BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

<table>
<tr><td>WASHINGTON UITILITIES AND
TRANSPORTATION COMMISSION

Complainant,

v.

AVISTA CORPORATION d/b/a
AVISTA UTILITIES

Respondent.</td><td>)
)
)
)
)
)
)
)
)
)
)</td><td>DOCKETS UE-170485 and
UG-170486 (Consolidated)</td></tr>
</table>

POST-HEARING BRIEF

OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

February 22, 2018

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases Page

Administrative Orders

Statutes and Rules

Other Authorities

I. INTRODUCTION

1 Pursuant to Prehearing Conference Order 03 and WAC § 480-07-390, the Industrial Customers of Northwest Utilities ("ICNU") submits this post-hearing brief requesting that the Washington Utilities and Transportation Commission ("WUTC" or the "Commission") adopt the recommendations of ICNU's witnesses in this proceeding. Based on the evidence in the record, ICNU recommends that the Commission set rates for Avista Utilities ("Avista" or the "Company") consistent with the following recommendations:

- Avista should be allowed to earn a 9.10% return on equity ("ROE"), as well as a 7.09% rate of return ("ROR"), -based on an approved capital structure that includes a 48.5% equity component and a 5.51% cost of debt;
- Based on its successful earnings history, the Commission should determine that Avista's current rates are "just, fair, reasonable, and sufficient" and would provide the Company a reasonable opportunity to earn its allowed return in the rate year;
- If the Commission concludes a rate increase is necessary, limit Avista's increase to no more than $196,527 (0.04 %) for electric service, effective no earlier than April 26, 2018;
- The tax reduction benefits of H.R. 1, (the "Tax Cut and Jobs Act" or "TCJA") should be incorporated into the base rates determined in this docket, resulting in a $32 million decrease in revenue requirement for electric service;
- Deny Avista and Staff requests to approve a rate plan that would increase Avista's rates incrementally in 2019 and again in 2020;

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

- Reject the elements of the multi-party settlement executed by Avista, Commission Staff ("Staff"), the Northwest Industrial Gas Users ("NWIGU") and The Energy Project ("TEP) pertaining to electric rate spread and rate design; and,
- Approve the cost of service study presented by ICNU, proposing a non-uniform electric rate spread that fairly, justly and reasonably distributes Avista's costs among its customer classes, and ends the considerable inter-class subsidies that have been embedded within Avista's rate structure for many years.

2 The revenue requirement "end results" proposed by ICNU have been determined using the Commission's time-honored modified historic test year methodology, as well as reasonable pro forma adjustments for major additions of plant in service outside the test year. In addition, ICNU has recommended cost of capital, capital structure, electric rate spread and cost of service results consistent with the record evidence and relevant Commission legal and policy standards.

II. SUMMARY OF ESSENTIAL FACTS

3 Avista is a very healthy utility. Over the period 2013 to 2016, Avista's electric utility earned an actual return on equity equal to 10.7 percent.[1/] For 2017, Avista is expected to earn an overall return on equity approximating 9.7 percent.[2/] The Company's remarkable electric utility returns over the past five years underscore Avista's financial health; even with the denial of <u>any</u> rate relief in its2016 rate case.[3/] To put this in perspective, Avista's actual returns on

---

[1/] Mullins, Exh. BGM-1T at 7:6-8.

[2/] Thies, Tr. at 378: 22-25 and at 379:22-23. To this point, Mr. Thies testified that the electric utility would earn "slightly under" 9.5 percent, while the gas utility is expected to earn "approximately" 11.4 percent, for an overall return on equity of "approximately" 9.7 percent.

[3/] <u>WUTC v. Avista Corporation</u>, Dockets UE-160228/UG-160229 (*Consolidated*), Order 06, Final Order Rejecting Tariff Filing (Dec. 15, 2016).

equity for the electric have exceeded its authorized returns by up to 200 basis points over the last five reporting seasons.[4/] Examining only the last two years following Avista's rate increase in 2015, the Company's actual returns have exceeded authorized returns by an average of 80 basis points.[5/] Yet, it again seeks significant rate relief from the Commission, asking for a cumulative $226,000,000 in rate relief over the next three years.[6/] Avista needs no rate relief in this docket to earn its authorized return. Without question, it is a very healthy utility.

4 No matter how postured, Avista is asking the Commission to award it extraordinary relief by way of a rate plan extending to 2021, requiring the Commission to use contemporary forecasts to justify two future rate increases.[7/] Moreover, Avista seeks these future rate changes without providing the Commission any opportunity to audit and test the Company's then-contemporary financial results. Typically, extraordinary rate relief is only awarded when the Commission determines that such relief is required to prevent further deterioration of a company's already precarious financial condition.[8/] Avista's robust financial returnsindicate that extraordinary relief is not needed to maintain the Company's financial health and its opportunity to earn its allowed return. If its future conditions call for rate relief, the Company can file a rate case and demonstrate that rate relief is necessary.

5 ICNU presents its evidence and supporting arguments in four parts. First, ICNU presents its cost of capital conclusions. Here, the evidence shows that Avista's return on equity

---

4/ Mullins, Exh. BGM-1T at 7:6-8.

5/ Id.

6/ Hancock, Exh, CSH-1T at 46. The $226 million dollars references the cumulative rate relief requested for Avista's utility business.

7/ Avista requests that the Commission authorize rate increases in 2019 and 2020 in this docket.

8/ See, WUTC v. Puget Sound Energy, Docket UE-011163, Sixth Supplemental Order, 2001 WL 1672343 (Wash.U.T.C.), 213 P.U.R.4th 337 (October 4, 2001). ("A request for extraordinary relief must provide a clear showing of the adverse consequences that will reasonably flow from the lack of the relief requested ….").

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

should be set at 9.1%. Further, the evidence demonstrates that Avista's capital structure should include 48.4% equity and 51.6% debt, at a cost of 5.31%. Using these reasonable assessments, Avista's overall return would be 7.09%. Next, ICNU presents its electric revenue requirement analysis demonstrating that Avista's revenue requirement should not exceed $196,527 (0.04%), should the Commission conclude that any increase is required. Third, ICNU shows that the Partial Multi-Party Settlement regarding Avista's cost of service should be rejected because its fails to meet the Commission's requirements for approval, namely the settlement's conclusions are not supported by specific and sufficient evidence. Finally, ICNU presents its cost of service study showing that it reasonably reflects Avista's current conditions and common industry practices. Overall, the recommendations and conclusions proffered by ICNU are reasonable and supported by sufficient evidence. The "end results" recommended by ICNU are fully supported, and would result in just, fair, reasonable, and sufficient rates.

III. COST OF CAPITAL

6 The Commission should reject Avista's proposal to increase its costs of capital because it is inconsistent with the current state of the economy and the capital markets. Capital costs continue to remain low because investor-owned utilities are seen as favorable investment opportunities, and the Commission should reflect this reality by setting Avista's ROE at 9.1%. Further, the Company's cost of debt should be set at 5.31%, instead of at the Company's proposed 5.62%, to reflect the maturation of several mortgage bonds.[9/] Additionally, Avista's equity share should be set at 48.4%, which reflects the Company's actual capital structure as of

---

[9/] Gorman, Exh. MPG-1T at 30:8-22.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

the end of 2016.[10/] These changes reduce Avista's overall rate of return from the Company's proposed 7.76% to 7.09%.[11/] These figures ensure the Company's access to capital at reasonable rates while simultaneously protecting ratepayer interests.

