Exh. ECO-6T
Dockets UE-170485/UG-170486
Witness: Elizabeth C. O'Connell

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-170485 and UG-170486 (*Consolidated*)**

CROSS-ANSWERING TESTIMONY OF

Elizabeth C. O'Connell

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Cost of Service and Rate Spread

December 1, 2017

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I. INTRODUCTION

Q. Please state your name.

A. Elizabeth C. O'Connell.

Q. Are you the same Elizabeth C. O'Connell who testified previously in this case?

A. Yes.

Q. Please explain the purpose of your testimony.

A. My testimony responds to the proposals concerning cost of service and rate spread presented by ICNU witness Robert Stephens. Staff witness Ms. Jennifer Snyder will provide Staff's response to Mr. Stephens's proposals for changes to Avista's demand-side management contributions and a new demand-response program, which Staff believes are more appropriately addressed as conservation issues.

II. COST OF SERVICE

Q. Please summarize ICNU's testimony related to cost of service issues.

A. Mr. Stephens requests that the Commission not wait for the results of the generic proceeding that it instituted in the wake of Avista's last rate case to perform a technical review of Avista's cost of service methodology.[1] He testifies that the Commission should affirmatively evaluate and adopt substantial changes to cost of service calculation methodologies in the current general rate case (GRC).[2] Mr. Stephens's proposals encompass modifications to the allocation of production and transmission costs, and include a recommendation that the Commission treat Avista as a dual-peaking utility when allocating demand among its customer classes.[3] Ultimately, Mr. Stephens relies on his proposed modification to Avista's cost-of-service study to support a rate spread in which residential customers could bear the brunt of the rate increase.

Q. Please briefly describe the electric rate spread terms that Staff agreed to in the Multiparty Partial Settlement.

A. The Settlement provides that each of Avista's electric service customer classes, except for two, will receive a base rate increase or decrease equal to the overall base rate increase. The two exceptions are Avista's Residential Service Schedules and its General Service Schedules. If the Commission approves a revenue requirement increase, the Residential Schedules will receive a base rate increase that is 106 percent of the overall base rate increase; its General Service

[1] Stephens, Exh. RRS-1CT at 2:4-9.
[2] *Id.* at 2:10-34.
[3] *Id.*

Schedules will receive a base rate increase that is 80 percent of the overall base rate increase.[4]

Q. Setting aside the merits of Mr. Stephens's cost-of-service proposals, would you change your recommendation of rate spread in light of his testimony?

A. No. A cost-of-service study (COSS) is simply a tool used for allocating the revenue requirement among ratepayer classes: it informs, but does not dictate, the rate spread produced in a GRC. Even if the Commission accepted the changes advocated by Mr. Stephens, which I do not recommend it do, those changes would not modify my recommendation concerning rate spread.

The rate spread proposal presented in the Settlement Agreement is a reasonable approach that balances cost-of-service (COS) considerations with other ratemaking principles, such as moving customer classes gradually toward cost-of-service parity. Moreover, it accomplishes some of Mr. Stephens's goals, like moving general service and residential classes closer to the parity ratios produced by Avista's COSS. Mr. Stephens's testimony related to COS is most useful in the larger context of the ongoing generic proceeding.

Q. Please summarize ICNU's testimony about the generic cost-of-service proceeding.

[4] If the Commission approves a rate decrease then the general schedules will receive a larger share of the overall base rate decrease and the residential schedules will receive a smaller share of the overall base rate decrease. If a rate plan is approved, the same rate spread design would apply to years 2 and 3.

