REVISED January 19, 2018

Exhibit BGM-1Tr
Dockets UE-170485/UG-170486
Witness: Bradley G. Mullins

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*)

RESPONSE TESTIMONY OF BRADLEY G. MULLINS

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

AND

THE NORTHWEST INDUSTRIAL GAS USERS

October 27, 2017

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RESPONSE TESTIMONY OF BRADLEY G. MULLINS

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I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Bradley G. Mullins, and my business address is 333 SW Taylor Street, Suite 400, Portland, Oregon 97204.

Q. PLEASE STATE YOUR OCCUPATION AND ON WHOSE BEHALF YOU ARE TESTIFYING.

A. I am an independent energy and utilities consultant representing large energy consumers throughout the western United States. I am appearing on behalf of the Industrial Customers of Northwest Utilities ("ICNU") and the Northwest Industrial Gas Users ("NWIGU"). ICNU is a trade association whose members are large electric customers served by electric utilities throughout the Pacific Northwest, including Avista Corporation ("Avista" or the "Company"). Similarly, NWIGU is a trade association whose members are large gas customers served by gas utilities throughout the Pacific Northwest, including Avista. Both organizations have an interest in ensuring that the electric and gas service rates of Avista are in the public interest.

Q. PLEASE SUMMARIZE YOUR EDUCATION AND WORK EXPERIENCE.

A. I have a Master of Accounting degree from the University of Utah. After obtaining my Master's degree, I worked at Deloitte in San Jose, California, where I specialized in research and development tax credit studies. I later worked at PacifiCorp as an analyst involved in power cost forecasting. I began performing independent energy and utility consulting in September 2013 and currently provide services to utility customers on matters such as power costs, revenue requirement, rate spread and rate design. I have sponsored testimony in several regulatory jurisdictions around the United States,

including before the Washington Utilities and Transportation Commission ("WUTC" or the "Commission"). A list of cases where I have submitted testimony can be found in Mullins, Exh. BGM-2.

Q. WHAT IS THE PURPOSE OF YOUR RESPONSE TESTIMONY?

A. I discuss my review of Avista's proposed revenue requirement based on a test period corresponding to the year ending December 31, 2016. I also discuss Avista's proposal for a three-year rate plan, which would establish a schedule of escalating rates remaining in effect as far into the future as mid-2021.

Q. WHAT WAS THE SCOPE OF YOUR REVIEW?

A. Effectively, Avista has relied on three different sets of revenue requirement calculations to develop its rate proposal in this matter.[1/] Using the traditional revenue requirement methodology—the Commission's longstanding method, based on use of a modified historical test period—Avista calculates a revenue requirement deficiency of $37,501,000[2/] for electric services, and $4,531,000[3/] for gas services. Under a second methodology, which it refers to as an End-of-Period ("EOP") Study, Avista calculates a revenue requirement deficiency of $61,356,000[4/] for electric services, and $8,269,000[5/] for gas services. Finally, Avista presents an analysis referred to as a K-Factor Study,

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1/ Andrews, EMA-1T at 7:9-8:31 (Note that while Avista lists four revenue requirement calculations, only the first three are used to develop its rate proposal. The Rate Year study was "not the basis of the Company's requested Three-Year Rate Plan relief, but rather [was] provided as additional evidence demonstrating the need for revenue increases").

2/ Andrews, Exh. EMA-2 at 1.

3/ Andrews, Exh. EMA-6 at 1.

4/ Andrews, Exh. EMA-3 at 1.

5/ Andrews, Exh. EMA-7 at 1.

which is similar to the attrition revenue requirement study it has presented to the Commission in the past proceedings. Based on the K-Factor study, Avista asks for two successive increases in the second and third years of its proposed three-year rate plan. For electric services, Avista proposes revenue increases of $13,863,034 on May 1, 2019, and $14,307,603 on May 1, 2020.[6/] For gas services, Avista proposes revenue increases of $4,294,927 on May 1, 2019, and $4,494,440 on May 1, 2020. Collectively, the culmination of all these different revenue calculations is that Avista is seeking revenue increases in this matter that amount to $89,526,637 for electric services, and $16,906,116 for gas services. Those represent staggering rate increases to the customers located in Avista's service territory of 18.24% for electric services and 19.03% gas services.

Q. BASED UPON YOUR REVIEW OF THESE CALCULATIONS, WHAT ARE YOUR PRINCIPAL RECOMMENDATIONS AND CONCLUSIONS?

A. Avista's proposals for rate increases of nearly 20 percent for both electric and gas services would have a significant, negative impact on customers in Avista's service territory. Avista tries to justify its request using several different ratemaking theories. When viewed under traditional ratemaking methods, however, it is apparent that Avista has little need for rate relief. Accordingly, the Commission must determine whether the financial conditions at Avista are so dire as to outweigh the negative ratepayer impact from rate increases of nearly 20%. Based upon my review, the financial condition of Avista has never been better, and accordingly, I have concluded as follows:

6/ Andrews, Exh. EMA-4 at 1.

- *Extraordinary Rate Relief.* I recommend that the Commission reject Avista's claims for extraordinary rate relief, including both the EOP Study and the K-Factor Study. Rather, I recommend the Commission establish rates using the traditional ratemaking principles that have been in place at the Commission for many decades.

- *Traditional Revenue Requirement.* I recommend that the traditional revenue requirement methodology be used to establish revenue requirement. Based upon that methodology, I have identified a modest revenue deficiency in the amount of $196,527 (0.04%) for electric services,[7/] and revenue sufficiency in the amount of $530,231 ((-)0.6%) for gas services.[8/]

- *Rate Plan.* I have updated the attrition analyses prepared in Avista's 2016 General Rate Case ("GRC"). These analyses show that, if a rate plan is to be approved, it would not be justified at the inflated revenue levels Avista proposes. These analyses can be found at Mullins, Exh. BGM-5 for electric services and Mullins, Exh. BGM-6 for gas services.

- *ERM Baseline.* Due to modeling insufficiencies, I recommend that the Commission reject the variable power supply calculations of Avista and maintain the existing Energy Recovery Mechanism ("ERM") baseline, until the ERM balance reaches a more reasonable level.

