Service Date: April 26, 2018

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*) ORDER 07
In the Matter of the Petition of AVISTA CORPORATION, d/b/a AVISTA UTILITIES, For an Order Authorizing Deferral of Federal Income Tax Expenses for the Effects of Revisions of the Federal Income Tax Code Upon Avista's Cost of Service.	DOCKET UE-171221 (*consolidated*) ORDER 02
In the Matter of the Petition of AVISTA CORPORATION, d/b/a AVISTA UTILITIES, For an Order Authorizing Deferral of Federal Income Tax Code Upon Avista's Cost of Service.	DOCKET UG-171222 (*consolidated*) ORDER 02 FINAL ORDER REJECTING TARIFF SHEETS, APPROVING PARTIAL SETTLEMENT, AND DIRECTING COMPANY TO FILE TARIFF SHEETS IN COMPLIANCE WITH THIS ORDER

***Synopsis**: The Commission rejects the tariff sheets filed by Avista Corporation, d/b/a Avista Utilities (Avista or the Company) on May 26, 2017, including the Company's proposed multi-year rate plan. The Commission, considering the full record, authorizes and requires Avista to file tariff sheets that will result in an increase in revenue of approximately $10.8 million, or 2.19 percent, for its electric operations and a decrease in revenue of approximately $2.1 million, or 2.41 percent, for its natural gas operations, in accordance with the decisions below. These figures include a reduction in Avista's federal corporate tax rate starting May 1, 2018, and a 36-year amortization of the plant-related, protected, excess deferred income tax collected as of December 31, 2017. Avista will continue to defer the unprotected excess deferred income taxes of approximately $10.4 million for resolution and distribution in Docket U-170970 utilizing the accounting petitions consolidated with this instant proceeding. Further, we direct Avista to amortize the January to April 2018 excess deferred income tax through its previously proposed Schedule 74 – Temporary Federal Income Tax Rate Credit over a one-year amortization period. Because the Company withdrew its electric tariff filing in Docket UE-180176, we direct Avista to refile this request prior to May 1, 2018.*

The Commission leaves unchanged the Company's return on equity at 9.50 percent and does not authorize a flotation cost adjustment. The Commission accepts Avista's cost of debt of 5.62 percent. On a going-forward basis, Avista is expected to observe in its Interest Rate Risk Management Plan the risk mitigation approach as provided in the Commission's March 2016 policy statement on natural gas interest rate hedges. The Commission rejects the Company's proposed hypothetical capital structure and instead authorizes and sets rates with a capital structure of 48.5 percent equity, 48.6 percent long-term debt, and 2.9 percent short-term debt. This results in a rate of return for Avista of 7.50 percent.

The Commission authorizes an increase of $14.5 million to the energy recovery mechanism baseline to account for the increases in Washington's allocated share of power costs and transmission costs, and for the lost revenue of the Portland General Electric contract. While the Commission allows the power cost baseline to be reset in this proceeding, the Commission will consider carefully any future adjustments to the baseline and will change it only under extraordinary circumstances. Avista is ordered to engage the Commission's Staff, Public Counsel, the Alliance of Western Energy Consumers (formerly the Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users), and other interested stakeholders in a discussion to simplify and improve the Company's power cost modeling. The Commission also directs the Company to engage peer utilities, independent

experts in the power cost modeling industry, Staff, and the other parties in this case on ways in which Avista may document the functionality and rationale of its power cost modeling and make changes to eliminate its directional bias. Avista must report on this process and identify any resulting changes to its methodology in its next general rate case filing.

The Commission adopts Staff's August 31, 2017, cutoff deadline for inclusion of pro forma capital additions. Three projects, while below the threshold proposed by Staff for major projects, still merit recovery: the Little Falls Powerhouse Redevelopment; the Wood Pole Management project; and the Gas Replacement for Roads project. The Commission accepts Staff's capital additions adjustment, with these three additional inclusions, and authorizes the Company to receive its annualized depreciation expense for these adjustments.

The Commission approves the Company's operations and maintenance (O&M) offsets corresponding to the capital additions authorized above. This results in authorized O&M offsets associated with Wood Pole Management for the Company's electric operations and associated with Information Technology Refresh for Avista's electric and natural gas operations.