A. Mr. Stephens testifies that, other than an initial kick-off meeting, "no meaningful activities have occurred" in the generic proceeding[5] and that the Commission should therefore ignore the existence of the generic proceeding for purposes of setting rates in this proceeding.[6] Mr. Stephens also expresses skepticism of accomplishing anything in the generic proceeding, a mindset that he claims that the Commission shares.[7]

It is puzzling that ICNU's witness paints such a grim picture of the Commission's opinion of the generic proceeding when the order itself describes the proceeding as intended to "provide an opportunity to establish greater clarity and some degree of uniformity in cost of service studies going forward."[8]

Q. Please provide a status update on the generic cost of service proceeding.

A. Stakeholders held an initial meeting in February of this year. At that meeting, Staff was asked to prepare several summary documents before scheduling another meeting. Since that time, the majority of stakeholders in the generic proceeding have faced three general rate cases in addition to regular workloads, redirecting time and resources that otherwise would have gone to the generic proceeding. That cycle of rate cases is coming to a close, and Staff is committed to scheduling more meetings before February of next year and filing a status update with the Commission before the end of 2018.

[5] *Id*. at 8:5-6.
[6] *Id.* at 8:10-16.
[7] *Id.* at 8:17-20.
[8] *Id.* at 7:31-32.

Q. Has ICNU participated in the ongoing generic proceeding?

A. Yes.

Q. Has ICNU presented any materials or proposals to participants involved in the ongoing generic proceeding?

A. No.

Q. Has ICNU attempted to schedule any meetings to advance the ongoing generic proceeding?

A. No.

Q. Has ICNU asked Staff to schedule more meetings, or pressed it to speed up the pace of the generic proceeding?

A. No.

Q. Do you generally agree with Mr. Stephens's request to modify Avista's COSS in this proceeding?

A. No. I do not think the current general rate case is the appropriate venue to determine if Mr. Stephens has presented a modified COS that produces "the best estimate of the cost of serving each class."[9] There are pros and cons to accepting his methodology, or any methodology for that matter. The balancing of the effects of implementing any methodology should be based on a thorough

[9] *Id.* at 8:11-12.

discussion of ratemaking principles. Therefore, the appropriate methodology, especially in determining specific calculation techniques that are consistent with the current policy for certain class allocators, should be established in the ongoing cost of service generic proceeding.

The Commission ordered the ongoing generic proceeding to allow for more thorough and robust technical discussions by all stakeholders. Staff proposed, and the Commission ordered, the ongoing generic proceeding so that these thorough and robust discussions would provide it with all relevant information on which to make a decision regarding treatment cost of service issues in Washington. This will hopefully implement a policy that has some degree of homogeneity in COSS and thus reduce the burden associated with litigating COS issues going forward. The Commission should decline ICNU's invitation to dramatically alter Avista's COS in this case because there is a better, alternative procedural path that the Commission purposefully ordered with that objective in mind.[10]

Q. Could Mr. Stephens's proposed recommendations be addressed in the COS Generic Proceedings?

Yes. As just discussed, that is the whole point of the generic proceeding. To the extent that I address the merits of Mr. Stephens's proposals below, I do not do so to advocate for any particular outcome with regard to choosing a cost-of-service methodology in this proceeding or in the generic. Rather, I critique Mr.

[10] *Id.* at 7:20-21.

Stephens's proposals to show the Commission that the cost-of-service discussion is more complicated than he portrays and should take place in the generic proceeding.

Q. In general, what would be the effect of altering Avista's COS methodologies in the current general rate case?

A. Participation in the generic would likely lag as stakeholders realize that they can achieve one-off changes through separate litigation.

Q. What specific COS modifications does Mr. Stephens propose?

A. Mr. Stephens presents alternative classifications for plant investment and transmission costs. As I will show below, he proposes using a peak demand method, specifically the summer and winter peak demand method, for classifying production costs. Mr. Stephens also proposes to adopt a 12-coincident peak demand measure for classifying transmission costs.

A. Production Costs Allocation Method

Q. Please summarize ICNU's proposals regarding the classification of production costs.

A. Mr. Stephens recommends that the Commission discontinue the use of the peak credit method in classifying production costs.[11] He argues that the peak credit

[11] *Id.* at 2:16-22.

methodology is unusual and does not reflect principles of cost causation because, he believes, the variable that actually drives production investment is the need for sufficient capacity at peak demand.[12] Accordingly, he suggests that the Commission allocate production costs based solely on each class's contribution to Avista's system peaks.[13]

