BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION, d/b/a AVISTA UTILITIES

Respondent.

DOCKETS UE-240006 & UG-240007 (*Consolidated*)

CROSS-EXAMINATION EXHIBIT OF SCOTT J. KINNEY
ON BEHALF OF THE
WASHINGTON STATE OFFICE OF THE ATTORNEY GENERAL
PUBLIC COUNSEL UNIT

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Rebuttal Testimony of William G. Johnson, Exhibit WGJ-6T, *Wash. Utils. & Transp. Comm'n v. Avista Corp*, Docket UE-170485 (Dec. 1, 2017)

September 16, 2024

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-170485

DOCKET NO. UG-170486

REBUTTAL TESTIMONY OF

WILLIAM G. JOHNSON

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

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

A. My name is William Johnson. I am employed by Avista Corporation at 1411 East Mission Avenue, Spokane, Washington.

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

A. Yes. My testimony 1) identified and explained the proposed normalizing and pro forma adjustments to the 2016 test period power supply revenues and expenses, and 2) described the proposed level of expense and Retail Revenue Adjustment for Energy Recovery Mechanism ("ERM") purposes, using the pro forma costs proposed by the Company in this filing. I also described the proposed Power Cost Updates that are proposed to be a part of the Company's Three-Year Rate Plan.

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

A. My testimony will generally address the recommendations of Staff witness Mr. Gomez, Industrial Customers of Northwest Utilities ("ICNU") witness Mr. Mullins, and Public Counsel witness Ms. Wilson. For purposes of my testimony I will refer only to the testimony of Mr. Gomez since the other witnesses hold positions similar to his. Further, I will address 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. Finally, I will describe Avista's position on rebuttal related to power supply updates in Years 2 and 3 of the Three-Year Rate Plan and why the Company would forego those updates if the Commission approves the Company's power supply adjustment for Year 1.

Q. Are you sponsoring any exhibits?

A. No.

A Table of Contents for my testimony is as follows:

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II. POWER SUPPLY AND THE ENERGY RECOVERY MECHANISM (ERM)

Q. Please describe the recommendation of Mr. Gomez.

A. Mr. Gomez recommends that the Commission reject Avista's request for increased power costs and hold power costs at the current levels for the entire three year rate period.[1] He contends that since the Company's actual power supply expenses have been lower than the authorized level included in base rates in five of the last six years, there must be some inherent or intentional 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.[2] His remedy for this alleged bias is to completely eliminate all of the Company's proposed increase in baseline power costs and to let any power cost increases flow through the ERM.[3] While he does not say so, the end result of such a position is that, due to

[1] Exh. DCG-1CT, p. 3, ll. 16-18
[2] Exh. DCG-1CT, p. 9, ll. 2-12
[3] Exh. DCG-1CT p. 35 ll. 6-7

the dead band and sharing bands in the ERM, the majority of increased power supply costs will be absorbed by the Company as unrecovered costs.[4]

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

A. No. Neither Staff, nor ICNU, nor Public Counsel 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. Rather they simply assume that, because Avista didn't perfectly forecast costs during a period of rapidly falling expense, there must be something inherently or intentionally biased in its power cost modelling and that bias somehow magically offsets other undisputed power cost increases.[5] The problem with this position, however, is that they have not performed any empirical analysis whatsoever, or made any attempt to support their position that Avista's entire proposed power cost adjustment should be eliminated. However, neither one has presented any alternative results under their version of correct modeling that would provide an alternative adjustment. In short, they have provided nothing else for the Commission to land on, other than to kick this whole issue down the road.

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

[4] Under the ERM, the difference between actual and authorized power supply expenses are accumulated until the dead band of $4.0 million is reached. Fifty percent of power cost increases, or 75 percent of the decreases, between $4.0 million and $10.0 million, and ninety percent of the power cost increases or decreases in excess of $10.0 million are recorded as the power cost deferrals and added to the customer deferral-balancing account.
[5] Exh. DCG-1CT, p. 12, ll. 8-14

A. No, he did not. 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. For the first seven years the Company absorbed $41.4 million in unrecovered power costs and customers paid $60.3 million in surcharges. Those were not good times for anyone.