After a thorough review of testimony and evidence on the cost-of-service ratios presented, rate spread, and rate design by all parties, the Commission approves the Multi-Party Partial Settlement Stipulation addressing these issues. Additionally, Staff shall schedule meetings in the generic cost-of-service proceeding in Dockets UE-170002 and UG-170003 as soon as possible and report to the Commission its progress in this proceeding every three months from the effective date of this Order.

The Commission determines it is premature to impose any additional conditions on the Line Extension Allowance Program (LEAP) pilot. The Company has expressed its willingness to discuss the matter further, and we encourage the Company, Commission Staff, Public Counsel, and other stakeholders to discuss the metrics used to evaluate the success of the program, as Avista considers whether to continue LEAP at the end of the pilot.

While the Commission continues the Fuel Conversion program, the Commission determines it is not appropriate for electric ratepayers to subsidize the conversion from electric to gas. The Commission directs the Company and Staff to work with the Conservation Advisory Group on a plan that gradually transfers the funding obligation for the Fuel Conversion program from the electric conservation rider to the natural gas conservation rider by December 31, 2019. In developing this plan, the parties also should assess the effectiveness

and sustainability of the Fuel Conversion program under a new funding structure going forward.

The Commission authorizes the inclusion of working capital amounts as proposed in Avista's rebuttal filing that contains a relatively small total amount of interest-bearing accounts. The Commission cautions that, in the future, even small or inconsequential interest-bearing accounts will be classified as non-operating and excluded from any working capital adjustment.

The Commission approves an increase of $350,000 in the funding for low-income weatherization for Company's electric operations.

The Commission authorizes Avista to recover increases in union and non-union wages for 2017 and union wages for 2018. Non-union wage adjustments for 2018 are rejected.

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C. Power Costs

113 ***Avista.*** During the 2016 test year, Avista was authorized to spend $98.8 million on power costs, but only spent $88.4 million.[146] The Company is requesting authorized power costs of $114.8 million in this case, an increase of $16 million (16.2 percent) over authorized rates and $26.3 million (29.8 percent) over test year expenditures.

114 In his overview, Mr. William Johnson explains that the primary driver of the Company's requested power cost increase is the expiration of a capacity sales contract with Portland General Electric (PGE), which provided $8 million in annual benefits to Washington customers that are currently reflected in rates but are no longer being received by the Company.[147]

115 Mr. Johnson also argues that if the Company is granted the Rate Plan as requested, it should be allowed to update its power cost baseline each year because customer rates should reflect the costs that the Company is experiencing as closely as possible.[148] He further argues that such treatment would be consistent with Puget Sound Energy's (PSE) power cost only rate case mechanism and the annual purchased gas cost adjustments for natural gas companies.[149]

116 In his initial testimony, Mr. Clint Kalich describes the Aurora software that the Company uses to model its power costs. Generally, the tool models load, generation, and transmission constraints across the Western Interconnect and calculates hourly market prices at each market hub in the West.[150] Using those market prices as inputs, Aurora then optimizes Avista's system each hour by seeking the lowest-cost mix of Company generation, market sales, and market purchases.

117 Mr. Kalich also testifies that Aurora's forecasted market prices track closely with available market forwards, which demonstrates the model's accuracy.[151] Finally, he briefly describes

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[146] Johnson, Exh. WGJ-1T at 3:12-18.

[147] *Id.* at 5:17-21.

[148] *Id.* at 11:9-13. The Company abandons this position on rebuttal.

[149] *Id.* at 11:13-16.

[150] Kalich, Exh. CGK-1T at 3:8-18.

[151] *Id.* at 5:1-22.

the modifications that Avista makes to the Aurora database, which he says are consistent with how the Company has used Aurora in previous cases.[152]

118 At the request of Staff, Mr. Kalich filed supplemental testimony that explains in greater detail the modifications that the Company makes to the Aurora model to ensure that its modeled market prices align with forward market prices, and compares the changes made in this case with the changes made in the Company's 2015 GRC.[153] He also provides an overview of the Energy Recovery Mechanism (ERM) since it was instituted in 2003, which indicates that in the first seven years, the mechanism under-collected by an average of $14.6 million per year, while in the last six years, it over-collected by an average of $10.8 million per year.[154]

119 Mr. Kalich concludes that the largest driver of the differences in power costs between the 2015 GRC and the current proceeding is the expiration of the PGE contract, which accounts for 80 percent of the Company's requested power cost increase.[155]

120 Avista's witness, Mr. Jeff Schlect, identifies a need for a $1.2 million[156] increase to the ERM baseline to offset a decrease in Avista's transmission revenues.[157] The primary drivers are the expiration of large transmission sales contracts to the Bonneville Power Administration, Morgan Stanley, and First Wind Energy Marketing.[158] Two factors offset the increased costs to some degree: increased revenue from higher Open Access

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[152] *Id.* at 7:8-10:2.