Q. Please summarize the peak demand method recommended by Mr. Stephens.

A. As Mr. Stephens testifies, the traditional peak demand method classifies all generation investment as demand-related.[14] The method allocates to each class a share of the generation investment based on its contribution to a system coincident peak (CP), or multiple system coincident peaks.[15] One version of peak demand is the summer and winter peak method, which reflects the effect of two discrete seasonal peaks on customer cost assignment.[16]

Q. Please summarize the peak credit method used by Avista in its cost-of-service study.

A. As Ms. Knox describes, the peak credit method classifies generation investment as both demand- and energy-related.[17] The method splits generation investment

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[12] *Id.* at 21:11-22:6, 24:16-25:2.
[13] *Id.* at 24:16-18.
[14] NAT. ASS'N OF REGULATORY UTIL. COMM'NRS, ELECTRIC UTIL. COST ALLOCATION MANUAL 41 (Jan. 1992) (hereinafter NARUC Manual).
[15] *See* NARUC Manual at 41-48.
[16] NARUC Manual at 45.
[17] Knox, Exh. TLK-2 at 3:6-7.

into those two classes using the electric system load factor observed during the test year.[18] Avista allocates the demand-related costs to customer classes by measuring the contribution of each class to the average of the twelve monthly system coincident peak loads.[19]

Q. Please summarize the average and excess demand method mentioned by Mr. Stephens.

A. Like the peak demand method, the average and excess demand method usually classifies all generation investment as demand-related.[20] However, the method allocates costs on energy weighted basis through a multifactor allocator. The first factor measures the amount of capacity built to deliver energy that would be needed if all customers used energy at a constant 100 percent load factor; the second factor measures the amount of capacity meant to serve the class's non-coincident peak demand.[21]

Q. What would be the effect of accepting Mr. Stephens's recommendations?

A. Both Schedule 25 and Schedule 31/33 move from being close to parity to being over parity (ratio greater than 1).[22] If these results were to be used for rate spread purposes, it appears that only industrial customers could potentially benefit from a significantly higher parity ratio which in turn could signal the

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[18] *Id. at* 3:6-15.
[19] *Id.* at 3:17-19.
[20] NARUC Manual at 49.
[21] *Id.*
[22] Schedule 1/2 results show more acute under recovery and Schedule 11/12 with a bigger over recovery.

need of a reduced assignment of revenue requirement when considering a rate increase for those classes.

Q. Do you agree with Mr. Stephens's testimony regarding the lack of support for use of the peak credit method?

A. I do not. The Commission ordered Avista to use the peak credit method as far back as 1982,[23] and the Commission has expressed its preference for the method and has repeatedly accepted it.[24] The Commission is not alone in approving use of the peak credit methodology: a number of states have approved its use, or the use of one of its variants.[25]

Regardless, I find Mr. Stephens's testimony that the peak credit method receives "little if any"[26] discussion in the NARUC Electric Utility Cost Allocation Manual (NARUC Manual) puzzling. As others have recognized, the method is alternatively called the equivalent peaker method.[27] The NARUC

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[23] *Wash. Utils. & Transp. Comm'n v. Wash. Water Power Co.*, Causes Nos. U-82-10 & U-82-11, Second Supplemental Order, at 36-37 (Dec. 29, 1982).
[24] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket Nos. UE-140762 & UE-140617 & UE-131384 & UE-140094, Order 08, at 81 ¶ 190 (Mar. 25, 2015).
[25] *E.g., In re Application of Otter Tail Corp. d/b/a Otter Tail Power Co. for Authority to Increase Rates for Elec. Util. Serv. in Minn.*, Docket No. E-017/GR-07-1178, 2008 Minn. PUC Lexis 106, at * 146-52 (Aug. 21, 2008); *In re Avista Corp.*, Case Nos. AVU-E-04-1 & AVE-G-04-1, Order No. 29602, 237 PUR.4th 53, 78-80 (Idaho Pub. Utils. Comm'n Oct. 8, 2004); *Proceeding on Motion of the Comm'n as to the Rates, Charges, Rules, and Regulations of Cent. Hudson Gas & Elec. Corp. for Elec. Serv.*, Case 89-E-107, Opinion No. 90-16, 1990 N.Y. PUC Lexis 19, *31-44 (May 20, 1009); *In re: Petition of Tampa Elec. Co. for authority to increase its rates and charges; In re: Petition of Tampa Elec. Co. for closure of its existing interruptible rates schedules to new businesses and for approval of new interruptible rates schedules*, IS-3 and IST-3, Docket Nos. 850050-EI & 850246-EI, Order No. 15451, 85 FPSC 95, 1985 Fla. PUC Lexis 60 (Dec. 13, 1985).
[26] Stephens, Exh. RRS-1CT at 21:11.
[27] *Pac. Power & Light Co.*, Docket Nos. UE-140762 & UE-140617 & UE-131384 & UE-140094, Order 08, at 79 ¶ 185 (Mar. 25, 2015) (quoting Watkins, Exh. No. GAW-1T at 9:1-7).