Fortunately, 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, customers have received $108.5 million (or 82%) in both base power supply cost reductions and ERM rebates, and the Company has retained $24.6 (or 18%) million through the sharing bands of the ERM.

Mr. Gomez ignores the entire history of the ERM and focuses only on the latter period, 2011 through 2016.[6] Without anything but circumstantial evidence, Mr. Gomez contends the Company retained $24.7[7] million of savings through biasing[8] 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 cases.

[6] Exh. DCG-2
[7] Exh. DCG-1CT, p. 8, ll. 15
[8] Exh. DCG-1CT, p. 9, ll. 2-12

Q. To start would you please explain the history of the ERM and the annual filing requirement?

A. Yes. The ERM was approved by the Commission's Fifth Supplemental Order in Docket No. UE-011595, dated June 18, 2002, and was implemented on July 1, 2002. That Order approved and adopted a Settlement Stipulation (UE-011595 Stipulation) that explained the mechanism and reporting requirements. Pursuant to the UE-011595 Stipulation, the Company is required to make an annual filing on or before April 1st of each year. This filing provides an opportunity for the Commission Staff, and interested parties, to review the prudence of the ERM deferral entries for the prior calendar year. Interested parties are to be provided a 90-day review period, ending June 30th of each year, to review the deferral information. The 90-day review period may be extended by agreement of the parties participating in the review, or by Commission order.

Avista has made ERM annual review filings for each subsequent calendar year period. For every year the Commission found that the actual power cost expenses were prudently incurred and that the power cost deferrals were properly calculated and recorded. Table No. 1 below provides the annual ERM filings since 2013:

Table No. 1: Annual ERM Filings

Q. Please provide an overview of the deferral calculation methodology.

A. Energy cost deferrals under the ERM are calculated each month by subtracting base net power supply expense from actual net power supply expense to determine the change in net power supply expense. The methodology compares the actual and base amounts each month in FERC accounts 555 (Purchased Power), 501 (Thermal Fuel), 547 (Fuel) and 447 (Sales for Resale) to compute the change in power supply expense. These four FERC accounts comprise the Company's major power supply cost/revenue accounts. The ERM also includes changes in Accounts 565 (transmission expense), 456 (third-party transmission revenue), and broker fees. In addition, a category called resource optimization is included which primarily includes natural gas purchase expense and natural gas sales revenue related to optimizing the Company's natural gas-fired resources and natural gas transportation contracts.

The total change in net expense under the ERM is multiplied by the Washington Production/Transmission (PT) allocation ratio of approximately 65%. The total power cost change is accumulated during the calendar year until the dead band of $4.0 million is reached. Fifty percent of power cost increases, or 75 percent of the decreases, between $4.0 million and $10.0 million, and ninety percent of the power cost increases or decreases in excess of $10.0 million are recorded as the power cost deferrals and added to the power cost deferral-balancing account, as illustrated in the Table No. 2 below:

Table No. 2: Sharing of Power Supply Cost Variability

As can be seen in Table No. 2, the sharing between the customers and the Company is not equivalent. The second sharing band favors the customer because the customers receive 75% of reduced cost from $4 to $10 million but only have to pay 50% of increased costs from $4 to $10 million.

Q. Please provide a history of the ERM results.

A. The first full year of the ERM was 2003. In 2010 there was no ERM accounting, leaving a total of 13 full years of ERM history. In 6 years, the actual power supply expense exceeded the authorized level and in 7 years the opposite occurred. On a dollar basis, over the full 13 year history of the ERM, actual power supply costs have exceeded authorized costs by $37,330,117. Of that total amount, $16,779,560 (as shown in Table No. 4) was absorbed by the Company (i.e., was not charged to customers). Table No. 3 below shows the actual and authorized expense for the 13 year history of the ERM.

<u>Table No. 3: ERM History Actual Vs. Authorized (Washington)</u>

Q. Of these total power cost variances, what was the split between customers (deferrals) and the Company?

A. Of the total of $37,330,117 of higher than authorized power costs, $20,550,557 was deferred, i.e., charged to customers, and $16,779,560 was absorbed by the Company. During the first seven years of the ERM, actual power costs exceeded the authorized power costs by $101,737,081. Of that total, $60,338,746 was deferred and charged to customers and

$41,398,335 was absorbed by the Company. During the last six years of the ERM actual power costs were lower than the authorized power costs by $64,406,964. Of that total, $39,788,189 was deferred and rebated to customers and $24,618,775 of the power cost savings were retained by the Company. I split the total ERM history into these two periods because Mr. Gomez's recommendation is <u>based only on the last six years</u> while ignoring the first seven years of the ERM.