7 It is worth noting that Avista's requested ROE is identical to its proposal in its (rejected) 2016 GRC, and fully 40 basis points higher than its currently authorized ROE of 9.5%.[12/] And Avista has actually earned a considerably higher ROE; it averaged 10.7% from 2013 to 2016.[13/] Despite these healthy earnings, the Company now requests an ROE of 9.9%, which is well above its actual costs and industry averages. ICNU witness Michael Gorman's testimony indicates that Avista's current ROE is already excessive, and that Avista witness Adrian McKenzie's recommended ROE of 9.9% is wholly unreasonable.[14/] Mr. Gorman's recommendation is in line with proposals from Public Counsel and Staff as well.

8 The Commission sets an appropriate ROR to permit the utility to continue to attract the capital required to provide service at just and reasonable rates.[15/] A utility's ROE should be set to provide an opportunity for the utility to earn a return on the value of the property providing service to customers that is commensurate with the returns in other businesses that have similar risks.[16/] And a utility's cost of debt should be set to accurately reflect its actual borrowing costs, as determined by the market, and accounting for near-term future capital

---

10/ Id. at 2:4-15.
11/ Id. at 3:4-6.
12/ Dockets UE-160228 and UG-160229, Order No. 06 ¶ 9.
13/ Mullins, Exh. BGM-1T at 7:6-8.
14/ McKenzie, Ex. AMM-1T at 5:14-15.
15/ People's Org. for Wash. Energy Resources ("POWER") v. WUTC, 104 Wn.2d 798, 810 (Dec. 22, 1985).
16/ Docket UE-100749, Order No. 06 ¶ 44 (citing Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of W. Virginia, 262 U.S. 679 (1923), and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944)).

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

requirements of the enterprise.[17] Similarly, the Commission will adopt a capital structure that balances safety with the impact upon customers, while achieving an overall goal of financing the utility in a manner that provides ratepayers benefits commensurate with costs.[18]

9 Avista ignores the Commission's established standards in proposing to increase its ROR to 7.76%, which is primarily driven by a requested 9.9 % ROE and a 50% common equity ratio.[19] This is a significant increase compared to Avista's last approved ROR of 7.10%, which was based on a 9.5% ROE and a 48.5% equity ratio.[20] The Commission should reject this increased ROR, and instead set a lower cost of capital based on ICNU witness Michael Gorman's recommended 7.09% ROR, including a 9.1% ROE and a 48.4% equity ratio.[21]

A. The Company's Return on Equity Should Be Significantly Reduced

10 ICNU, Public Counsel, and Staff are unanimous in recommending a ROE at 9% or 9.1%. This consensus is notable in light of Avista's requested 9.9% ROE.

11 Determining the cost of equity is a well-settled process. Its fundamental purpose is summed up by the U.S. Supreme Court in Hope Natural Gas: "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."[22] In other words, it has been firmly established for decades that any estimation of a reasonable ROE must be based on an analysis of enterprises with *comparable* or *corresponding* risks. In this case, ICNU, Staff, and Public Counsel propose costs of equity that are nearly

---

[17] WUTC v. Puget Sound Energy, Docket UE-111048, Order 08 ¶ 58 (May 7, 2012); L. Saul Goodman, The Process of Ratemaking at 601 (1998).
[18] WUTC. v. Pacific Power & Light Co., Docket UE-100749, Order No. 07 ¶¶ 11-13 (May 11, 2011).
[19] McKenzie, Exh. AMM-1T at 6:45, 25:1-5.
[20] WUTC v. Avista Corporation, Dockets UE-150204 and UG-150205 (*Consolidated*), Order No. 05, Appendix C – Settlement Stipulation at 2 (Jan. 6, 2016).
[21] Gorman, Exh. MPG-1T at 2:1-3:6.
[22] Federal Power Comm'n v. Hope Nat. Gas, 320 U.S. 591, 603 (1944).

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

identical, calling into question whether the Company's analysis properly included enterprises with such comparable or corresponding risks.

12 The Commission has noted that estimating a cost of equity that is commensurate with the returns of other similar business can be "the most challenging" aspect of a general rate case filing.[23/] The Commission typically relies upon expert witness recommendations, but ultimately uses "a broader body of evidence to make [its] determinations, which are informed by, but not dictated by the experts' modeling results."[24/] Taken together, the facts of Avista's recent performance, coupled with the near-unanimity of non-Company cost of capital witnesses, strongly suggest that the Company's current approved ROE is excessive, and Mr. McKenzie's proposed ROE doubly so.

13 The weight of the evidence in this proceeding strongly supports lowering the Company's authorized ROE to 9.1%. As Mr. Gorman explains, "Regulated utilities' credit ratings have improved over the last few years and the outlook has been labeled "Stable" by credit rating agencies."[25/] Electric utilities are performing well, have favorable access to capital, and remain a popular safe haven for conservative investors.[26/] Similarly, Avista's individual credit rating outlook is positive, or at the very least stable.[27/] The Company's healthy financial position is evinced by its proposed acquisition by Hydro One, which further demonstrates that the utility's ability to attract capital is not in jeopardy. These factors suggest that Avista's cost of equity has fallen since its current 9.5% ROE was approved, not increased.

23/ Docket No. UE-100749, Order No. 06 ¶¶ 44-45.
24/ WUTC v. PSE, Docket UE-060266/UG-060267, Order No. 8 at ¶ 84 (Jan. 5, 2007).
25/ Gorman, Exh. MPG-1T at 13:6-7.
26/ Id. at 13:7-14:16.
27/ Id. at 20:4-21:4.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

14 The expert testimony in this proceeding also supports lowering, rather than increasing, Avista's authorized ROE. The Commission has traditionally used three generally accepted ROE models, including the Discounted Cash Flow ("DCF") method, the risk premium method, and the Capital Asset Pricing Model ("CAPM").[28/] The Commission has frequently relied upon the DCF and risk premium models to set actual ROEs, and used the CAPM as a useful check on the reasonableness of the other model results.[29/] Mr. Gorman followed this approach, recommending a 9.1% ROE based on the high end of his average cost of equity estimates of his DCF model results (8.8%) and risk premium model (9.3%), with their reasonableness verified by his CAPM model estimate of a 9.1% ROE.[30/] Similarly, Mr. Parcell's testimony supports a 9.1% ROE.[31/] And Mr. Garrett recommends a 9.0 ROE.[32/] Further, reasonable adjustments to Mr. McKenzie's model support lowering the Company's ROE to 9.1%.[33/] These recommended ROEs would be sufficient to support Avista's investment-grade bond ratings and allow the Company to attract reasonably priced capital.[34/]

15 The fundamentals of Mr. Gorman's DCF, CAPM, and risk premium models remain the same as in past cases before this Commission. However, and as noted above, his analysis here reflects Avista's history of robust earnings, its favorable access to capital, and the strength of the capital markets and overall economy. Of these, the Company's future earnings potential and the determination of a comparable risk factor are of particular importance. As

---

28/ E.g., Docket No. UE-100749, Order No. 06 ¶ 45.