Manual discusses the method by that name, giving it the same treatment it gives any other method.[28]

Q. What is your opinion on Mr. Stephens's criticisms of the peak credit method and support of the summer and winter peak demand method?

A. In my opinion Mr. Stephens portrays a skewed view of the Company's system that is driven only by its needs during peak demand.

Mr. Stephens states that "[a]lthough energy costs typically and appropriately are taken into account in determining what kind of generating unit to build to meet peak demand, it is the shrinking reserve margins over peak demand that typically cause new generation to be built."[29]

That provides less than half the story. Utilities provide energy at times other than their system peak; in fact a utility is almost always selling electricity at a time other than the system peak. Utilities shape their resource stacks with this reality in mind: they invest in capital-intensive baseload plants in order to achieve energy-cost savings over the long life of the plant.[30] In other words, utilities consider energy costs every time they build production plant.

The peak credit method recognizes the tradeoffs made by utilities when shaping their resource stacks. The peak demand method does not.

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[28] NARUC Manual at 52-55.

[29] Stephens, Exh. RRS-1CT at 24:21-25:2.

[30] NARUC Manual at 52-53; *see Wash. Water Power Co.*, Causes Nos. U-82-10 & U-82-11, Second Supplemental Order, at 36-37.

Q. What are your thoughts on Mr. Stephens's contention that the average and excess demand cost-of-service methodology better reflects cost causation than the peak credit methodology?

A. Mr. Stephens does not explain why he believes the average and excess demand methodology would be more appropriate. I note that both the average and excess demand and peak credit methods allocate production costs partially on the basis of energy. In choosing between the two, the average and excess method is more beneficial to industrial customers because of their load profiles. The NARUC manual explicitly addresses the magnitude of the impact in ICNU's clients' cost assignment when discussing the peak credit method:

> They generally result in significant percentages of total production plant costs as energy-related, with the results that energy unit costs are relatively high and the revenue responsibility of high load factor classes and customers is significantly greater than indicated by pure peak demand responsibility methods.

The average and excess demand method also allocates energy costs based on each class's non-coincident peaks (NCP). As Mr. Stephens repeatedly mentions in his testimony, a utility's system is strained during peak times, so it appears that it makes little sense to allocate any costs based on non-coincident peaks.

Q. Please summarize Mr. Stephens's testimony with regard to the proper data for calculating demand allocators.

A. Mr. Stephens presents Avista as a dual-peaking utility, with both summer and winter peaks.[31] He wants the Commission to use a non-traditional 5-CP methodology that gives equal weight to the average of summer and winter allocators (meaning an average of each class's proportionate share of the system peaks during three summer peaks and also an average of each class's proportionate share of demand during two winter peaks).[32]

Q. How do you respond to Mr. Stephens's proposal?

A. Mr. Stephens's proposal is interesting. But its appropriateness and applicability for Avista should be examined in the ongoing generic proceeding. The NARUC Manual suggests two predicates before adopting a summer and winter methodology: the utility must actually peak in both summer and winter and these peaks must affect the utility's expansion planning.[33] Mr. Stephens presents no evidence of such influence in the Company's planning. Perhaps he or ICNU could do so in the generic.