- *Depreciation Study.* I recommend that the Commission take into consideration in this case the impact of Avista's deprecation study, which is expected to be filed before the end of the year.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. First, I discuss Avista's persistent requests for extraordinary rate relief, and demonstrate that there is no evidence to indicate that Avista will be subject to financial distress, if the

7/ See Mullins, Exh. BGM-3 (Electric Traditional Revenue Requirement Calculations).
8/ See Mullins, Exh. BGM-4 (Natural Gas Traditional Revenue Requirement Calculations).

traditional revenue requirement methodology is used. Second, I discuss the results of the traditional revenue requirement methodology, and propose a few adjustments to that methodology. Third, I briefly discuss the new depreciation study that Avista intends to file before the end of the year.

Q. ARE OTHER WITNESSES PROVIDING TESTIMONY ON BEHALF OF ICNU OR NWIGU IN THIS PROCEEDING?

A. Yes. Mr. Michael P. Gorman is providing testimony on behalf of ICNU regarding cost of capital. My revenue requirement calculations incorporate the cost of capital recommendation of Mr. Gorman. In addition, Mr. Robert R. Stephens will be providing testimony on behalf of ICNU on electric cost of service, rate spread and rate design issues.

II. AVISTA'S NEED FOR EXTRAORDINARY RATE RELIEF

Q. DOES AVISTA HAVE A HISTORY OF FILING FOR EXTRAORDINARY RATE RELIEF?

A. Yes. Over the past twelve years, Avista has, with great consistency, come before the Commission requesting significant rate relief, and recently of an extraordinary type.[9/] Most commonly, these requests have come in the form of attrition adjustments. In the 2012 GRC, for example, Avista first proposed an attrition adjustment.[10/] That case resulted in a settlement and a two-year rate plan.[11/] In the 2014 GRC, Avista presented

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9/ WUTC v. Avista, Dockets UE-160228 and UG-160229 (Consolidated), Order 06 at ¶ 13 (Dec. 15, 2016).

10/ Id. at ¶ 29 & n.44.

11/ Id. at ¶ 33.

the same attrition study.[12/] That case was also settled.[13/] In the 2015 GRC, Avista presented the same attrition study once more.[14/] That case was litigated, and the Commission approved an attrition adjustment.[15/] In the 2016 GRC, Avista proposed an attrition adjustment based off the use of a trending analysis.[16/] The Commission rejected Avista's filing in that matter.[17/]

Q. IS AVISTA CONTINUING TO SUGGEST IT SHOULD BE ENTITLED TO EXTRAORDINARY RATE RELIEF?

A. Yes. As described in the Direct Testimony of Ms. Andrews, Avista's filing includes two different extraordinary requests for rate relief.[18/] First, Avista includes a study it refers to as an EOP Study, which relies on a forecast of plant balances on December 31, 2017. Second, Avista includes a K-Factor Study, which is effectively the same as the attrition revenue requirement Avista has prepared in the past.

Q. DOES AVISTA NEED EXTRAORDINARY RATE RELIEF?

A. No. Avista's earnings show that Avista is far from needing any sort of extraordinary rate relief measures. In response to ICNU Data Request 67, Avista provided its historical earnings over the period 2013 through June 2017, which has been presented in Table 1, below.[19/]

12/ Id. at ¶ 37.
13/ Id. at ¶ 38.
14/ Id. at ¶ 45.
15/ Id. at ¶¶ 56-58.
16/ Id. at ¶ 61 & n.119.
17/ Id. at ¶ 114.
18/ Andrews, Exh. EMA-1T at 7:9-8:18.
19/ Mullins, Exh. BGM-7 at 4 (the Company's Response to ICNU Data Request ("DR") 67).

TABLE 1
Avista Historical Return on Equity

	2013	2014	2015	2016	06 2017
Actual					
Electric	10.8%	11.5%	10.2%	**10.4%**	9.8%
Gas	7.6%	5.8%	5.6%	**11.5%**	10.8%
Normalized					
Electric	9.9%	10.6%	9.4%	9.4%	
Gas	6.2%	5.8%	6.1%	8.0%	

Q. WHAT DOES TABLE 1 SHOW?

A. Table 1 shows that Avista was in a position of severe overearning in 2016, corresponding to a return on equity of 10.4% for electric services and 11.5% for gas services. Part of this overearning was due to weather conditions that were favorable to the utility in 2016. Notwithstanding, the historical pattern of actual earnings indicate a very healthy utility. Over the period 2013 through 2016, Avista achieved an average actual return on equity equal to 10.7% on the electric business line, which constitutes the majority of Avista's revenues in Washington.

While gas results have produced lower return on equity values in the past, gas returns are still within a range of reasonableness of approved return levels. Avista's actual returns on the gas business line also improved materially in 2016.

Given this historical pattern of healthy earnings, there is no valid reason why the traditional approach—which has been used successfully as recently as the 2017 Puget Sound Energy GRC—should not be used.

Q. IS DECLINING USE PER CUSTOMER A REASON TO APPROVE THESE EXTRAORDINARY MEASURES?

A. No. Mr. Morris identifies declining use per customer as a reason that the traditional revenue requirement methodology is insufficient. Notwithstanding, nearly every utility in the Northwest is dealing with the issues associated with declining use per customer. Portland General Electric, for example, recently concluded a general rate case, where it initially forecast declining sales of -0.3% in 2017, followed by a slight increase of sales of 0.2% in 2018.[20/] Notwithstanding, Portland General Electric Company was capable of resolving that proceeding with an overall electric rate increase of only about 1.5%. In addition, Avista now has a decoupling mechanism to insulate it from declining customer use.

Q. IS AVISTA HAVING DIFFICULTY ATTRACTING CAPITAL?

A. No. In fact, quite the opposite. Ontario's Hydro One Limited ("Hydro One") has recently offered to purchase Avista for $5.3 billion,[21/] representing a premium of approximately 300% over book equity values of approximately $1.7 billion.[22/] The fact that Hydro One was willing to offer such a premium is evidence that Avista is by no means having difficulty attracting capital, another factor weighing against the use of the extraordinary rate relief measures that it seeks in this case.

20/ In re Portland General Electric Company, Request for a General Rate Revision, Or.PUC Docket No. UE 319, PGE/1202 at 1.

21/ WUTC v. Avista, Docket U-170970, Joint Application at ¶ 15 (Sept. 14, 2017).

22/ See, e.g., Avista, Form 10-Q at 8 (June 30, 2017); Docket U-170970, Lopez, Exh. CFL-1T at 12:17-18.