Table No. 4 below shows the amounts deferred and the amounts absorbed by the Company during the <u>entire</u> 13 year history of the ERM.

<u>Table No. 4: ERM History Deferrals & Amortization (Washington)</u>

Q. What is the recent history of baseline (ERM authorized) power costs?

A. ERM authorized power supply costs have decreased significantly from 2011 to 2017. ERM related expenses have decreased by approximately $47.7 million from 2011 to 2017, a decrease of 25.6%. Normalized for changing loads, the ERM related costs per MWh have decreased from $20.67/MWh in 2011 to $14.99/MWh in 2017, a decrease of 27.5%. Table No. 5 below shows the baseline power costs for the period 2011 through 2017.

<u>Table No. 5: ERM History Authorized Expense (System)</u>

Q. What has been the impact of the reduction in power costs since 2011?

A. The total reduction in power costs paid by Washington customers for the 2011 through 2017 period is $133.1 million. This savings is a comparison of actual power costs versus a scenario where ERM baseline power costs had remained at the 2011 level. Of the total reduction in power costs over the period, customers received $108.5 million (82%), which is comprised of $68.7 million of cost reductions in base rates and $39.8 million of ERM rebates. The Company retained $24.6 million (or 18%) of cost reductions through the ERM sharing bands.

Table No. 6 below shows the impact of power cost reductions since 2011.

<u>Table No. 6: ERM Power Cost History (Washington)</u>

Q. Since 2011 power costs have fallen significantly, but actual costs have fallen even more. Is this proof that the Company's power cost modeling is inherently biased to overestimate forecasted costs?

A. No, it just means that costs have been falling and the decreases in forecasted power costs have not kept pace with the actual decrease in costs (as shown earlier, prior to

2011, just the opposite occurred which forced the Company to absorb increased costs). The reductions since 2011 are primarily due to actual natural gas and power prices continuing to fall during the course of the rate periods below the levels existing when the power cost forecasts were developed. The Company has also avoided any really bad hydro conditions in recent years, and other than the Colstrip outage in 2013, has had good availability of power plants. In summary, it's been falling natural gas and power prices and simple good luck with hydro conditions and power plant availability that explain why power costs have been lower than authorized in recent years.

And again, I want to emphasize that the methodology for rate case forecasted power costs was thoroughly vetted by all parties in prior rate case proceedings and approved by the Commission. They were not developed by Avista without any scrutiny. Avista has not somehow changed the methodology to work only in its favor.

The Company is always managing and optimizing its power resource portfolio to reduce costs. The Company is not managing power supply costs to match baseline ERM costs, which we could do by simply closing positions and buying weather-related hedges as soon as rate case costs are approved. Doing so may result in power costs closer to baseline, but would be bad for customers by foregoing the opportunity to further lower costs through optimization and creating rebate deferrals for customers. Instead, we have been taking advantage of the continuing decline in natural gas and power prices below the costs embedded in baseline costs to further reduce power costs. The ERM structure, by its very design, incentivizes the Company to behave in this manner and the outcome has been good for customers.

In either instance, a six-year trend doesn't prove or even imply that there is an inherent or intentional bias in the Company's power cost modelling. The opposite of what has happened the last six years occurred for the first six years of the ERM. Actual power costs exceeded the authorized costs in five of the first six years of the ERM. Does this mean that the Company's power cost forecasting then was inherently biased to understate power costs? No, it just meant that costs were rising and the increases in forecasted power costs wasn't keeping pace with the actual increase in costs.

Q. Why have actual power supply costs in 2017 stayed under the ERM authorized base despite the Commission's rejection of Avista 2016 general rate case?