[153] Mr. Kalich explains why the Company goes through the exercise of adjusting the Aurora model to align with forward market prices in Exh. CGK-3T at 7:13-8:12.

[154] Kalich, Exh. CGK-3T at 28:9-20.

[155] *Id.* at 4:12-20.

[156] Schlect, Exh. JAS-1T at 9:17. The $1.9 million figure provided there, multiplied by the Washington allocation factor of .6574, yields $1.2 million.

[157] The transmission revenues that Mr. Schlect addresses are tracked through the ERM. The transmission expenses that he discusses, related to various regional body memberships, are not tracked through the ERM, but are included in adjustment 3.01. See Andrews, Exh. EMA-2 at 25:7-22 and 44:11-20.

[158] Schlect, Exh. JAS-1T at 15:1-10; 15:19-16:12.

Transmission Tariff (OATT) rates that FERC recently authorized the Company to charge,[159] and an increased revenue forecast for short-term transmission sales.[160]

121 Mr. Schlect also provides an update on Avista's consideration of joining the Energy Imbalance Market (EIM). He indicates that the Company is still considering the EIM and is not requesting recovery of any EIM costs in this proceeding.[161] For Avista, a primary driver in its analysis of joining the EIM is reduced daily market liquidity resulting from fewer available bilateral trading partners, as a growing number of regional utilities are now relying on the EIM for short-term power needs.[162]

122 ***Staff.*** Testifying on behalf of Staff, Mr. David Gomez argues that Avista has not met its burden of proof for its requested increase. Based on the Company's recent history of consistently over-forecasting its power costs, he recommends that the Commission deny Avista's request and make no changes to the baseline until the next rate case or until the ERM deferral balance, $21.6 million in ratepayers' favor as of November 2017, falls below $10 million.[163]

123 Mr. Gomez briefly recounts the history and purpose of Avista's ERM, which uses dead bands and sharing bands to: (1) equitably allocate between Avista and its Washington customers the risk of ordinary power cost variability, and (2) incentivize Avista to effectively manage or even reduce its power costs.[164] Table 4 summarizes Avista's current ERM structure:

Table 4
Avista ERM Structure

If collected revenue is, relative to authorized baseline:	Customer responsibility is:	Company responsibility is:
+/- $0 to $4 million	0%	100%

[159] *Id.* at 9:20-10:8.

[160] *Id.* at 12:22-14:2.

[161] *Id.* at 17:20-21.

[162] Kinney, Exh. SJK-1T at 27: 21-24.

[163] Gomez, Exh. DCG-1CT at 3:20-4:3.

[164] *Id.* at 5:11-13 (citing Order 03 in Docket UE-060181).

+ $4 million to $10 million	50%	50%
- $4 million to $10 million	75%	25%
+/- $10 million and up	90%	10%

124 Mr. Gomez concludes that, because of the way dead bands and sharing bands are structured, an appropriately set baseline is a necessary component of the ERM. If it is consistently set too low, the Company will absorb much of that difference between the authorized baseline and higher actual costs, and not recover its costs. If the authorized baseline is consistently set too high, the Company will receive a windfall at customers' expense. Mr. Gomez concludes that an appropriate ERM baseline should balance those risks by having an equal likelihood of costs coming in higher or lower.[165]

125 However, Mr. Gomez argues, Avista's power cost model is biased toward consistently over-estimating its power cost needs, which works to the Company's favor in two ways: generating excess revenue that the Company can keep through the dead and sharing bands and padding the ERM deferral account, which the Company then uses as an offsetting tool to facilitate its rate requests.[166]

126 As evidence for his claims, Mr. Gomez testifies that since 2011, Avista has over-collected its power costs by $64.6 million and, because of the dead and sharing bands, has kept $24.1 million – an average of $4.1 million per year.[167] He also briefly recounts the Company's recent history of annual rate case filings and concludes that the practice of allowing the Company to use ERM deferral balances to offset rate increases should cease, as it creates a strong incentive for the Company to over-forecast its power costs.[168] Mr. Gomez concludes that Avista's chronic over-forecasting of its power costs has prevented the ERM from working properly and raises questions regarding the Company's requested power cost increase.[169]

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[165] *Id.* at 7:18-8:6.