Q. IS THE LACK OF A CURRENT DEPRECIATION STUDY ALSO PROBLEMATIC WHEN CONSIDERING AVISTA'S REQUESTS?

A. Yes. As identified in its response to ICNU Data Request 49, Avista expects that it will file a new depreciation study before the end of the year.[23/] The expectation for a new depreciation study casts doubt over the viability of the extraordinary measures Avista proposes, as well as the viability of revenue requirement based on the tradition revenue requirement methodology. Under RCW 80.04.350, the Commission is provided with the following authority with respect to setting the depreciation rates of Avista:

> The commission shall have power after hearing to require any or all public service companies to carry proper and adequate depreciation or retirement accounts in accordance with such rules, regulations and forms of accounts as the commission may prescribe. The commission may from time to time ascertain and by order fix the proper and adequate rates of depreciation or retirement of the several classes of property of each public service company. Each public service company shall conform its depreciation or retirement accounts to the rates so prescribed. In fixing the rate of the annual depreciation or retirement charge, the commission may consider the rate and amount theretofore charged by the company for depreciation or retirement.[24/]

Since Avista will file for new depreciation rates after parties have submitted testimony in this case, there is no rational way, in this case, to viably consider the adequacy of the depreciation rates that Avista proposes.

Q. HAS THE TRADITIONAL REVENUE REQUIREMENT BEEN SUFFICIENT FOR OTHER UTILITIES?

A. Yes. In Docket UE-170033, Puget Sound Energy filed its case using the traditional revenue requirement methodology. I reviewed Puget Sound Energy's revenue

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23/ Mullins, Exh. BGM-7 at 3 (the Company's Response to ICNU DR 49).

24/ RCW 80.04.350.

requirement in that matter, which was based on the use of a modified historical test period with limited major pro forma additions. Puget Sound Energy also relied upon the use of average-of-monthly-averages in establishing rate base. In addition, parties in that matter settled on a modest revenue increase of 0.9% for electric services and a revenue decrease of 3.8% for gas services,[25/] in contrast to Avista's request for nearly 20% rate increases. Puget Sound Energy found the traditional revenue requirement methodology to be sufficient, and did not find it necessary to inflate its filing with aggressive revenue requirement methodologies, such as the EOP Study and K-Factor study Avista proposes, which I will discuss further below.

a. End-of-Period Study

Q. PLEASE PROVIDE AN OVERVIEW OF THE EOP STUDY.

A. The most important thing to recognize with respect to the EOP Study is that the EOP *Study* is not the same as EOP *rate base*. The Commission has in the past considered using EOP rate base on a case-by-case basis. In Pacific Power & Light Company's ("Pacific Power") 2014 GRC, for example, the Commission rejected Pacific Power's use of EOP rate base.[26/] In Pacific Power's 2015 GRC, however, the Commission approved the use of EOP rate base, albeit on a modified basis.[27/] Avista seems to imply that it is proposing EOP rate base in this matter, but it is not. The EOP Study is materially different from EOP rate base, and therefore, the two should not be conflated.

25/ WUTC v. Puget Sound Energy, Dockets UE-170033 and UG-170034 (Consolidated), Mullins, Exh. BGM-17T at 1:15-2:8.

26/ WUTC v. Pacific Power, Dockets UE-140762 *et al.*, Order 08 at ¶ 151 (Mar. 25, 2015).

27/ WUTC v. Pacific Power, Docket UE-152253, Order 12 at ¶ 173 (Sept. 1, 2016).

Q. HOW IS THE EOP STUDY DIFFERENT THAN EOP RATE BASE?

A. EOP rate base, as it has been considered by the Commission in the past, represents using plant balances at the end of the test period, rather than relying on the average-of-monthly-average ("AMA") plant balances—the Commission's preferred approach. In contrast, Avista's EOP Study represents a forecast of capital expenditures, used to develop an estimate of future plant balances, as of December 31, 2017. Thus, Avista's EOP Study proposal is different than EOP rate base because it extends plant balances well beyond the end of the test period.

Q. HAS THE COMMISSION HISTORICALLY ALLOWED THE USE OF FORECAST PLANT BALANCES, AS PROPOSED IN THE EOP STUDY?

A. No. The EOP Study of Avista is inconsistent with the Commission's historical methodology for performing rate base valuation, and for that reason, is not appropriate to be used to establish rates in this matter. The Commission's practice for considering post-test-period capital additions is well established. Historically, the Commission has only considered major pro forma capital additions, and has done so on a case-by-case basis. I discuss this practice further, below, in the context of traditional revenue requirement calculation. This practice has its roots in the requirements of RCW 80.04.250, which provides that property must be "used and useful for service in this state," to include its fair value in rate base.

Q. SHOULD EOP RATE BASE BE USED IN THIS MATTER?

A. No. The Commission has traditionally required that utility rates be established relying on the measurement of rate base using the AMA approach.[28/] The Commission has deviated from the AMA rate base approach in the past by relying on EOP rate base. Notwithstanding, Avista did not explicitly request the use of EOP rate base in this matter, as its request associated with the EOP Study is materially different than the EOP rate base that the Commission has used in the past. The only salient connection between the two is the fact that the names both contain "EOP," and to the extent that Avista intended for the EOP Study to be interpreted as the same thing as EOP rate base, that would be an indication that Avista's proposal was somewhat misleading.

Finally, between the depreciation study and pending merger, there is a great deal of uncertainty surrounding Avista's expected plant balances. It might be that an adjustment to plant balances is necessary as a result of the new depreciation study. Consideration of a Nevada Power's theoretical reserve imbalance, for example, was recently an issue in the depreciation study prepared concomitantly with Nevada Power's ongoing GRC.[29/] Similarly, it is not clear if some form of plant adjustment might be made in connection with the merger. These uncertainties factor against using EOP rate base, since any changes to plant balances will produce a more moderate result based on using the traditional AMA methodology.

28/ Id. at ¶172.

29/ See Application of Nevada Power Company d/b/a NV Energy for approval of new and revised depreciation and amortization rates for its electric and common accounts, Nv.PUC Docket 17-06004, Allis-DIRECT at 21.

b. K-Factor Study

Q. PLEASE PROVIDE AN OVERVIEW OF AVISTA'S K-FACTOR STUDY.

A. Functionally, the K-Factor Study is similar to the attrition revenue requirement studies Avista has presented in the past. The analysis functions by comparing historical trends in Avista's costs to forecast revenue growth. The primary distinction between the K-Factor Study and Avista's former attrition analyses is, however, that the escalation factors were considered on a *percentage of revenue requirement* basis to develop a singular revenue requirement escalator, which Avista refers to as the K-Factor. In contrast, the attrition studies that Avista prepared in prior proceedings applied the escalation factors for the various elements of the revenue requirement study to calculate the overall year-to-year change in revenue requirement. Formulaically, the same basic calculation is being performed between the K-Factor Study and the former attrition studies, except that the order of operations is different. In addition, there are a number of simplifying assumptions that are made in the K-Factor Study to develop the singular revenue requirement escalator using the percentage of revenue requirement method.