29/ Docket No. UE-100749, Order No. 06 ¶¶ 88-91; WUTC v. PSE, Dockets UE-090704/UG-090705, Order No. 11 at ¶¶ 292-300 (Apr. 2, 2010).

30/ Gorman, Exh. MPG-1T at 59:14-60:9.

31/ Parcell, Exh. DCP-1T at 4:12-13

32/ Garrett, Exh. DGJ at 4:10.

33/ Gorman, Exh. MPG-1T at 65:12-14.

34/ Id. at 60:11-15, 63:9-11.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

demonstrated below, ICNU's analysis of these factors is not only reasonable but could be considered conservative in light of Avista's demonstrated financial success.

16 Mr. Gorman and Mr. McKenzie begin their DCF analysis with near-identical proxy groups, but their methods quickly diverge.[35] Mr. McKenzie's estimates are immediately skewed by a decision to remove 19 low-end "outliers" from his dataset, representing over 20% of the data points in his proxy group.[36] And the contrast between Mr. Gorman's analysis and that of Mr. McKenzie continues as the two develop estimates of long-term growth – Mr. Gorman posits that a public utility's growth cannot consistently outperform the economy as a whole, which is an assumption that Mr. McKenzie relies on.[37] Mr. McKenzie conducted only a constant-growth DCF analysis, which presumes that a firm's growth will continue at the same rate, forever.[38] In contrast, Mr. Gorman's analysis relied upon three DCF models (the analysts' growth DCF, the sustainable growth DCF, and the multi-stage growth DCF models), that he combined to estimate a 8.8% ROE for Avista.[39] It bears repeating that Mr. Gorman did not discount Mr. McKenzie's analysis – he accepted it as one of several appropriate DCF methods and enhanced the analysis with other, well-accepted models.

17 Mr. McKenzie argues that several of Mr. Gorman's DCF methods should be rejected or modified, for a variety of reasons.[40] But this Commission has frequently relied on

[35] McKenzie, Exh. AMM-6 at 1; Gorman, Exh. MPG-8 at 1. Mr. Gorman excludes Avista due to its proposed merger with Hydro One, which was announced after Mr. McKenzie's opening testimony was filed in this proceeding. Mr. McKenzie indicates that this is a reasonable adjustment. McKenzie, Exh. AMM-1T at 31:10.

[36] McKenzie, Exh. AMM-6 at 3.

[37] Gorman, Exh. MPG-1T at 41:1-42:30; McKenzie, Exh. AMM-14T at 69:1-16.

[38] McKenzie, AMM-3 at 9:20-22. Mr. McKenzie conducted his constant-growth DCF analysis using "four alternative measures of expected earnings growth," but all assume that those growth rates will last indefinitely.

[39] Gorman, Exh. MGP-1T at 47:1-3 and Table 9.

[40] McKenzie, Exh. AMM-14T at 58:19-59:10, 59:19-62:3.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

identical analysis by Mr. Gorman, and often over identical protests by other utility witnesses.[41/] Mr. McKenzie has presented no markedly new arguments here, and there is no reason for the Commission to depart from its well-accepted practice.

18 Mr. Gorman's DCF results form the heart of his recommendation, but they are also supported by his CAPM and risk premium models. Again, Mr. Gorman's work diverges from Mr. McKenzie's because the two view Avista's fortunes, and those of the economy, quite differently. Generally, Mr. McKenzie views Avista as a riskier bet that Mr. Gorman, which leads him to conclude that investors will require higher returns to assume such a risk. But the facts show that an investment in Avista is a decidedly safe choice, in a decidedly safe field.

19 The risk premium model assumes that investors require a higher return to assume risk – so it comes as no surprise that Mr. Gorman's assessment shows that investors are happy with strong, but modest, returns on a safe bet such as Avista. Based on the risk premium model, Mr. Gorman concludes that investors require a 9.3% return, contrasting with Mr. McKenzie's proposed 10.6%. While a number of factors contribute to these differing results, Mr. McKenzie's risk premium model relies heavily on a posited 6.12% yield on a Baa-rated bond.[42/] Further, Mr. McKenzie argues at length that risk premiums narrow when interest rates are high, and widen when they drop.[43/] Neither assumption stands up to much scrutiny. First, Mr. McKenzie's projected 6.12% Baa yield assumes that AA-rated utility bonds will pay 5.45% during Avista's proposed rate period.[44/] But notably, those AA-rated utility bonds were yielding

41/ See, e.g., Docket UE-111048, Order No. 08 ¶¶ 87-89.
42/ Gorman, Exh. MPG-1T at 78:10-17.
43/ McKenzie, Exh. AMM-1T at 34:15-18; McKenzie, Exh. AMM-14T at 76:11-77:7.
44/ Gorman, Exh. MPG-1T at 78:10-17.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

3.7% as of September 2017, 185 basis points below Mr. McKenzie's 2018-22 assumptions.[45] Mr. McKenzie's forecast is possible – but hardly probable. Second, Mr. McKenzie makes much of a potential relationship between interest rates and risk premiums, arguing that interest rates are likely to rise and thus investors will require a commensurately higher return. But as Mr. Gorman points out, this oversimplifies complex economic history. Mr. McKenzie's belief relies on evidence from the 1970s, which is valid, but omits that era's interest rate volatility, inflation, and serious economic uncertainty. And Mr. Gorman further points out that forecasts of interest rates are notoriously inaccurate.[46] Mr. Gorman's models take Mr. McKenzie's concerns into account, but they add significant nuance that yields a more reliable conclusion.

20 Mr. Gorman's CAPM conclusions further support his overall recommended ROE for Avista. Based on his analysis, the CAPM model yields an expected ROE of 9.1% - near the midpoint of his DCF and risk premium results, and his recommended overall ROE.[47] Mr. Gorman's analysis accurately reflects Avista's risks, whereas Mr. McKenzie overstates the company's risk and thus the presumed returns investors will require. Mr. McKenzie adds a "size adjustment" to his CAPM, theoretically to reflect risks comparable to Avista's.[48] But that adjustment is based on firms that operate in much riskier fields, with betas in excess of 1.00, and is thus inappropriate for a public utility, with an average beta of 0.72.[49] Mr. Gorman correctly assesses Avista's risk by using an accurate beta of 0.71, which accurately reflects the low-risk nature of Avista's business.[50]

45/ Id.
46/ Id. at 80:3-81:2.
47/ Id. at 59:13, 60:1-4.
48/ McKenzie, Exh. AMM-8 at 2.
49/ Gorman, Exh. MPG-1T at 69:18-70:15.
50/ Id. at 56:6-7.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

