrition study analyses, showing that their recommendations do not lead to reasonable results.

Ms. Karen Schuh, Senior Regulatory Analyst, explains the fact that the ratemaking studies prepared by Staff and other parties do not reflect a level of plant-in-service that will benefit customers during the Rate Plan. She provides the Company's revised "functionalized threshold" proposal on rebuttal for the level of rate base that should be included in customers' rates. Finally, Ms. Schuh discusses the Parties' comments on the Company's upcoming depreciation study, and the capital reporting the Company is proposing for Years 1, 2, and 3 of the Rate Plan.

Mr. Scott Kinney, Director of Power Supply, addresses the Company's generation capital projects included in the Company's pro forma capital adjustment based on a "functionalized" threshold as discussed by Company witness Ms. Schuh. He also addresses Staff's commentary about Colstrip capital expenditures, and Public Counsel's Energy Imbalance Market evaluation request.

Ms. Heather Rosentrater, Vice President of Energy Delivery, addresses the Company's Transmission, Distribution (electric and natural gas) and General Plant capital projects included in the Company's pro forma capital adjustment based on a "functionalized" threshold as discussed by Company witness Ms. Schuh.

Mr. Jim Kensok, Vice President and Chief Information and Security Officer, addresses the Company's Information Service / Information Technology (IS/IT) capital projects included in the Company's pro forma capital adjustment based on a "functionalized" threshold as discussed by Company witness Ms. Schuh.

Mr. Clint Kalich, Manager of Resource Planning & Power Supply Analyses, refutes specific Dispatch Model-related concerns raised by the parties, and shows why the Company's case provides an appropriate level of increase, and that an outright rejection of the power supply adjustment is unreasonable.

Mr. William Johnson, Wholesale Marketing Manager, rebuts Staff's general contention that there must be some inherent bias in the Company's power cost forecasting methodology that consistently overstates power costs and that this has harmed customers and unduly benefitted the Company. He also explains why power supply costs in 2017 have been lower than authorized, even though the Company did not receive a reset of base power supply costs in the Company's 2016 general rate case.

Mr. Kevin Christie, Vice President, External Affairs and Chief Customer Officer, provides the Company's response to Staff testimony regarding the natural gas line extension allowance program, electric-to-natural gas fuel conversion program, and goals set forth and approved by the Commission for the Company's Low-Income Rate Assistance Program. He also responds to The Energy Project's testimony regarding increased funding for the Company's low-income weatherization program, and the ICNU's testimony regarding funding proposals for the Company's demand-side management programs.

Mr. Patrick Ehrbar, Director of Rates, explains that the electric cost-of-service and rate spread proposal of ICNU should be rejected, given the cost of service/rate spread/rate design Settlement Stipulation filed in this case. He also responds, affirmatively, to the decoupling proposals of Commission Staff.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.