Q. IS THE K-FACTOR STUDY APPROPRIATELY USED TO ESTABLISH RATES?

A. No. There are several reasons why the K-Factor Study is not an appropriate form of rate relief for Avista, given the current circumstances. First, the K-Factor Study is the equivalent of the attrition analysis that Avista proposed in prior proceedings, albeit at a less precise level, and the Commission rejected the attrition analysis in Avista's 2016

GRC.[30/] Second, the K-Factor Study relies on historical trends that are not reliable estimates of future results, and that Avista has not adequately explained. Third, any expectation about the future plant levels and depreciation expenses will become moot once Avista files its next depreciation study. Fourth, the pending merger with Hydro One is another source of uncertainty that will have material impacts on the results of Avista in coming years. For all of these reasons, I recommend that the Commission not approve the K-Factor Study.

Q. IS THE K-FACTOR STUDY AN IMPROVEMENT TO THE ATTRITION ANALYSES AVISTA HAS PERFORMED IN THE PAST?

A. No. While the formula is much the same, the K-Factor Study is performed at a higher level than the former attrition studies, and therefore, is even less desirable to be used in establishing the service rates for Avista. Rather than detailing the historical trends by major cost categories, Avista aggregates the historical trending data into four categories: Depreciation, Operations and Maintenance ("O&M") Expenses, Taxes Other than Income Taxes, and Net Plant. The historical trends are relied upon to develop an estimate of the rate of growth in these categories over the rate period. The rate of growth of these items is then compared to the rate of growth of sales on a percentage of revenue requirement basis, to develop an estimate of the percentage change in revenue in future periods.

In doing it this way, however, many elements of revenue requirement get overlooked. For example, when calculating the revenue weighted escalation rate for rate

30/ Dockets UE-160228 and UG-160229 (Consolidated), Order 06 at ¶ 59.

base, Avista's model did not consider the impacts associated with deferred debits and credits, and working capital. Avista's model also did not make any consideration associated with changes to other revenues in developing the escalation rates. Similarly, Avista did not consider the impact of regulatory amortizations when considering the escalators associated with net operating income items. By applying the K-Factor to the totality of revenue requirement, however, Avista assumes escalation associated with the revenue requirement elements. In the former attrition analyses, the escalation factors were applied to the individual components of revenue requirement and these types of revenue requirement elements were explicitly considered independently from the elements where escalation was applied.

Q. WHAT IS DRIVING THE REVENUE INCREASE IN THE K-FACTOR ANALYSIS?

A. Since it was done at a less granular level than the former attrition study, the driving factors behind the results of the K-Factor Study are even more difficult to ascertain. When approving Avista's attrition analysis in the 2015 GRC, the Commission established that claims of attrition should be based on factors beyond the control of the utility.[31/] It is not possible to understand from the K-Factor Study whether the resultant rate increases are due to factors beyond Avista's control, since the analysis was performed at such a high level. Notwithstanding, I have performed a historical review of each individual cost component included within Avista's results of operations, which may be found in the

[31/] WUTC v. Avista, Dockets UE-150204 and UG-150205 (Consolidated), Order 05 at ¶136 (Jan. 6, 2016).

attrition analyses in Mullins, Exh. BGM-5 for electric services, and Mullins, Exh. BGM-6 for gas services.

Q. ARE DEPRECIATION EXPENSES A DRIVING FACTOR IN THE K-FACTOR STUDY?

A. Yes, increasing depreciation expenses was a key driver of the revenue increases calculated in the K-Factor Study. Avista expects depreciation expense to increase by 9.13% per year for electric services, and 10.93% per year for gas services. Since Avista will be filing a new depreciation study before the end of the year, however, these increases are not accurate representations of the depreciation expenses expected in the rate period and beyond.

Q. WHEN NEW DEPRECIATION ACCRUAL RATES ARE APPROVED, WILL THAT MAKE THE HISTORICAL TRENDS IRRELEVANT?

A. Yes. The historical trends associated with depreciation expense and net plant will become irrelevant once a new depreciation study is approved. Changes to depreciation accrual rates will cause any observable trend in the historical data to be irrelevant, since the rates will be different than the rates that have impacted depreciation expenses in the past.

Q. ARE OPERATING EXPENSES A DRIVING FACTOR IN THE K-FACTOR STUDY?

A. Yes. Avista forecasts escalation in operating expenses in the amounts of 2.5% for electric services and 3.62% for gas services. Yet, upon closer review, it is apparent that many of Avista's operating expenses categories have actually been declining in recent years. For example, between 2015 and 2016, administrative and general operating

expenses declined by (-)1.9% for electric services,[32/] and (-)5.1% for gas services,[33/] which are not insignificant reductions. Similar reductions can be identified in distribution operating expenses for gas services, which declined by (-)2.2% over the period 2015 to 2016.[34/] On the electric side, distribution operating expenses declined by 11.0% over the period 2015 to 2016.[35/]

It is not clear if these reductions have any relation to the ongoing merger proposal. When preparing for a sale, one expects a company to make efforts to cut costs in order to improve results, consistent with the observed pattern.

What is clear, however, is that these are not immaterial reductions to operating expense. Yet, Avista would still allege to the Commission that these costs categories are escalating in a manner beyond its control, an allegation clearly confuted in the observed data.

Q. WHAT DOES THE K-FACTOR STUDY ASSUME WITH RESPECT TO PLANT BALANCES?

A. Avista assumes that net plant balances will grow by 4.8% per year for electric services and 5.2% per year for gas services. Similarly, the rates of change associated with net plant balances are also dependent on the depreciation reserve amounts, thus causing the trajectory of those amounts to change when the depreciation study is implemented.

32/ Mullins, Exh. BGM-5 at 19.
33/ Mullins, Exh. BGM-6 at 20.
34/ Id. at 15.
35/ Mullins, Exh. BGM-5 at 14.

Therefore, the historical data that Avista relied upon is not a reasonable expectation of what will occur with respect to these plant balances into the future.