21 According to Mr. McKenzie, Mr. Gorman and other witnesses miss the mark for a variety of reasons. Generally, Mr. McKenzie argues that Mr. Gorman and others have developed ROEs that are "simply too low and fail to reflect the risk perceptions and return requirements of real-world investors in the capital markets."[51/] But Mr. Gorman's testimony does no such thing. The facts amply demonstrate that Avista has not struggled to attract investment at its current ROE, and that the returns proposed by Mr. Gorman and other witnesses will be entirely sufficient as well. Mr. McKenzie's estimated ROE is simply too high to reflect Avista's true cost of equity. As Mr. Gorman's adjustments indicate, reasonable modifications to Mr. McKenzie's calculations result in a ROE figure in line with those of all other ROE witnesses.[52/]

B. The Commission Should Account for Known Changes to Avista's Cost of Debt

22 Avista proposes to set its cost of debt at 5.62%, which fails to account for near-term opportunities to refinance debt.[53/] As Mr. Gorman discusses, Avista has over $270 million in high-interest mortgage bonds that will mature in May and June of 2018.[54/] The interest rates on these mortgage bonds are considerably higher than Avista would pay under current market conditions.[55/]

23 Mr. Gorman proposes adjusting the Company's cost of debt to 5.31% to account for refinancing those high-interest bonds at current market rates for BBB-rated debt (such as Avista's), plus a small adjustment to account for the possibility of increasing interest rates.[56/]

[51/] McKenzie, Exh. AMM-14T at 1:17-18.
[52/] Gorman, Exh. MPG-1T at 66, Table 12.
[53/] Thies, Exh. MTT-1T at 2:12-14.
[54/] Gorman, Exh. MPG-1T at 30:8-18.
[55/] Id.
[56/] Id. at 30:8-20.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Mr. Thies objects to Mr. Gorman's proposal on the grounds that it "includes items in the actual rate year that the Commission should not selectively include."[57] ICNU disagrees with this assertion and notes that it is entirely inconsistent with other parts of the Company's rate proposal, much of which relies on doubtful forecasts of unknown future costs.[58] Failing to include the probable refinancing of this high-cost debt would ignore economic reality, and would provide a significant windfall to shareholders. There is no doubt that these refinances will occur; the Company has had a formal hedging plan to obtain interest rate swaps for these high-interest bonds since 2013, and has been informally hedging interest rates for well over a decade.[59] Finally, these swaps represent fully 73% of the debt the Company plans to issue in 2018.[60] The Commission should not ignore such a major, certain refinance, with such significant implications for Avista's cost of debt.

24 If the Commission accepts Mr. Thies' arguments, ICNU suggests that there is a straightforward way to protect ratepayers and wait for these costs to be fully known and measurable. Mr. Gorman's suggested adjustment could easily be reconciled with Mr. Thies' objections through the establishment of a regulatory asset – such a course would protect ratepayers, and the Company, by crediting savings to ratepayers once they are known and measurable.

57/ Thies, Exh. MTT-6T at 15:16-17.
58/ See, e.g. ¶¶ 42-43, 52-54, 62, infra.
59/ Thies, Transcript, Vol. V at 337:1-19.
60/ Id. at 458:7-20.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

C. The Company's Capital Structure Should Be Set Consistent with its Actual 2016 Structure

25 Fundamentally, a utility's cost of capital must be determined to balance the needs of safety and economy. The tension between these interests is most evident as the Commission determines a utility's capital structure, because a proper structure will allow a company to efficiently balance its long-lived assets at the lowest possible cost.[61/] This means that Avista should manage its capital structure so as to finance its rate base investments and maintain a strong investment grade credit rating, financial integrity, and preserve its access to external capital – all while maintaining just and reasonable prices to customers. Avista's current capital structure, which Mr. Gorman supports, has appropriately balanced these interests. The Company has not struggled to attract capital with its current 48.4% common equity share.

26 In practice, just and reasonable rates require that a utility only include costs in its cost of service that have been minimized by efficient utility cost management. Importantly, this efficient cost management also applies to the capital structure used to set rates. Avista is proposing to use a capital structure in this case that contains more common equity than its actual capital structure contained every year over the last five years.[62/] The Commission should reject this request because it does not properly balance safety and economy, and instead adopt Mr. Gorman's proposed structure of 48.4% common equity, 2.9% short-term debt and 48.7% long-term debt.[63/]

61/ See Docket UE-100749, Order 07 at ¶ 10; WUTC v. Pacific Power & Light Co., Docket UE-140762 et al., Order No. 8 at ¶ 24 (Mar. 25, 2015).

62/ Gorman, Exh. MPG-1T at 25, Table 5.

63/ Id. at 26, Table 6.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

27 By proposing a capital structure with an increased common equity ratio of total capital structure, Avista would increase its total cost of capital because it would rely more on high-cost equity instead of low-cost debt. The cost difference to customers should be highlighted: after taxes, Avista's equity financing is three times more expensive than its debt.[64] The Company has not put forward any evidence that shows a need for this costly change – the Company's recent strong performance is proof of this.

28 Avista's forecasted capital structure it proposes to use in this case includes a 50% equity ratio and a 50% debt ratio. This change cannot be justified. Avista's actual capital structure of 48.4% common equity, 2.9% short-term debt and 48.7% long-term debt, which Mr. Gorman proposes to retain, has supported its investment grade bond rating and supports its current credit outlook of stable or positive.[65] Avista's actual 2016 capital structure was reasonable and balanced because it has supported Avista's credit standing and financial integrity – just as similar capital structures have done over the last five years.[66] This actual capital structure over the period 2011-2016 was comparable to the industry average capital structure approved for setting rates by regulatory commissions over this same time period, and is comparable to credit rating adjusted debt ratios for the regulated utility industry for companies with credit ratings similar to Avista.[67]

29 There is no question that a utility is due a ROE that allows it to attract capital at reasonable rates, sufficient to ensure a strong credit rating and financial integrity. But a utility is

[64] Id. at 27:9-10.
[65] Id. at 21:1-3.
[66] Id. at 25, Table 5. Specifically, Mr. Gorman showed that Avista's actual capital structure over the period 2011 through 2016 maintained a total debt ratio between 52.2% and 53.9%, always considerably more debt and less common equity than Avista's projected capital structure debt ratio in the test year of 50%.
[67] Gorman, Exh. MPG-1T at 29, Table 7.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

not owed any more than this.[68] The Commission should maintain Avista's capital structure at actual 2016 levels, which will help keep the Company's revenue requirement at a more appropriate level. Customers should not be asked to pay a higher revenue requirement, and provide greater profitability to Avista, to support a capital structure with more common equity than needed to maintain its credit standing and financial integrity. Placing this unnecessary cost burden on customers will provide excess compensation or profits to Avista, and result in rates higher than a just and reasonable level to its retail customers.

30 Furthermore, the Commission accepting an adjustment to Avista's forecasted capital structure will not result in a disallowance to the Company. Avista can adjust its actual capital structure in a future test year to correspond to what the Commission finds to be a reasonable capital structure for setting rates.[69] Hence, the Company can fully recover its actual cost of service by conforming its forecast to align with the Commission's findings on a just and reasonable capital structure, which will continue to support its strong investment grade credit rating and financial integrity, but at lower cost to retail customers.

31 Avista's proposal to modify its projected capital structure for the future test year, relative to its actual capital structure over the last five years, should be denied. Instead, rates should be set using a capital structure mix that has been proven to be adequate to maintain credit and financial integrity, but at a lower cost to retail customers than the Company's proposal in this case.