Avista states that the Company is usually a winter peaking utility, but it also experiences high summer peaks and careful management of capacity requirements is necessary throughout the year. The use of the average of twelve monthly peaks recognizes that customer capacity needs are not limited to the heating season.[34]

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[31] Stephens, Exh. RRS-1CT at 11:20-22.
[32] *Id*. at 26:6-20.
[33] NARUC Manual at 45.
[34] Knox, Exh. TLK-2 at 3:19-22.

In addition, the determination of the number of summer and winter peak hours should be the result of a well-documented policy decision. The NARUC manual emphasizes how critical the selection of hours can be and the importance of the establishment of selection criteria. It also highlights that these COS judgements must be made jointly with system planners. Avista has not proposed this kind of methodology, and it does not appear that ICNU has requested the input from the Company's system planners for the potential implementation of summer and winter peak. These sort of decisions, establishment of selection criteria, and policy discussions that require a more collective discussion are precisely the ones that should take place in the ongoing generic proceeding. It is uncertain if the observed winter and summer peak is actually the driver for additional capacity building. Nevertheless, in a hypothetical circumstance where it was determined that these peaks are the drivers for additional capacity building, I do not think the current general rate case is the place to determine if this is the method that best reflects how the system is actually used.

B. Transmission Costs Allocation Method

Q. How does Avista currently classify transmission costs?

A. Avista classifies transmission costs the same way it allocates production costs. It allocates those costs to its customer classes by class contribution to the average of the 12 monthly system coincident peak loads.[35]

Q. How does Mr. Stephens propose classifying transmission costs?

A. Mr. Stephens rejects the use of the peak credit methodology to classify transmission costs.[36] He states that he is "unaware of any case outside Washington where a utility has classified or allocated traditional transmission costs on the basis of energy to any degree" and contends that there is "no justification" for doing so as there is "not even an arguable trade-off" between fixed and variable costs in transmission investment.[37] Mr. Stephens proposes classifying transmission costs entirely as a demand-related because, he asserts, Avista designed its transmission facilities solely to withstand the highest peak loads.[38] Accordingly, he urges the Commission to allocate transmission costs based solely on demand using the 12-CP method.[39]

Q. Are you aware of any case outside of Washington where a utility has classified or allocated traditional transmission costs on the basis of energy to any degree?

A. One example immediately springs to mind. Pacific Power's Multi-State Protocol methodology allocates transmission costs partially on an energy basis, and the participating states therefore classify transmission costs on a 75/25 percent

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[35] Knox, Exh. TLK-2 at 3:7-19.
[36] Stephens, Exh. RRS-1CT at 28:1-20.
[37] *Id.* at 28:11-20.
[38] *Id.* at 28:21-29:15.
[39] *Id.* at 31:1-4.

demand/energy basis.[40] Other states also allocate transmission costs on a partial energy basis. For example, both Maine and Michigan have recognized an energy-component to transmission costs.[41]

Q. Is there an argument that there is an energy and demand tradeoff in transmission investments?

A. Yes. There are at least two. First, as both this Commission and the NARUC Manual recognize, the transmission system is an extension of the production system, and transmission investments should be classified and allocated in a similar manner as production investments.[42] Second, other commissions have recognized that the construction of transmission lines can reduce the costs associated with transporting energy to production plant, and that transmission cost allocation should therefore have an energy component.[43]

Q. Do you agree that utilities only consider serving peak demand when they consider and execute transmission investments?

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[40] *In re Pacificorp d/b/a Pacific Power*, Docket UM-1050, Order 16-319, 332 PUR.4th 68, 77 (Aug. 23, 2016). *See also In re Rocky Mountain Power*, Docket No. 20000-446-ER-14, Record No. 13816, 319 PUR.4th 326, 354-55, 363 (Wyo. Pub. Serv. Comm'n Jan. 23, 2015); *In re Rocky Mountain Power*, Docket No. 09-035-23, 279 PUR.4th 1, 62 (Utah Pub. Serv. Comm'n Feb. 18, 2010).