Q. HAVE YOU BEEN ABLE TO EXPLAIN THE HISTORICAL GROWTH IN NET PLANT?

A. In the 2016 GRC, I expressed concern that growth in general plant has also been a key driver of Avista's historical escalation factors. This rapid growth in general plant has continued into 2016. General plant, however, is typically not a type of plant that I view as being capable of driving a need for attrition. Investments in transmission and production plant can be time-sensitive and outside of Avista's control. In contrast, the need to invest in general plant is generally less time-sensitive, meaning Avista has greater discretion to control and defer those capital outlays as necessary. For example, it is probably unnecessary for a Company experiencing low load growth to invest in a new office building, and accordingly, such an investment may be better deferred. I have not been able to explain the growth in general plant and the concerns that I raised in the 2016 GRC remain unresolved.

Q. DOES THE EXPECTED GROWTH IN PLANT IN THE K-FACTOR STUDY REQUIRE THE COMMISSION TO APPROVE PLANT IN RATE BASE THAT HAS NOT BEEN DEMONSTRATED TO BE USED AND USEFUL?

A. Yes. The above escalation amounts for net plant will increase rate base, yet the amount of the increase is not attributable to any discrete plant addition which the Commission might consider against the used and useful standard. Thus, increasing the plant balances by the escalation rates identified above will require plant to be included in rate base that has not been demonstrated to be used and useful, as required by RCW 80.04.250.

Q. IS THE K-FACTOR STUDY A REASONABLE WAY FOR THE COMMISSION TO IMPLEMENT A RATE PLAN?

A. No. While the continuation of Avista's pattern of filing annual rate cases may not seem desirable, requiring rate cases is an important, and necessary, ratepayer protection. For the utility, rate cases are difficult and risky, and thus provide a deterrent against proposing frivolous rate increases while encouraging rate stability. A rate case also allows the Commission to establish rates holistically, considering all elements of a utility's revenue requirement, based on the most recent information available. For those reasons a rate plan is not desirable.

In addition, the K-Factor revenue increases that Avista seeks do not represent discrete capital additions or revenue requirement items, in contrast to the rate plan that was recently approved for Pacific Power. Thus, the Commission would have no way to validate the subsequent rate increase, as it did recently for Pacific Power.

Q. ARE THERE OTHER CHANGES EXPECTED THAT CREATE UNCERTAINTY SURROUNDING THE NEED FOR A RATE PLAN?

A. Yes. There are many changes that will occur in the coming years with respect to Avista's results of operations. In response to ICNU Data Request 39, Avista identified the amortization of the cost of WNP-3 settlement exchange power.[36/] The WNP-3 regulatory asset amount, however, is expected to be fully amortized by 2019. In Avista's K-Factor Study proposal, there would be no mechanism to account for the savings associated with that change, and other similar changes, which will occur over the rate period.

36/ Mullins, Exh. BGM-7 at 1 (the Company's Response to ICNU DR 39).

Q. IF A RATE PLAN IS TO BE APPROVED, SHOULD IT BE AT LOWER REVENUE LEVELS?

A. Yes. In Mullins, Exh. BGM-5 and Mullins, Exh. BGM-6, I updated the attrition revenue requirement model that I presented in the 2016 GRC, based on Avista's results for the test period. I also modified the model to calculate trend-based revenue requirement for the successive years of Avista's proposed rate plan. To be clear, I do not support the use of the attrition revenue requirement methodology due to its imprecision and other modeling issues, as discussed in the 2016 GRC. Notwithstanding, if any escalation methodology is to be used to inform a rate plan, the model that I developed in the 2016 GRC produces a more informed view of revenue requirement than the K-Factor Study.

Q. WHAT WAS THE RESULT OF YOUR ANALYSIS?

A. Based on the concerns identified above, my base model excluded any escalation for depreciation expenses or operating expenses. For electric services, my model calculates incremental revenue increases of $164,285 (0.03%) on May 1, 2019, and $161,562 (0.03%) on May 1, 2020. For gas services, my model calculates incremental revenue increases of $354,947 (0.41%) on May 1, 2019, and $305,667 (0.35%) on May 1, 2020.

Q. WHAT ARE YOUR MODEL RESULTS IF ESCALATION IS APPLIED TO DEPRECIATION EXPENSES AND OPERATING EXPENSES?

A. Even if escalation is applied to depreciation expenses and operating expenses, my model produces rate increases well below the revenue increases Avista seeks in the subsequent years of the rate plan. For electric services, my model, adjusted for these parameters, calculates incremental revenue increases of $5,200,310~~5,053,041~~ (1.040~~1~~%) on May 1, 2019, and $5,130,410~~4,968,868~~ (0.97%) on May 1, 2020. For gas services, my model,

adjusted for these parameters, calculates incremental revenue increases of $1,411,891 (1.58%) on May 1, 2019, and $1,350,801 (1.49%) on May 1, 2020. In the Excel version of the respective exhibits, there is a toggle switch on the Tab "2) ROR," which allows the user to analyze the impacts of excluding, or including, escalation for these two cost categories.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATION.

A. Based on the foregoing, I recommend that the Commission decline to approve the rate plan proposal of Avista and establish its revenues based on the application of the traditional revenue requirement methodology. As detailed above, my model indicates that the Avista's revenues should effectively remain flat over the rate plan period. To the extent that Avista is in need of further rate relief in subsequent years, it has the ability to file future ratemaking requests based upon the application of the traditional revenue requirement methodology, which will incorporate all known factors and current information at the time the rate case is filed.

III. TRADITIONAL REVENUE REQUIREMENT

Q. WHAT IS YOUR RECOMMENDATION RELATED TO THE TRADITIONAL REVENUE REQUIREMENT CALCULATIONS OF AVISTA?

A. In conducting my initial review, I have concluded that Avista's revenues should be increased by approximately $196,527 (0.04%) for electric services and reduced by $530,231 ((-) 0.35%) for gas services. Further detail underlying these calculations can be found in Mullins, Exh. BGM-3 for electric services, and Mullins, Exh. BGM-4 for gas services. In addition, I might adjust these figures in Cross-Answering Testimony, as I

review the Response Testimony of other parties filed in this matter. To arrive at my recommendation, I have contested the following adjustments:

- Electric Adjustment 3.10, Natural Gas Adjustment 3.10: Pro forma Plant Additions.
- Electric Adjustment 3.12, Natural Gas Adjustment 3.12: Director Fees.
- Electric Adjustment 3.02, Natural Gas Adjustment 3.02: Pro Forma Labor, Non-Exec.
- Electric Adj. 4.00: Pro Forma Power Supply and Transmission Revenues

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATIONS ON THESE ADJUSTMENTS?