[166] *Id.* at 9:2; 11:8-21.

[167] *Id.* at 8:8-17.

[168] *Id.* at 10:1-11-21.

[169] *Id.* at 9:7-11.

127 Mr. Gomez contests the Company's claim that the expiration of the PGE sales contract necessitates a change in the power cost baseline. Avista made this same argument in the 2016 rate case, arguing that rates in 2017 had to be reset to account for the contract's expiration at the end of 2016. When the Commission rejected that case and left the baseline unchanged, rates continued to reflect the revenue that Avista received from the contract.[170] Despite that, Mr. Gomez testifies that Avista still over-collected on its power costs by $3.6 million through September 2017, suggesting that Avista overstated the impact of the PGE contract expiration and that granting the Company's request in the 2016 case would have only resulted in additional deferrals in 2017.[171]

128 Mr. Gomez also compares Avista's power cost modeling from 2011 to 2016 to that of PSE over the same period, and finds that PSE, on average, over-forecasted its power costs by 0.6 percent per year, while Avista, on average, over-forecasted its power costs by 7.4 percent per year over the same period.[172] He concludes that Avista's forecast inaccuracies are the result of its flawed usage of the Aurora model and spends the bulk of his testimony providing a detailed explanation of the specific flaws he identified.[173] Mr. Gomez argues that the problems he identifies demonstrate that Avista is manipulating the model to overestimate its power costs.[174] He identifies eight specific issues with the Company's usage of Aurora and presents Staff's alternative for how the issues should have been handled. In brief, Mr. Gomez identifies the following issues:

1. Rate year loads: Avista's modeled load in the rate year is 4 percent higher than weather-normalized test year load. Using projected load growth rates from Avista's 2015 Integrated Resource Plan, rate year loads should only be 0.5 percent higher than the test year.[175]

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[170] *Id.* at 12:6-8. See also *WUTC vs. Avista Corporation,* Dockets UE-160228 and UG-160229, Exh. WGJ-1T at 5:9-6:3.

[171] *Id.* at 12:8-17. Through November, Avista over-collected by $3 million.

[172] *Id.* at 13:1-5.

[173] *Id.* at 13:13:6-14:2.

[174] *Id.* at 14:13-15.

[175] *Id.* at 15:1-12.

2. Hourly load shape: Avista does not normalize its hourly load shape, resulting in larger hourly variations during costly peak hours.[176]

3. Forced outage rates: Avista does not provide documentation for its forced outage rate assumptions for some plants and does not reflect recent reliability investments that the Company represented as reducing forced outage rates at certain plants.[177]

4. Variable O&M costs: Avista could not provide documentation for the variable O&M costs that it input into Aurora.[178]

5. Marginal cost adders: Avista applies marginal cost adders to certain resources to make the modeled dispatch more reflective of actual dispatch, but it does not document how those adders are determined.[179]

6. Resource dispatch margin: Avista uses this input to align Aurora's modeled power prices with current market forward prices, but it results in further model distortions and has failed to deliver accurate price forecasts.[180]

7. General model settings: Avista acknowledges that it made general changes to Aurora's dispatch settings but did not explain the purpose for these modifications. Changes of this nature require significant discovery to understand and effectively shift the burden of proof onto Staff and other intervenors.[181]

8. Out-of-model adjustments: Avista's process for incorporating its power and natural gas contracts into the Aurora model is unclear and inconsistent.[182]

129 Mr. Gomez concludes that Avista's power cost request should be rejected because its modeling has been consistently inaccurate and its manipulations of the Aurora model are undocumented and result in power costs that other parties cannot validate.[183] He further

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[176] *Id.* at 16:16-18:6.

[177] *Id.* at 18:8:22:2.

[178] *Id.* at 22:6-23:11.

[179] *Id.* at 23:14-27:12.