---

[68] Docket UE-100749, Order No. 7 at ¶¶ 8-11.
[69] Gorman, Exh. MPG-1T at 29:4-7.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

D. Cost of Capital Conclusion

32 Avista's recent performance has been remarkable. Despite a wholesale rejection of its last general rate case filing, the Company's earnings have outpaced this Commission's expected levels. Avista's testimony and arguments sound like those of a struggling utility. This is not the case.

33 ICNU believes that the Commission should set a ROE that allows the Company to access capital at reasonable rates and maintain its credit rating – but not more, because ratepayers bear every penny of costs associated with an inflated ROE. Mr. Gorman's recommended ROE of 9.1% would strike this balance. Similarly, Mr. Gorman's proposed cost of debt is more accurate than the Company's because it takes into account expected debt refinances that will take place later this year. Avista protests that these swaps should be excluded from its cost of debt are belied by the fact that it has been hedging interest to prepare for this refinance for years. Finally, Mr. Gorman's suggested capital structure should be adopted – he proposes leaving Avista's current debt and equity shares as they are, which is reasonable on its face given the Company's recent performance.

IV. REVENUE REQUIREMENT

34 Avista asks the Commission to approve a cumulative $226,000,000 in rate relief over the next three years.[70] Avoiding limitations imposed by the Commission's approved methodology to calculate its revenue deficiency,[71] Avista introduces two unique devices to

---

70/ Hancock, Exh, CSH-1T at 46. The $226 million references the cumulative impact of the rate relief requested for Avista's electric utility business in this case and in years 2019 and 2020.

71/ The Commission has consistently endorsed its Modified Historical Test Year, as adjusted by pro forma test-year adjustments, to set rates. See, Dockets UE-160228/UG-160229 (*consolidated*), Order 06.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

calculate its rates – the End-of-Period ("EOP") and K-Factor studies. Succinctly stated, Avista's EOP Study relies simply on a forecast of plant balances projected to be present on December 31, 2017,[72] and its K-Factor Study is a renamed version of Avista's rejected attrition study that extends the expense, revenue, and rate base estimates to 2020.[73] As the record evidence demonstrates, neither of Avista's alternative ratemaking methods produce results reliable enough to set rates.

A. ICNU's Revenue Requirement is Reasonable and Incorporates the Benefits Resulting from the TCJA's Tax Cuts

35 ICNU's testimony demonstrates that Avista's electric utility would require a small rate increase to maintain its healthy earnings. ICNU's witness, Mr. Mullins,[74] thoroughly reviewed Avista's financial results, and, using the Commission-approved modified historic test year methodology and reasonable pro forma adjustments, derived a revenue increase for Avista in the amount of $196,527 (0.04%).[75] However, ICNU's as-filed revenue requirement calculations have been significantly modified as a result the TCJA's passage. Table 2 (revised) below sets forth the conclusions resulting from Mr. Mullin's revised analysis, including his re-calculation of Avista's revenue requirement using post-TCJA[76] tax rates.

---

[72] Andrews, Exh. EMA-1T at 25: 12-13.
[73] Mullins, Exh. BGM-1T at 6:6-12. See also, Dockets UE-150204/UG-150205, Order 05 (Jan. 6, 2016), and Dockets UE-160228/UG-160229 *(consolidated)*, Order 06.
[74] For ease of identification throughout the remainder of this brief, citations and references to Mr. Mullins' testimony and proposals will be associated simply with ICNU. Whenever appropriate, however, Mr. Mullins' testimony should always be understood in his capacity as a joint ICNU/NWIGU witness.
[75] Mullins, Exh. BGM-1T at 21: 15-18. See also, Mullins, Exh. BGM-3 for electric services.
[76] TCJA refers to HR 1 of the 115th Congress, The Tax Cuts and Jobs Act ("TCJA"), signed into law on December 22, 2017.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Table 2 (revised)

Adjustments to Traditional Revenue Requirement Model

Deficiency / (Sufficiency) ($000)

Company Proposed (Initial Filing)	**37,501**
Impact of Contested Adjustments	
Cost of Capital (Gorman)	(14,333)
3.10: Pro Forma Plant Additions	(6,599)
3.12: Director Fees	(394)
3.02: Pro Forma Labor (Non-Exec)	(1,121)
3.01: Power Supply	(16,609)
2.17: Interest Sych. (Cost of Debt)	1,751
TCJA-1: Restate Income Tax Expense	(26,263)
TCJA-2: Restate EDFIT	(6,297)
TCJA-3: TCJA Deferral (1/1/18 - 4/30/18)	-
TCJA-4: Conversion Factor	(35)
Total Impact of Contested Adjustments	**(69,899)**
ICNU Recommended Revenue Requirement	**(32,398)**

36 The Joint Parties'[77/] response to Bench Request 1 demonstrates that the TCJA will reduce Avista's revenue requirement for its electric and gas utilities by approximately $32 million and $6 million, respectively.[78/] The Joint Parties also requested that Avista's rates be reduced by the amount demonstrated to be known and accurate in this docket, believing that the revised revenue requirement calculation accurately represents most but not all significant beneficial impacts resulting from the TCJA.[79/]

[77/] Here, the Industrial Customers of Northwest Utilities ("ICNU") and the Northwest Industrial Customers ("NWIGU") are collectively referred to as the "Joint Parties."

[78/] Joint Parties Response to Bench Request 1 at 2 (Jan. 26, 2018). The Joint Parties' response included all revenue requirement calculations, spreadsheets and workpapers used by Mr. Mullins to calculate Avista's post-TCJA revenue requirement.

[79/] Joint Parties' Response to Bench Request 1 at 2.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

37 In sum, ICNU urges the Commission to include the TCJA's demonstrated benefits in rates without delay. If there is uncertainty as to the totality of recognized benefits, the Commission can provide immediate rate relief in an amount it determines to be both reasonable and likely to be accurate. This could be accomplished by setting interim rates, subject to refund, until all impacts resulting from the TCJA were identified and recognized in rates.[80/]

B. Avista's Current Earnings Indicate That Its Rates Are "Just, Fair, Reasonable, and Sufficient"

38 Avista is enjoying a succession of very healthy earnings. As presented above, Avista's electric utility earned an actual return on equity equal to 10.7 percent from 2013 to 2016.[81/] The return for its electric utility moderated slightly in 2017, but Avista should still achieve an actual return on equity "slightly under" 9.5 percent.[82/] Further, the Company's overall return for 2017 is expected to approximate 9.7 percent.[83/] Avista's strong earnings in 2017 shows that it can sustain earnings above its allowed rate of return, even when forced to absorb the impacts of its rejected 2016 rate case.[84/]

39 Avista's strong earnings history indicates its existing rates continue to be sufficient, allowing it a reasonable opportunity to earn its authorized return. Put in practical terms, Avista's continued success demonstrates that its current rates are sufficient to maintain its financial integrity, attract capital, and appropriately compensate its investors.[85/] Despite the

---

80/ Id. at 3.
81/ Mullins, Exh. BGM-1T at 7: 6-8.
82/ Thies, Tr. at 378: 24-25.
83/ Id. at 378: 22-25 and 379: 22-23. To this point, Mr. Thies testified that the electric utility would earn "slightly under" 9.5 percent, while the gas utility is expected to earn "approximately" 11.4 percent, for an overall return on equity of "approximately" 9.7 percent.
84/ Dockets UE-160228/UG-160229 (*consolidated*), Order 06.
85/ WUTC v. Puget Sound Energy, Docket No. U-82-38, 1983 WL 909312 (Wash.U.T.C.) (July 22, 1983). ("Determination of a fair rate of return must be aimed at providing satisfactory and efficient service to the public at the lowest rates consistent with protection of the company's capacity to function and provide the

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Company's demonstrated ability to earn its allowed return, it now asks the Commission to again increase its rates. As in 2016, Avista needs no rate relief in this docket to earn its authorized return. Should the Commission decide that some rate relief is necessary, ICNU's revenue requirement calculation would allow the Company to earn its authorized return.