A. Table 2, below, details the impacts of my recommendations on the above adjustments.

Table 2
Adjustments to Traditional Revenue Requirement Model
Deficiency / (Sufficiency) ($000)

	Electric	Gas
Company Proposed (Traditional)	**37,501**	**4,531**
Impact of Contested Adjustments		
Cost of Capital (Gorman)	(14,333)	(3,004)
Pro Forma Plant Additions	(6,599)	(1,882)
Director Fees	(394)	(113)
Pro Forma Labor (Non-Exec)	(1,121)	(319)
Power Supply	(16,609)	
Interest Sych. (Cost of Debt)	1,751	256
Total Adjustments	**(37,304)**	**(5,061)**
Initial Recommendation	**197**	**(530)**

a. Electric Adj. 3.10, Natural Gas Adj. 3.10: Pro forma Plant Additions.

Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO AVISTA'S PRO FORMA PLANT ADJUSTMENT?

A. In Avista's Traditional revenue requirement model, it applies pro forma adjustment number 3.10 to apply the Commission's practice of allowing only major pro forma plant additions, relative to test period results. I recommend that Avista be allowed to include some of the major pro forma plant additions in revenue requirement, consistent with past Commission practice. Notwithstanding, I disagree with many of the capital projects that Avista has proposed to include in revenue requirement on a post-test-year basis.

Q. WHAT IS YOUR UNDERSTANDING OF THE COMMISSION POLICY ON POST-TEST-YEAR CAPITAL ADDITIONS?

A. The Commission's policy on pro forma capital additions has been established over a long series of contested proceedings, extending back several decades. In the Pacific Power 2014 GRC, the Commission reaffirmed its policy, stating that its "long-standing practice is to consider post-test-year capital additions on a case-by-case basis following the used and useful and known and measurable standards while exercising the considerable discretion these standards allow in the context of individual cases."[37/] According to the Commission, "[t]his approach provides the Commission with flexibility when evaluating relevant factors without being confined by 'too rigid an approach' through a consistent, bright-line standard."[38/]

37/ WUTC v. Pacific Power, Dockets UE-140762 *et al.*, Order 08 at ¶ 165 (citing WUTC v. PacifiCorp, Docket UE-130043, Order 05 at ¶ 198 (Dec. 4, 2013)).

38/ Id. (citing Docket UE-130043, Order 05 at ¶¶ 198-199).

In addition, only *major* pro forma plant additions have been allowed on a post-test-year basis, although the Commission has not necessarily defined what constitutes *major* in the context of pro forma plant additions. Similarly, the projects that the Commission has approved in the past were not routine replacements of existing mass property, but represented major additions of discrete pieces of property, such as a new fish ladder or construction of a cooling tower at a power plant.

Q. IS THERE AN EXPECTATION THAT CAPITAL EXPENDITURES WILL BEGIN TO SLOW AT AVISTA?

A. Yes. In the past Avista has had a number of major capital additions, such as the Aldyl-A pipe replacement program, new customer information systems, and upgrades at hydro facilities. Many of these projects, however, are completed, or very near to being completed. Accordingly, my expectation has been that Avista's level of capital expenditures will begin to slow in the future. It is not uncommon for utilities to go through build cycles, where a great deal of capital is required, followed by a period of relative stability in capital expenditure levels. At some point, Avista's rate of capital expenditures must slow, and I expect we are near to reaching that point where reduced capital is required of Avista.

Q. WHAT CAPITAL PROJECTS HAS AVISTA CHARACTERIZED AS MAJOR CAPITAL ADDITIONS?

A. Exhibit KKS-2 contains a list of eleven pro forma plant additions which Avista requests be included in the traditional revenue requirement study. These projects can be found on page 1 under the heading Traditional Pro Forma Study Projects.

Q. DO YOU RECOMMEND THAT THE COMMISSION ACCEPT THE PRO FORMA PLANT ADDITIONS AVISTA IDENTIFIED?

A. No. Based upon my review, I recommend that the Commission approve only two of the pro forma plant additions Avista proposed and that the Commission reject the remaining nine projects. The specific projects that I recommend be included in the traditional revenue requirement study are as follows:

- Little Falls Plant Upgrade
- Aldyl-A Pipe replacement

Q. WHY DO YOU RECOMMEND THE OTHER PROJECTS BE EXCLUDED?

A. In general, I disagree that the remaining projects are *major* plant additions, which are appropriately included in revenue requirement on a post-test-year basis. When making this finding, I used a general threshold around $8,000,000 to $12,000,000 to determine whether a discrete project constituted a major plant addition, although I do not believe it is necessary to adhere rigidly to any particular bright-line when considering Avista's additions. In developing that range, I relied on professional judgement, as well my understanding of the projects that the Commission has allowed on a post-test-year basis in past proceedings.

In addition, I also excluded projects which consisted of routine replacement of existing property. Projects consisting of routine replacements cannot be effectively reviewed under the Commission's practice since the routine replacements consist of an aggregation of many small projects. While these individual small projects might have

been aggregated for reporting purposes, that is not a reason to consider those projects as a major, post-test-year plant addition.

Q. WHICH PROJECTS DID YOU EXCLUDE SOLELY ON THE BASIS OF PROJECT SIZE?

A. I excluded the following projects, on the basis that the total capital outlays were lower than, and not near to exceeding, the $8,000,000 to $12,000,000 threshold include:

- New Downtown Netwk Bldg ($6,558,909);
- Gas Non-Revenue Program ($6,095,731); and,
- Gas Replacement Street and Highway Program ($3,319,431).

The project titled Distribution Wood Pole Management ($9,000,000) fell within the threshold range, however, I have otherwise excluded that project because it consists of a collection of small projects, rather than a discrete major plant addition.

Q. WHICH PROJECTS HAVE YOU EXCLUDED ON THE BASIS THAT THEY CONSTITUTE ROUTINE REPLACEMENT OF MASS PROPERTY?

A. The projects that I have excluded on the basis that they constitute routine replacements of mass property include:

- Technology Refresh to Sustain Business Process ($21,191,067);
- Substation - Station Rebuilds ($17,523,887);
- Distribution Grid Modernization ($15,050,687);
- Distribution Wood Pole Management ($9,000,000);
- COF Long-Term Restructuring Plan 2 ($13,694,824);
- Technology Expansion to Enable Business Process ($13,941,487); and
- Gas Replacement Street and Highway Program ($3,319,431).

Note that the project Gas Replacement Street and Highway Program was excluded both on the basis that it was small and consisted of routine replacements.