[180] *Id.* at 27:14-32:5.

[181] *Id.* at 32:32:7-33:12.

[182] *Id.* at 33:14-34:17.

[183] *Id.* at 35:3-19.

argues that the structure of the ERM and the current deferral balance of $21.3 million provide both the Company and ratepayers with sufficient protections during the Rate Plan.[184] He recommends that Avista undertake a complete overhaul of its power cost forecasting and begin investigating the sources of its forecast errors.[185]

130 ***Public Counsel.*** Rachel S. Wilson of Synapse Energy Economics responds to Avista's requested power cost increase on behalf of Public Counsel. She concludes that Avista's frequent overearning through the ERM mechanism is driven by the Company's efforts to match the Aurora output to Mid-C forward prices and the many distorting adjustments it makes to the model to reach that target.[186] She recommends that the Commission reject the Company's requested power costs, that the ERM be allowed to function as designed and balance over time, and that Avista fully explore participation in the EIM.[187]

131 Ms. Wilson argues that the ERM was designed to manage power cost variability from year-to-year, but Avista's requests to reset the baseline every year since 2011 have prevented it from operating in this manner.[188] She also argues that recent years have been relatively stable both in terms of natural gas prices and hydropower production, and that Avista's persistent over-collection of actual power costs – which the Company has not explained – must therefore be the result of modeling flaws.[189]

132 Avista's use of Mid-C forward prices as its modeling target is inappropriate, Ms. Wilson argues, because market forwards and dispatch modeling serve different purposes. Market futures are financial instruments used for regional trading, while the purpose of dispatch modeling is to determine the least-cost solution for meeting demand in a given area, based on known factors such as resource costs and expected load.[190]

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[184] *Id.* at 35:17-19.

[185] *Id.* at 36:2-14.

[186] Wilson, Exh. RSW-1CT at 4:7-17.

[187] *Id.* at 4:18-5:2.

[188] *Id.* at 8:1-8.

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

[190] *Id.* at 9:4-10:9.

133 Ms. Wilson argues that Aurora should be used to forecast expected costs under average conditions, which is why Avista and other utilities use 80 years of hydro data. By contrast, Mid-C futures are based on what market participants expect to happen given current conditions.[191] Furthermore, Mid-C prices represent profit-maximizing behavior by market participants to get the most value for their generation, whereas a dispatch model is seeking a least-cost balance of load and resources.[192]

134 Ms. Wilson argues that while a dispatch model has to solve for 24 hours every day, Mid-C contract prices are only divided into peak and non-peak offerings, which does not provide sufficient granularity for an hourly dispatch solution.[193]

135 To match its modeled prices to Mid-C forwards, Avista modifies inputs like resource costs and expected loads. Ms. Wilson argues that Aurora is not equipped to respond appropriately to those kinds of changes, and the output is distorted as a result.[194] In general, she argues, Avista's practice of increasing load to get the model to match Mid-C forwards results in it over-forecasting Avista's need to dispatch or purchase energy from high-cost peaking units, which, in turn increases Avista's power costs.[195]

136 Ms. Wilson concludes that the Commission should reject the Company's request and require Avista to explain the reason for its over-earnings from 2011 to 2016.[196] She testifies:

> At a minimum, the Commission can require Avista to provide the reasoning behind its overearning in the relevant historical years from 2011 through 2016. This may include backward-looking validation of the Aurora$_{XMP}$ model, where Avista compares modeled results from Aurora$_{XMP}$ to actual prices at Mid-C, and/or using evidence from its own purchases and sales, to discern the causes behind deviations in actuals from forecasts. Avista may want them to calibrate the model, making adjustments based on historical data (rather than the current iterative process used by

[191] *Id.* at 10:10-19.

[192] *Id.* at 11:1-7.

[193] *Id.* at 11:13-12:8.

[194] *Id.* at 13:1-14:14.

[195] *Id.* at 15:1-16:11.