C. Avista's Revenue Requirement Methodologies Do Not Conform with Commission Practice and Precedent

40 Avista's $61.4 million rate increase for Year One is premised upon a hybrid revenue model that combines its Traditional Pro Forma Study ("Traditional Study") with its newly-conceived EOP Rate Base Study ("EOP Study").[86] To put this relationship in monetary terms, Avista's Traditional Study alone produces a revenue request of $37.5 million.[87] By tacking on the EOP Study results, Avista increases its revenue demand by an additional $23.9 million to reach the requested $61.4 million increase.[88] By comparison, Staff can only justify a rate increase of $10.3 million.[89] Using an approach comparable to Staff, ICNU caps the Company's revenue need at $196,527 by including a limited number of pro forma plant adjustments.

41 Avista's rate plan is based on a hybrid model that combines Avista's Traditional Study with its EOP Study model and its K-Factor Study model. To this point, Avista uses its Traditional Study to create a rate request floor, upon which the rate base forecasts generated by

---

same measure of service. The company must be given the opportunity to earn a return sufficient to enable it to maintain its financial integrity, attract capital on reasonable terms, and appropriately compensate investors for use of their money.")

[86] Andrews, Exh. EMA-1T at 7:22-28 and 8: 1-3.

[87] Id. at 7:19-20.

[88] Id. at 7:29 and 8: 1.

[89] Hancock, Exh. CSH-1T at 44:14. Staff's revenue requirement was calculated using a modified historical test year, with limited pro forma adjustments. Hancock, Exh. CSH-1T at 34:20-21.

its EOP Study are added.[90] It then uses the escalator factors imbedded in its K-Factor Study to create revenue increases for 2019 and 2020.[91] As demonstrated below, Avista's EOP and K-Factor studies are not reliable tools to set rates, particularly given the paucity of verifiable information now available to the Commission regarding Avista's future expenses and revenues.

D. Avista's Extraordinary Request to Set Rates Using its EOP and K-Factor Studies

42 As this Commission is fully aware, EOP adjustments are utilized on a case by case basis as an alternative to the Commission's preferred Average of Monthly Averages methodology.[92] Importantly, EOP adjustments are generally confined to the test year.[93] In contrast, Avista's EOP Study uses a forecast of capital expenditures to develop estimated plant balances, as of December 31, 2017,[94] a period extending *one full year* beyond the test year.[95] Avista's unverified rate base should not be allowed into rates.

43 First, the EOP-Study's inclusion of unaudited and untested future rate base presents obvious issues associated with the reliability of estimated future costs. From Staff's perspective, the task of verifying costs incurred beyond the test year is constrained by the time limits imposed by this case.[96] To this point, Mr. Hancock testified that

> "Finally, pro forma plant adjustments should be limited in number and scale because it is simply not feasible for a company to demonstrate, or for intervening parties to verify, with certainty and specificity, every single capital transfer to

---

[90] Andrews, Exh. EMA-1T at 7:22-24. (Avista's EOP Study "starts with the electric and natural gas Traditional Pro Forma Study results …, which is then adjusted to include EOP 2017 rate base, and an adjusted capital structure.")

[91] Id. at 7:26-28. ("For Rate Years 2 and 3, an annual "K-Factor" revenue escalator is applied to non-ERM and non-gas cost revenues to determine the Year 2 and Year 3 proposed rate changes.")

[92] Mullins, Exh. BGM-1T at 12:2-4. See, WUTC v. Pacific Power, Docket UE-152253, Order 12 at ¶ 172 (Sept. 1, 2016).

[93] Mullins, Exh. BGM-1T at 11:4-6. See, Hancock, Exh. CSH-1T at 24:17-19.

[94] Mullins, Exh. BGM-1T at 11:4-6.

[95] Id. at 11:6-8. See, Hancock, Exh. CSH-1T at 24:1-3.

[96] Scanlan, Exh. KBS-1T at 34:3-5.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

> plant, and then to demonstrate, capture, and verify offsetting benefits for every single capital transfer to plant in separate pro forma adjustments."[97]

44 Next, Avista's EOP Study was not limited to, and included "all minor projects … below the Commission's 0.5 percent threshold for 2017."[98] To this point, Staff concluded that the adjustments made by Avista's EOP Study "are more accurately described as indiscriminate pro forma rate base additions, regardless of the size of the individual capital additions contained in the adjustment."[99] In other words, the EOP Study disregards the Commission's guidance on use of a major plant threshold to determine the projects included in pro forma adjustments.[100]

45 Staff recommends that the Commission "ignore Avista's 'EOP Rate Base Studies,'"[101] concluding that accepting their "indiscriminate capital adjustments would be beyond extraordinary ratemaking treatment" and represent a "clear divergence from the Commission's long-established ratemaking practice."[102] Staff goes further to criticize the accuracy of Avista's forecasts, concluding that

> "[n]ot only do Avista's "limited" pro forma studies contain non-major plant, and not only do Avista's transfers to plant through December 2017 contain currently unverifiable forecasts, but the transfers to plant that are known and measurable as of August 31, 2017, are substantially lower than what Avista forecasted when it filed its case."[103]

---

[97] Hancock, Exh. CSH-1T at 26:10-14.

[98] Scanlan, Exh. KBS-1T at 25:14-16.

[99] See Hancock, Exh. CSH-1T at 24:14- 25:1.

[100] Dockets UE-150204/UG-150205 (C*onsolidated*), Order 05 at ¶ 40. ("We find it reasonable to set the threshold in proportion to a company's rate base. In the instant case, we find it reasonable to use the one-half of one percent threshold.") Here, the Commission was adopting the 0.5% threshold set forth in WAC 480.140.040 to determine the major plant additions allowed into rates.

[101] Scanlan, Exh. KBS-1T at 26: 16.

[102] Id. at 26:20-27:2.