[41] *Pub. Utils. Comm'n; Investigation of Cent. Maine Power Co's Stranded Costs, Transmission and Distribution Util. Revenue Requirements, and Rate Design*, Docket No. 97-580, 1999 Me. PUC Lexis 259, *304-09 (Mar. 19, 1999); *In re application of the Detroit Edison Co. for authority to amend its rate schedules governing the supply of elec. energy and to amend other miscellaneous rates*, Case No. U-6949, 1983 Mich. PSC Lexis 865, *140-52 (Mar. 31, 1983).

[42] *Wash. Water Power Co.*, Causes Nos. U-82-10 & U-82-11, Second Supplemental Order, at 37; NARUC Manual at 75 (although noting this is not commonly practiced).

[43] *E.g.*, *In re Wash. Water Power Co.*, Case No. U-1008-185, Order No. 18679, 58 PUR.4th 126, 144-45 (Id. Pub. Utils. Comm'n Feb. 6, 1984); *In re Nova Scotia Power Incorp.*, Docket No. M05473, Opinion, ¶¶ 63-75 (Nova Scotia Bd. of Comm'nrs of Pub. Utils. Mar. 11, 2014).

A. No. Utilities take into account many considerations when building transmission systems. These include reliability, resiliency, efficiency, and, more recently, to incorporate renewable generation into their resource stack. These transmission costs are incurred deliver energy rather than to meet peak demand.[44]

III. RATE SPREAD

Q. Please summarize Mr. Stephens's proposed rate spread.

A. Mr. Stephens states that, if the Commission grants Avista its full revenue requirement request, it should spread the rate increase in the manner initially proposed by Avista and adopted by the settling parties for any revenue increase.[45] He states that, if the Commission approves less than Avista's full requested revenue requirement increase, Schedules 1 and 2 should still receive the same initial base rate increase associated with its full request, with the "savings" accruing to other classes.[46] In reality, Mr. Stephens effectively advocates making Avista's residential customers solely responsible for any revenue requirement increase up to approximately 28 million dollars.

Q. In your opinion, would Mr. Stephens's rate spread result in fair rates?

A. Absolutely not. A number of principles inform rate spread. One of these principles is the appearance of fairness, which in this case means that all classes

[44] *See* NARUC Manual at 75 (although recognizing that this approach is not commonly used).
[45] Stephens, Exh. RRS-1CT at 34:16-37:2.
[46] *Id.* at 36:4-10.

should bear at least some share of any increased revenue requirement in an equitable manner. By making the residential schedules solely responsible for any 2018 revenue requirement increase of less than nearly 28 million dollars, Mr. Stephens's proposal completely ignores that principle. ICNU's proposal is noticeably strenuous to residential customers. Following Mr. Stephens's advice to impose the initial revenue requirement amount proposed by the Company to residential customers, would mean that these customers will receive a base rate increase that is 214% percent of the overall base rate increase if the Company is granted half of what it requested.[47]

Q. Please explain why Staff supports the rate spread terms in the settlement.

A. Avista's cost-of-service studies show that it over- or under-recovers from some of its classes. The Settlement's rate spread was agreed to with the purpose of addressing those over- or under-recoveries and reducing cross-class subsidization in an incremental way while striking a balance among the settling parties diverse interests. In the case of an increase in the overall revenue requirement, the Settlement calls for classes with a parity ratio of less than 1 to receive an above average portion of the revenue increase. In the case of a reduction in the overall revenue requirement, the Settlement calls for classes with a parity ratio of less than 1 to receive a smaller portion of the revenue decrease. This also helps maintain the perception of equity and gradualism.

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[47] In this scenario the Company would be authorized to an overall increase of 6.2% while residential customers would still receive a 13.3% base rate increase, more than twice the amount of the overall increase. These figures were obtained from Mr. Stephens's testimony, Table 5, page 36, line 10.

Finally, a three-year rate plan, such as that proposed by Avista or Staff, provides predictability in rate changes. Following the COS generic proceeding, the Commission can adopt adjustments to rate spread in the second and third years of a three-year rate plan.

Q. Does this conclude your testimony?

A. Yes.