[196] *Id.* at 18:7-9.

the Company) with the goal of more accurately matching forecasted net power supply expenses to actuals.[197]

137 She also recommends that Avista return to a fundamentals-based approach to forecasting power costs, which makes minimal model adjustments.[198] Finally, she suggests that the Commission consider requiring Avista to conduct a backward-looking validation of its power cost forecasts from 2011 through 2016, to identify the causes of its forecast error and better calibrate the model.[199]

138 ***ICNU.*** ICNU witness, Mr. Bradley G. Mullins recommends that the Commission deny the Company's request, based on Staff's discovery that "Avista's power cost modeling is based on a number of arbitrary assumptions which are intentionally designed to inflate the level of power costs in setting the ERM."[200] Mr. Mullins states, while in previous cases he has raised many of the power cost modeling issues that Staff identified in this case, Staff's investigation in this case has demonstrated that the impact of the Company's "arbitrary assumptions" is greater than he had understood.[201] He concludes that the authorized power costs should remain at the current level as the Company's current ERM deferral balance provides a sufficient hedge in the event that the Company's projected power cost increases are realized.[202]

139 ***Avista's Rebuttal.*** Mr. Johnson testifies that if Avista's power cost baseline is not increased, the ERM's dead band structure will force the Company to absorb a majority of its projected power cost increase as unrecovered costs.[203] He argues that Staff and the other parties have failed to provide any evidence to support their recommendations, and instead "assume that, because Avista didn't perfectly forecast costs during a period of rapidly falling expense,

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[197] *Id.* at 18:7-15.

[198] *Id.* at 18:16-21.

[199] *Id.* at 18:7-13.

[200] Mullins, Exh. BGM-1T at 31:17-19.

[201] *Id.* at 31:19-23.

[202] *Id.* at 31:1-8.

[203] Johnson, Exh. WGJ-6T at 2:18-3:2.

there must be something inherently or intentionally biased in its power cost modelling and that bias somehow magically offsets other undisputed power cost increases."[204]

140 However, in light of the parties' recommendations, Mr. Johnson suggests that Avista would be willing to forego its proposed annual power cost adjustments in years two and three of the Rate Plan, if the Commission approves the Company's requested first-year increase, to allow the parties to "reach a common understanding of what the ERM is designed to do."

141 He argues that the ERM should be evaluated in terms of its overall history since 2003, to recognize that the Company has absorbed significant losses as well, and to appreciate the decline in power costs since 2011, which has been a positive development for all parties and resulted in significant benefits to customers.[205] He also argues that attacks on the Company's modeling practices are unfair, as the Commission has approved the modeling approach on many occasions.[206]

142 Mr. Johnson testifies that since 2003, the net position of the ERM mechanism is $37.3 million in under-forecast power costs, of which the Company has absorbed $16.8 million and customers have paid $20.6 million.[207] He argues that the recommendations of Staff and the other parties ignore the first seven years of the ERM.[208]

143 Mr. Johnson asserts that the recent trend of lower-than-forecast power costs is the result of rapidly falling power cost prices. Since 2011, he states, Washington's allocated power costs have fallen by $133.1 million, and customers have captured $108.5 million of those reductions through reduced rates and ERM rebates.[209] Prices for natural gas and power have simply fallen faster than the ERM mechanism could adjust, and Avista has had good water conditions and good luck with plant availability, which have further reduced power prices.[210] According to Mr. Johnson, Avista has been successfully responding to the ERM's

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[204] *Id.* at 3:5-12.

[205] *Id.* at 4:1-13.

[206] *Id.* at 14-21.

[207] *Id.* at 8:1-17.

[208] *Id.* at 9:4-6.

[209] *Id.* at 10:20-11:4.

[210] *Id.* at 12:1-8.

incentives to manage its power costs, not manipulating the model as the parties allege.[211] Similarly, he argues that the Company's over-collection of power costs in 2017, despite the rejection of its 2016 GRC, is the result of good luck related to favorable hydro conditions and the continued decline in natural gas prices, not modeling deficiencies.[212]

144 Mr. Johnson argues that the loss of the PGE sales contract accounts for $10.6 million, or 66 percent of the Company's requested power cost increase, and that known contract terms for purchased power account for another $3.3 million.[213] He also asserts that Avista is entitled to recover known, legitimate increases such as these, and that allowing them to flow through the ERM, as the intervenors suggest, is contrary to the mechanism's purpose.[214]

145 Mr. Kalich argues that none of the other parties presented alternate power cost calculations, and that their scattershot criticisms do not produce any tangible alternatives.[215] He maintains that Staff had all of the tools and information necessary to conduct alternative Aurora model runs but did not do so.[216] ICNU and Public Counsel were provided with similar opportunities to conduct their own Aurora runs, but each also declined to do so.[217]