[103] Id. at 31: 6-10.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

In the end, Staff cautions the Commission against relying on the forecasts made by Avista's EOP-Study because they "contain rate base amounts that are inflated and substantially incorrect."[104/]

46 Based on the record, the Commission could not possibly identify the specific facilities Avista will put into future service. Nor can it know and verify the actual cost of these facilities (in aggregate or individually). Moreover, the proper allocation of cost and revenue between Avista's customer schedules would be impossible to determine.[105/] Without these fundamental facts in evidence, the Commission has no way of knowing whether the Company's future rates would be "just, fair, reasonable, and sufficient."[106/]

47 Like the EOP Study, Avista's K-Factor Study also uses forecasted expenses but with a new twist; the escalation factor (K-Factor) would be *uniformly* applied across the spectrum of Avista's business, without regard to the individual cost drivers affecting each component or division of its operations.[107/] To create an expense and revenue base, Avista's K-Factor analysis uses historical trends to forecast Avista's future expenses and rate base, and then compares the trend analysis to its forecast revenue growth.[108/] The K-Factor Study's use of simple forecasts to set rates is quite similar to Avista's now-rejected attrition analysis.[109/] Any further similarity ends with the introduction of the K-Factor.

104/ Id. at 31: 12-13. See also, id. at 30: 7-17, testifying to specific examples of Avista's inaccurate forecasts and the inherent inaccuracy of forecasts "because uncertainty increases with longer time horizons."

105/ Staff would spread these future costs consistent with the cost of service study settlement but provides no evidence that it would be reasonable given future conditions. See, O'Connell, Exh. ECO-1CT at 6: 14-17.

106/ RCW 80.28.010(1).

107/ Mullins, Exh. BGM-1T at 14:12-16.

108/ Id. at 14:16-19.

109/ See, Dockets UE-160228/UG-160229 (*consolidated*), Order 06. Avista makes no attempt to explain why its K-Factor Study would be more accurate at forecasting costs than its prior attrition studies, or why it would be a better ratemaking tool for the Commission.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

48 Simply stated, the K-Factor is a cost escalator derived from escalation factors that were "considered on a *percentage of revenue requirement* basis to develop a singular revenue requirement escalator …."[110/] By comparison, Avista's previous attrition studies applied individual escalation factors to the "various elements of the revenue requirement study to calculate the overall year-to-year change in revenue requirement" – ostensibly to consider the variety of conditions driving costs across its operations.[111/] Thus, the K-Factor produces future cost estimates less reliable than its previously rejected attrition studies.[112/]

E. The K-Factor Study Fails to Reflect Avista's Actual Operating Conditions

49 The unreliability of Avista's forecasts were directly addressed by ICNU's unrebutted testimony. Mr. Mullins provides numerous examples of how Avista's forecasts fail to reflect the actual operating conditions facing the Company. He also points out that the K-Factor Study suffers from the same infirmities found in Avista's prior attrition studies. Both are based on simple forecasts "that are not reliable estimates of future results, and that Avista has not adequately explained."[113/] Furthermore, the K-Factor Study's uniform escalation factor (the K-Factor itself), would be even less representative of the Company's actual future conditions.

50 Unlike Avista's prior attrition studies, the K-Factor Study does not detail historical trends by major cost categories.[114/] Instead, it aggregates the Company's historical trend data relative to operations into four categories: Depreciation, Operations and Maintenance

---

110/ Mullins, Exh. BGM-1T at 13:5-8 (emphasis added).

111/ Id. at 13:8-11 and 15:7-10. ("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.")

112/ Id. at 14:8-12.

113/ Id. at 14:1-2.

114/ Id. at 14:12-13.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

("O&M") Expenses, Taxes Other than Income Taxes, and Net Plant.[115] It then uses the rate of growth in these categories to forecast costs, expected sales and resulting revenues.[116] By aggregating the trend data into four categories, the Company ignores other cost and revenue factors that impact its revenue requirement. To this point, Avista's K-Factor Study fails to incorporate the impacts "associated with deferred debits and credits, and working capital …," when calculating the revenue weighted escalation rate for rate base.[117]

51 Furthermore, Avista's K-Factor Study fails to incorporate the Company's actual operating conditions, including the "impact of regulatory amortizations when considering the escalators associated with net operating income items."[118] Here, Avista assumes a level of escalation for these revenue requirement elements, and then adds additional costs through the uniform application of its K-Factor.[119]

52 For example, Avista's K-Factor Study forecasts a 2.5% increase in operating expenses for its electric business.[120] Yet, the evidence shows that the Company's operating costs have been decreasing across many of its expense categories. To this point, Avista's administrative and operating expenses declined by 1.9% for its electric utility services and 5.1% for gas services between 2015 and 2016.[121] Further, distribution operating expenses for the electric utility declined by 11.0% over this same period.[122] These declines represent material

---

[115] Id. at 14:13-15.
[116] Id. at 14:15-19. ("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.")
[117] Id. at 14:20-15:2.
[118] Id. at 15: 3-5.
[119] Id. at 15: 5-7.
[120] Id. at 16: 20-21.
[121] Id. at 16:23-17:2.
[122] Id. at 17: 4-5, citing Mullins, Exh. BGM-5 at 14.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

reductions to Avista's costs and corresponding demand for revenue that are disregarded in favor of the K-Factor Study's indiscriminate use of the escalation factor.

53 On the plant-in-service side of the ledger, Avista forecasts that "net plant balances will grow by 4.8% per year for electric services and 5.2% per year for gas services."[123/] Even taken at face value, these forecasts raise immediate questions about Avista's future depreciation rates and tax expenses in light of the new depreciation study and the impacts of the TCJA, as neither are captured by the EOP or K-Factor Study.[124/]

54 Finally, the K-Factor Study's forecasts include escalations of both future plant levels and current depreciation expenses. The unrebutted evidence shows that Avista's current depreciation expenses will become irrelevant and unreliable once Avista files its expected depreciation study.[125/] To this last point, the historical trends used by the K-Factor Study creates an expectation that Avista's depreciation expenses will increase by 9.13% per year for electric services. Avista's new depreciation study will undoubtedly change this forecast, thus decreasing the already-suspect reliability of the K-Factor Study's conclusions.[126/]

V. AVISTA'S AND STAFF'S RATE PLANS

55 Staff and Avista request that the Commission incrementally approve rate increases for Avista over a three-year period, beginning with the rate year established by the final order in this case. To put this in perspective, the Commission is being asked to use the test year

---

123/ Id. at 17: 15-16.

124/ Id. at 17: 16-18. Similarly, the benefits expected from the full amortization of the WNP-3 settlement exchange power in 2019 are not included in the K-Factor Study. See, id. at 19:16-21.

125/ Id. at 14:2-4.

126/ Id. at 16:6-10. ("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.").

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

in this case, ending December 31, 2016,[127] to set rates through April 30, 2021.[128] No matter how this fact is spun, the simple truth is that Avista and Staff would have the Commission reset rates twice after the conclusion of this docket, with only the audited financials through December 31, 2016, to support its determinations.

56 If Avista had its way, electric rates over this period would increase by approximately $90 million from current rates.[129] Staff would increase electric rates over this same period by approximately $33 million.[130] Incredibly, both Avista and Staff ask the Commission to impose these rate increases upon ratepayers, without affording it the opportunity to audit the Company's expenses, revenues, and return.