Q. WHY SHOULD ROUTINE REPLACEMENTS OF MASS PROPERTY NOT BE CONSIDERED A MAJOR PRO FORMA PLANT ADDITION?

A. These projects are not representative of a project that can be singularly reviewed by applying the used and useful criteria. Rather, these projects primarily represent initiatives to replace existing mass property that is otherwise near to retirement. The fact a portion of these facilities might be near to retirement, however, is a factor that is more appropriately considered in the context of Avista's depreciation study.

Q. DO THE DEPRECIATION RATES ACCOUNT FOR THE DEGREE TO WHICH MASS PROPERTY IS IN NEED OF REPLACEMENT?

A. Yes. In establishing depreciation rates for mass property accounts, the service age of equipment in those accounts is considered. To the extent that a large portion of an account is old, and near to retirement, the study will assign higher depreciation accrual rates to account for the higher level of retirements expected in coming years. As the mass property is replaced with newer equipment, however, the depreciation accruals tend to decline, corresponding to a longer average remaining life for equipment remaining in the account. Due to the interaction between these unspecified, small replacements with the mass property accounts considered in the depreciation study, I do not believe it is reasonable to single them out as major post-test-period capital additions, since the effects of the expected retirements are already captured in depreciation accrual rates.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION RELATED TO MAJOR PRO FORMA PLANT ADDITIONS?

A. Removing the nine projects described above from Avista revenue requirement calculations reduces revenue calculated under the traditional revenue requirement method by approximately $6,598,955 for electric services, and $1,881,604 for gas services.

b. Electric Adjustment 3.12, Natural Gas Adjustment 3.12: Director Fees.

Q. WHAT DID THE COMMISSION ORDER IN AVISTA'S 2015 GRC WITH RESPECT TO DIRECTOR FEES?

A. In the 2015 GRC, the Commission noted that "Avista only removed 3 percent of the director fee expenses, while our practice is to allow Avista recovery of 50 percent of director fees from ratepayers."[39/]

Q. DID AVISTA COMPLY WITH THE COMMISSION'S DECISION IN THIS PROCEEDING?

A. No. As discussed in Avista's response to ICNU Data Request 107, Avista continues to remove only 3% of director fees from its results as a restating adjustment.[40/]

Q. WHY DOES AVISTA BELIEVE THE COMMISSION SHOULD CHANGE ITS POLICY?

A. Avista conducted a survey suggesting that the time of each and every director is dedicated 97% to utility service and 3% to non-utility service. Avista also draws parallels to directors' and officers' insurance, which is included in revenue requirement based upon 90% of amounts incurred.

39/ Dockets UE-150204 and UG-150205 (Consolidated), Order 05 at ¶ 220.

40/ See Mullins, Exh. BGM-7 at 8-9 (the Company's Response to ICNU DR 107).

Q. HAVE YOU REVIEWED THE BOARD SURVEYS AVISTA CONDUCTED?

A. Yes. These surveys were provided in the workpapers of Ms. Andrews and have been attached as Mullins, Exh. BGM-8. As can be seen, the surveys are not based upon any sort of detailed time-tracking performed by the directors. The survey identifies that each and every director reported spending exactly 3% of his or her time on utility matters in 2015. It then instructed the directors to individually estimate the amount of time that was spent on non-utility matters in 2016. Unsurprisingly, each and every director reported spending the same amount of time, 3%, on non-utility matters in 2016. Such an approach is hardly scientific.

Q. IS IT A COINCIDENCE THAT EACH AND EVERY DIRECTOR SPENT EXACTLY THE SAME AMOUNT OF TIME ON NON-UTILITY MATTERS?

A. No. The lack of diversity amongst the time spent on non-utility matters reported by the directors is an indication that there is little in the way of precision in the percentages reported in the surveys provided within Mullins, Exh. BGM-8. This may be due to the fact that the survey was somewhat leading, in that it identified the 3% value that every director assumed in 2015. By reporting the 2015 information in the survey, the implicit request was for each director to also assume the same 3% value for 2016, without regard to the time actually spent on utility and non-utility matters.

Q. ARE THE SURVEYS RELEVANT TO THE ISSUE?

A. No. The fundamental question is whether the work performed by directors is for the benefit of shareholders or ratepayers. A director might be spending time on utility matters, but that time is often spent for the benefit of shareholders, not ratepayers. Applying a 50/50 split, as the Commission has assumed previously, is appropriate

because it assumes that half of a director's time is spent for the benefit of shareholders and half is spent for the benefit of ratepayers.

Q. WHAT IS THE IMPACT OF APPLYING A 50/50 SPLIT TO DIRECTOR FEES?

A. Adjusting the pro forma adjustment related to director fees based on the 50/50 split previously used by the Commission results in an approximate $393,518 reduction to electric revenue requirement, and an approximate $113,333 reduction to gas revenue requirement.

c. Electric Adj. 3.02, Natural Gas Adj. 3.02: Pro Forma Labor, Non-Exec.

Q. WHAT DO YOU RECOMMEND WITH RESPECT TO AVISTA'S PRO FORMA LABOR CALCULATIONS?

A. I recommend that the escalation to labor expenses be to only those wage increases that have actually been implemented for 2017 and excluding any wage escalation into 2018.

Q. WHAT AMOUNTS OF WAGE ESCALATION HAS AVISTA INCLUDED IN ITS FILING?

A. Avista escalates its overall labor expense by a factor corresponding to the actual wage increases that were put into effect as of March 2017, as well as wage increases that are expected to be implemented in March 2018. For both union and non-union employees, Avista assumes a 3% wage escalation in each year.

Q. IS THE 2018 WAGE INCREASE KNOWN AND MEASURABLE?

A. While Avista might have approval to implement a wage increase in 2018, the ultimate effects of any such increases are not yet certain, and for that reason I disagree that the 2018 wage increase represents an appropriate known and measurable adjustment. It is possible that Avista might ultimately implement a smaller wage increase, or perform

other actions which have the effect of reducing labor expenses. For example, implementation of a voluntary severance incentive program, as Avista implemented around 2012, would have the effect of reducing labor expenses relative to the escalation Avista has proposed. In recognition of this uncertainty, I recommend that Avista be allowed to include wage escalation through 2017, but that any provision for wage escalation in 2018 be eliminated.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. Eliminating the 2018 wage escalation results in a reduction to the pro forma labor adjustment amount by $1,121,219 for electric services, and $318,513 for electric services.

d. Electric Adj. 4.00: Pro Forma Power Supply and Transmission Revenues

Q. HAVE YOU REVIEWED AVISTA'S POWER COST MODELING IN THIS MATTER?

A. Yes. Avista developed its power cost forecast using the AuroraXMP model, as described in the Direct Testimony of Mr. Kalitch, as well as Mr. Kalitch's supplemental testimony.