146 Mr. Kalich testifies that Avista conducted 23 alternative Aurora runs in response to data requests from the parties, and additional runs to evaluate the recommendations of Mr. Gomez.[218] He implies that the parties ignored these analyses because the analyses resulted in higher power costs.[219]

147 Mr. Kalich argues that Avista's power cost modeling methodology has been developed over many years with significant input from Staff and other parties. Modeling changes have only been adopted after significant vetting and Commission approval, and should not be changed

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[211] *Id.* at 12:13-22.

[212] *Id.* at 13:8-23.

[213] *Id.* at 14:1-21.

[214] *Id.* at 15:5-14.

[215] Kalich, Exh. CGK-4T at 2:21-25.

[216] *Id.* at 3:1-23.

[217] *Id.* at 6:13-7:5.

[218] *Id.* at 4:3-5; *Id.* at 6:5-12.

[219] *Id.* at 7:16-20.

based on how current conditions benefit one party or another, particularly in the absence of alternative model recommendations.[220]

148 In response to intervenors' comparisons of actual power costs to authorized power costs in historical years, Mr. Kalich contends that power cost modeling is based on normalized conditions, not forecasts, and it is therefore unreasonable to expect that the forecast will match actual costs in a given year.[221]

149 Mr. Kalich responds to the criticisms of each party directly. He takes exception to Mr. Gomez's assertion that the Company's filing lacks transparency, stating that parties had full access to the model and all of the Company's assumptions. No other party has made that accusation, he points out.[222]

150 Mr. Kalich then undertakes a point-by-point response to the eight issues that Mr. Gomez identified. He generally argues that the Company's practices in these areas are based on previous precedent and that Mr. Gomez does not provide a strong rationale for changing the practice. Many of the changes that Mr. Gomez recommends are related to ensuring the proper dispatch order, and do not have a material impact on power costs. When the Company conducted a model run that incorporated all of Mr. Gomez's recommendations, it actually increased system power supply costs by $2.7 million, Mr. Kalich states.[223]

151 Mr. Kalich also provides a response to the critiques of Public Counsel witness Ms. Wilson. He argues that her position rests on a flawed assertion that water levels and natural gas prices have been "relatively stable" since 2011.[224] He also dismisses her argument that matching Aurora's output to market forwards is distortionary, stating that matching the model to market forwards is consistent with Commission-approved practice and results in a more realistic model outcome. Not matching the model to market forwards would distort the results and reduce the accuracy of power cost forecasts, he concludes.[225] When Ms.

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[220] *Id.* at 8:14-9:10.

[221] *Id.* at 11:3-10.

[222] *Id.* at 12:21-13:9.

[223] *Id.* at 20:3-7.

[224] *Id.* at 22:2-10.

[225] *Id.* at 24:1-20.

Wilson's recommendations are included in the model, Mr. Kalich testifies that power costs increase by $5.6 million.[226]

152 In response to ICNU, Mr. Kalich simply states that Mr. Mullins relied wholly on the testimony of Staff for his recommendation, and in the absence of any evidence or analysis to support it, that recommendation should be rejected.[227]

153 ***Discussion and Decision.*** As Avista witness Mr. Kalich indicates in his rebuttal testimony, the contention over power costs in this case has risen to a level that we have not seen in some time.[228] That said, the issues raised by intervening parties suggest that this debate was long overdue. Regardless of whether changes in Avista's modeling practices have been made incrementally and with the support of the Commission and parties, as Mr. Kalich argues,[229] it is clear that those changes have collectively pushed the modeling to a tipping point and injected controversy into a topic that has historically been marked by general agreement among the parties.

154 The power cost debate in this case revolves around two central points: Avista's power cost modeling practices and the appropriateness of changing the ERM baseline. We take each of these in turn.

155 Mr. Kalich correctly identifies the Commission's previous endorsement of the bidding factor approach to aligning the power cost model. However, his own testimony also makes it clear that the Company has added a number of modeling modifications in addition to bidding factors, such as "adjusting congestion and costs to transmission from the Northwest to California, adjusting Northwest hydro shaping factors, and modifying Northwest electricity loads."[230]

156 It is not clear in the record whether the parties and the Commission have reviewed and accepted these additional modifications. What is clear in the record is that Avista's power cost forecasts have been consistently unbalanced in the Company's favor over recent years.