A. The reason why power supply costs in 2017 are lower than authorized is due to hydro generation that was well above average expectations and the fact that natural gas prices continued to fall during the year. Hydro generation and natural gas prices (and, correspondingly, wholesale power prices which are affected by those two items) are the most important factors affecting power costs. Hydro generation is simple: more free power reduces expenses. Natural gas prices are also important because, after accounting for baseload thermal (coal and wood) generation and hydro generation, Avista's short energy position is met with either natural gas or power purchases. When natural gas and power prices decline, Avista's power costs decline. Put another way, power supply conditions in 2017 could not have been better. Instead of seeing approximately $14 million in increased power supply costs as originally budgeted, lower wholesale power costs, lower natural gas costs, excellent hydro conditions, and resource optimization of the Company's assets mitigated almost all of the projected cost increases. But much of this is attributable to "good luck" and does not mean that the Company's long-standing approach to modelling is somehow deficient.

Q. Why do you project power costs to increase in the next three years over the current costs in base rates?

A. Some power cost increases are absolutely known and measurable. The largest factor is that the PGE contract ended in December 2016.[9] The loss of the PGE contract alone accounts for roughly half, or $10.6 million, of the Company's increased power cost request, and that has nothing to do with modeling – it is a simple fact. There are also several other contracts that have known and measurable cost increases. For example, the annual payments for the Chelan PUD purchase are contractually fixed and increase each year through 2020. The Lancaster PPA capacity payment increases by both a fixed and variable escalation factor each year and won't decrease. The agreement related to the output of Palouse Wind, and most of the PURPA power purchase contracts, have fixed price schedules that increase each year. The Wells Dam power purchase agreement changes from a project cost contract to a higher cost fixed-rate contractual arrangement starting September 2018. These aren't cost increases that the Company can eliminate, nor are they cost increases related to any AURORA modelling assumptions. They are just facts that no party disputes. Table No. 7 below illustrates the primary factors which have contributed to changes (Washington Share):

Table No. 7: Large Contracts

[9] WGJ-1T, p. 5, ll. 12-19

Even if natural gas prices remain at their current low level, the embedded cost increases in these contracts will lead to overall cost increases under normal hydro generation conditions.

Q. Why not just let these known cost increases flow through the ERM as Mr. Gomez proposes?

A. That is not what the ERM was designed for. Flowing costs through the ERM, by definition, means the Company will absorb legitimate power supply costs that should be recovered in rates. The ERM is meant to pick up variability in hydro generation, weather and other changes that cannot be forecasted or changes in commodity prices that the Company has a limited ability to control. **<u>It is not intended to insulate customers from legitimate cost increases due to known contract changes</u>**. Ignoring known and measurable contract changes in the pro forma period is the equivalent of purposely setting the ERM baseline costs incorrectly.

Q. Does the Company still propose annual adjustments to baseline power costs in Years 2 and 3 of the rate plan period?

A. No. If the Commission approves the Company's proposed power supply adjustment for Year 1 of the Three-Year Rate Plan, which includes the known contract changes discussed above, the Company would forego updates in Years 2 and 3. The Company believes that, on rebuttal, this strikes a reasonable balance between the Company's position and that of Staff. Perhaps during this time, the parties can reach a common understanding of what the ERM is designed to do.

Q. Does Mr. Gomez' proposal, at page 35 of his testimony (Exh. No DCG-1CT), to allow the Company to file for increased power costs prior to the end of the three year rate period should the ERM rebate balance fall below $10 million, limit the potential harm to the Company?

A. No. In order for the rebate balance to fall below $10 million by the end of 2019, actual power costs would need to exceed authorized costs by $13.3 million or more in both 2018 and 2019. Should that happen, the Company would absorb at least $14.7 million of unrecovered power costs, and that would penalize the Company. Even this scenario is problematic because the 2019 ERM review schedule would need to be moved ahead and accelerated in order to know if the $10 million criteria was met in time to file and vet increased power costs for the last year of the Three-Year Rate Plan (i.e., May 2020 through April 2021.).

Mr. Gomez's proposal can only help in the event of one or two extremely high power cost years in 2018 and/or 2019. One should not merely assume that will be the case. Based on current and forward market prices, it is unlikely that would come into play during the Three-Year Rate Plan. As such, Mr. Gomez's approach almost guarantees that the Company will have unrecovered power costs during the Three-Year Rate Plan, if baseline power costs remain at the current level as he recommends.

Q. Does this conclude your rebuttal testimony?

A. Yes.