Q. DO YOU HAVE ANY CONCERNS WITH RESPECT TO THE POWER COST FORECAST?

A. Yes. Staff has conducted extensive discovery in this matter which provides evidence 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. I have identified many of these arbitrary assumptions in the past, such as the negative variable O&M expense that Avista assigns to owned hydro resources. As this matter has proceeded, however, it has become apparent that the extent of these arbitrary assumptions is much more extensive than I had previously understood.

Q. BASED ON THESE DEFICIENCIES, WHAT DO YOU RECOMMEND?

A. Based on these deficiencies, I recommend that the Commission approve no change to Avista's ERM baseline. As of September the ERM mainlined a balance of approximately $21,793,215.[41/] By keeping the ERM baseline flat, the Commission will have the opportunity to continue monitoring Avista's power costs. If Avista's power costs do increase at the magnitude Avista identified in its filing, that will serve to reduce the ERM balance. I might develop this issue further in Cross-Answering testimony in response to Staff and other parties filing testimony on power costs.

Q. WHAT IS THE IMPACT OF YOU RECOMMENDATION?

A. The impact of my recommendation is a reduction to Avista's revenue requirement request by $16,608,547.

IV. DEPRECIATION EXPENSES

Q. PLEASE SUMMARIZE AVISTA'S INTENTION WITH RESPECT TO FILING A DEPRECIATION STUDY.

A. As noted above, Avista stated in response to ICNU Data Request 49 that it intends to file a new depreciation study by the end of the year.[42/]

Q. WHEN WERE THE EXISTING DEPRECIATION RATES APPROVED?

A. The most recent depreciation study was completed by Avista based on plant balances as of December 31, 2010. That study was approved Dockets UE-120436 and UG-120437. Accordingly, Avista's depreciation accruals will be approximately seven years out-of-date by the rate effective period in this matter.

41/ See Docket UE-011595, Power Cost Deferral for the Month of September 2017 at 4 (Oct. 16, 2017).

42/ Mullins, Exh. BGM-7 at 3 (the Company's Response to ICNU DR 49).

Q. WHY DIDN'T AVISTA INCLUDE THE DEPRECIATION STUDY AS A PART OF ITS FILING?

A. It is not clear why Avista did not time the filing of its depreciation study to correspond to the timing of its general rate case. Puget Sound Energy, for example, proposed new depreciation rates in the general rate case that it filed earlier this year. Typically, new depreciation rates are filed prior to, or as a part of, a utility's general rate filing. Making a depreciation rate filing immediately after a rate filing, particularly one where the utility is requesting a three-year rate plan, is problematic. If depreciation rates decline, that will provide a windfall to Avista. If depreciation rates decline, any rates approved in this matter will over compensate the utility relative to the ultimate depreciation expense it incurs.

Q. IS AVISTA'S TIMING PROBLEMATIC?

A. Yes. There is no basis to approve the depreciation rates reflected in Avista's initial filing this matter, if it is known that the depreciation rates are going to change in the near future.

Q. CAN DEPRECIATION RATES BE RESOLVED INDEPENDENTLY FROM A GENERAL RATE CASE?

A. As the Commission is aware from Puget Sound Energy's 2017 GRC, changes to depreciation rates can often result in complex trade-offs between competing aspects of revenue requirement. For example, the use of regulatory accounting in general rates to account for unrecovered costs associated with Colstrip Units 1 and 2 was a key consideration for ICNU when stipulating to the depreciation treatment of those facilities in the Puget Sound Energy 2017 GRC. Notwithstanding, those kinds of issues cannot be

considered outside of a general rate case, and accordingly, Avista's intent to file its depreciation study after testimony is problematic.

For example, I expect useful life of Colstrip Units 3 and 4 to be an issue in Avista's forthcoming depreciation study. If the probable service life of those facilities is reduced, the depreciation accrual will be accelerated. A shorter depreciable life might increase rates in the short run, as plant levels in the facility will be declining rapidly, resulting in reduced rate pressure in future periods, a factor that Avista would not have considered when developing its proposals for extraordinary rate relief. Stated differently, prior to resorting to extraordinary rate measures, it is imperative that depreciation expenses be established at a reasonable level. Yet, since the depreciation study has not yet been filed, there is no real basis to say whether the extraordinary measures are warranted.

Where utilities are going long periods without filing rate cases, it might be appropriate to adjust depreciation rates in between rate cases. For a utility, such as Avista, that is filing annual rate cases, there should be an expectation that depreciation rates are considered as a part of, or at least in parallel to, a general rate case.

Q. HOW DOES AVISTA PROPOSE TO HANDLE THE DEPRECIATION STUDY?

A. Based on its response to ICNU Data Request 074(c), Avista states "[a]s depreciation expense should be recovered in retail rates to reflect the return of investment in plant assets, to the extent the outcome of the in-process depreciation study suggests updates to depreciation rates are necessary, Avista would propose associated changes in its service

rates. Avista will file an application separate from this general rate case."[43/] At this point, however, it is not clear what form that application might take.

Q. IS AVISTA'S APPROACH REASONABLE?

A. No. It is not fair for Avista to propose additional changes to service rates while the general rate case is still pending. As in the case of Puget Sound Energy, there may be other revenue requirement issues that need to be addressed when implementing the new depreciation study. Similarly, the depreciation study might require changes to reserve balances, and other related aspects of Avista's filing, which would be difficult to analyze outside of the context of the rate case. For example, the adjustment related to major pro forma plant balances includes a provision for depreciation expenses, and it is not clear how the impact of that adjustment might be addressed in a stand-alone proceeding initiated after parties have filed testimony in the general rate case.

Q. WHAT DO YOU RECOMMEND?

A. Given the poor timing, however, there is really no good alternative to dealing with depreciation expenses in this matter. More will be known about the depreciation study and its potential effects of revenue requirement in the next few months. Notwithstanding, ratepayers should not be penalized simply because Avista failed to complete its depreciation study in time for its rate filing. Probably the only reasonable alternative, from a ratepayer perspective, would be to require Avista to refile its revenue requirement case once the new depreciation rates have been proposed.

[43/] Mullins, Exh. BGM-7 at 6 (the Company's Response to ICNU DR 074).

Q. DOES THIS CONCLUDE YOUR RESPONSE TESTIMONY?

A. Yes.