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[226] *Id.* at 27:11-18.

[227] *Id.* at 28:1-12.

[228] *Id.* at 9:1-2.

[229] *Id.* at 9:4-10.

[230] Kalich, Exh. CGK-3T at 10:1-5.

Avista has not supplied a backcast or other analysis to isolate the effect of lower natural gas prices and power prices on the directionally biased results observed over the last six years. The modeling concerns Mr. Gomez and Ms. Wilson raise are a first effort to remedy the repeated, unbalanced outcomes and may offer some explanation as to the cause of the observed inaccuracies.

157 The second point relates to the justification for increasing Avista's ERM baseline. Most of this discussion centered on the expired PGE contract, which Avista represents as a $10.6 million annual net loss.[231] Mr. Gomez argues that the Company should not be granted an increase based on the expiration of the PGE contract because it has already gone one year since the expiration of the contract without an adjustment and still over-recovered its power costs, which indicates that the Company overstated the loss and did not need an adjustment.[232] Mr. Johnson counters that low gas costs and favorable hydro conditions allowed the Company to absorb the lost PGE revenue in the test year.[233]

158 We agree with Mr. Johnson. Power costs are set based on known and forecast costs during a normalized year, and decisions should not be made solely based on how the forecast performed during the specific circumstances of a single test year. The expiration of the PGE contract is a finite, known event with a measurable impact, and adjusting the ERM baseline based on how that event would impact power costs during a normalized year is appropriate.

159 We authorize an increase of $14.5 million to the ERM baseline. This increase accounts for the increase in Washington's allocated share of power costs and the increased transmission costs identified by Mr. Schlect, which were both uncontested. It also accounts for the lost revenue from the PGE contract, which we find to be a significant change that justifies a baseline adjustment.

160 While we are authorizing an increase to the baseline in the instant case, the Commission believes the number of recent baseline adjustments is excessive. As Staff has pointed out, setting a proper baseline is necessary for the ERM to function as intended. Moving the baseline upward or downward in each general rate case results in distorted results. Going forward, the Commission will consider carefully any adjustments to the power cost baseline

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[231] Johnson, Exh. WGJ-6T at 14:1-21.

[232] Gomez, Exh. DCG-1CT at 12:8-17.

[233] Johnson, Exh. WGJ-6T at 13:8-23.

and change it only in extraordinary circumstances, which would include more closely matching the baseline to actual collections.

161 Further, we order the Company to engage Staff, Public Counsel, ICNU, and other interested stakeholders in a discussion about how power cost modeling may be simplified and improved. While we do not think that a technical topic like power cost modeling lends itself to a formal collaborative or Commission proceeding at this time, we direct Avista to consult with its peer utilities, independent experts in the power cost modeling industry, Staff, and the other parties in this case on ways in which the Company may document the functionality and rationale of its power cost modeling and make changes to eliminate its directional bias. We order the Company to report back on this process and identify any resulting changes in its methodology in its next general rate case filing.

162 We recognize the apparent incongruity in questioning the Company's power cost model, but accepting that model's representation of how the PGE contract expiration affected the Company's revenue requirement. However, we find that the end of the PGE contract is a significant change to Avista's power costs that justifies a change in the baseline, and Avista's representation of how the revenue loss impacts the baseline is the only representation we have in the record. We therefore accept that representation for the purposes of this case only, and take this opportunity to remind intervening parties that they should endeavor to prepare and propose their own adjustments to power cost models and, where practical, to support their arguments with power cost modeling.

D. Capital Additions

163 ***Avista.*** In its initial filing, Avista proposes two separate pro forma capital adjustments each for electric and natural gas operations, resulting in four total adjustments. The first series of adjustments are based on a traditional pro forma study, while the second are based on the Company's proposed EOP study.

164 For the traditional pro forma adjustments, Avista proposes to use a cutoff date of December 31, 2017, and a threshold of 0.5 percent of rate base, which translates to a threshold of $6.9 million for electric projects and $1.3 million for natural gas projects.[234] Using this approach,

[234] Schuh, Exh. KKS-1T at 9:8-18.