A. The Rate Base Forecasts Included in the Rate Plans Proffered by Avista and Staff Cannot Meet the Commission's Prudence and "Used and Useful" Tests

57 In almost all circumstances, forecasts do not satisfy the requirement that costs be known, measurable, and verifiable before being allowed into rates.[131] When establishing the prudence of rate base, there are no justifiable exceptions to this requirement. To this point, the test articulated by this Commission to determine prudence *looks back* to actions taken by a utility and does not look forward.[132] The Commission recently articulated its long-standing test when considering the prudence of Puget Sound Energy's Lower Snake Wind Project, stating:

---

[127] Andrews, Exh. EMA-2 at 1.
[128] Andrews, Exh. EMA-1T at 6:9-13.
[129] Id. at 8:1-3.
[130] Hancock, Exh. CSH-1T at 44.
[131] See, WUTC v. PacifiCorp, Docket UE-050684, Order 04 (April 17, 2006). The notable exception is the forecast of power costs filed in each general rate case.
[132] Dockets UE-060266 and UG-060267 (consolidated), Order 08 at ¶ 156. ("The Commission evaluates the prudence of resource acquisitions by asking what "a reasonable board of directors and company management [would] have decided given what they knew or reasonably should have known to be true at the time they made a decision." This test applies both to the question of need and the appropriateness of the expenditures.") (citing, WUTC v. Puget Sound Power & Light Co., Cause No. U-83-54, Fourth Supp. Order at 32 (1984)).

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

> The test the Commission applies to measure prudence is what would a reasonable board of directors and company management have decided given *what they knew or reasonably should have known to be true at the time they made a decision.* This test applies both to the question of need and the appropriateness of the expenditures. The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made.[133/]

Thus, the Commission's prudence review examines facts in evidence that can only be known *after* but not before a final decision to acquire or build has been implemented by the utility.[134/]

58 Here, the record includes no tangible evidence demonstrating that Avista's future rate base additions will truly materialize. This is because Avista's EOP and K-Factor Studies and Staff's Rate Plan are based on forecasts grounded in historical trends. As a result, the record includes no evidence satisfying or even comporting with the Commission's prudence test. Certainly, Staff has not attempted to provide such evidence in support of its rate plan.[135/] But, how could it? The Company's future decisions to add rate base have not yet been made. The same would be true for any utility expenditure now sought to be recovered in rates. Importantly, the prudence requirement is not limited to rate base, but applies to all utility costs whether in rate base or not.[136/] Nor is it the only step in the approval process. Avista and Staff must also show

---

133/ Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶ 408 (citing, WUTC v. Puget Sound Energy, Docket UE-031725, Order 12 at ¶ 19 (April 7, 2004) (footnotes and related citations omitted) (emphasis added)).

134/ Decisions to build or acquire rate base would be made by the board of directors in the budget cycle prior to acquisition or construction.

135/ It has, however, testified to the inaccuracy of Avista's near-term rate base forecasts, finding them to be "inflated" and "substantially incorrect." See, Scanlan, Exh. KBS-1T at 31: 12-13. See also, id. at 30: 7-17, testifying to specific examples of Avista's inaccurate forecasts and the inherent inaccuracy of forecasts "because uncertainty increases with longer time horizons."

136/ See RCW 80.28.010(1) ("(1) All charges made, demanded or received by any gas company, electrical company, wastewater company, or water company for gas, electricity or water, or for any service rendered or to be rendered in connection therewith, shall be just, fair, reasonable and sufficient.") See, WUTC v. Avista Corporation, Docket UE-011595, Fourth Supp. Order (March 4, 2002) (concerning the prudence and recoverability of certain deferred power costs).

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

that capital plant is "used and useful for service in this state" before its fair value will be added to rate base.[137]

59 On the question of whether plant in service is "used and useful," this Commission has interpreted the statutory term to require actual and demonstrated benefits, expressing the requirement that the facility be *providing service* to ratepayers, not anticipated to provide service. To this point, the Commission concluded:

> "We interpret the phrase 'used and useful for service in this state' to mean benefits to ratepayers in Washington, either directly (e.g., flow of power from a resource to customers) and/or indirectly … Under either circumstance, the Company must demonstrate a quantifiable benefit to Washington ratepayers. *When a facility is actually used to provide service, its costs and benefits can be readily identified and allocated appropriately*."[138]

60 The Commission's interpretation of the "used and useful" statute leaves no doubt that utility plant must be serving Washington ratepayers before being added to rate base. Like the prudence discussion above, the forecasts used by Avista and Staff cannot satisfy the contemporary service test required by the "used and useful" statute. In fact, Staff testified to this very point, concluding that Avista's *near-term* forecasts of plant in service should be rejected.[139]

61 The record also contains no evidence that Avista's future rate base will produce quantifiable benefits. This is because the forecasts conceived by Avista and Staff cannot produce evidence that does not yet exist. Once plant is put into service, the necessary evidence will be available for review, audit, and judgment. Until that occurs, ratepayers should be spared the obligation to pay for plant that may not be in service or that may cost less than the forecasts

---

137/ Mullins, Exh. BGM-1T at 11:17-19, referring to RCW 80.04.250. See also, Docket UE-050684, Order 04.
138/ Docket UE-050684, Order 04 at ¶¶ 50, 51 (emphasis in original).
139/ Scanlan, Exh. KBS-1T at 23:3-9. ("Staff cannot attest that the Company's forecasts accurately reflect actual project costs, the prudence of those final costs, offsetting factors, or whether the project will be used and useful to ratepayers in the rate year.").

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

predict.[140] Uncertainties of this significance undermine the Commission's ability to set "just, fair, reasonable, and sufficient" rates.

62 In summary, the Commission satisfies its comprehensive authority to set rates that are "just, fair, reasonable, and sufficient" and its specific obligation to determine that utility plant is both "used and useful" to ratepayers by applying its judgment to facts in evidence – not "indiscriminate" and impossible to verify forecasts.[141] Simply stated, Avista's EOP Study's forecasts cannot satisfy the evidentiary burdens imposed by statute.[142] Staff's forecasts suffer from the same lack of tangible evidence. The forecasts contain no detailed facts as to project need, actual cost, or for the known offsets resulting from future construction. Importantly, the record evidence does not allow the Commission to isolate specific facilities for review or to determine how the costs should be allocated to Avista's customer classes. This is because the forecasts used to support both Staff's and Avista's Rate Plans are general in character, having been derived from the Company's historical trends and then escalated.[143] In short, the forecasts offered by Avista and Staff can be generously described as their contemporary guess as to the Company's future operations. It is Avista's burden to prove the elements of its case, and it offers the EOP Study as such proof.[144] However, the EOP-Study's lack of specific detail as to operational timeliness, actual cost, and offsetting benefits fails to do so.[145] Staff's forecasts

---

[140] Id. at 30: 7-14.
[141] See 80.28.010(1), 80.28.020 and 80.04.250.
[142] Scanlan, KBS-1T at 25: 16-18. ("Avista's "EOP Study" is more appropriately thought of as an indiscriminate pro forma study with unlimited pro forma adjustments through December 2017.")
[143] Hancock, Exh. CSH-1T at 34: 18-23.
[144] See RCW 80.04.130(4).
[145] Like Integrated Resource Plans submitted biannually for Avista, the EOP-Study's forecasts are insufficient for ratemaking, and fail to articulate evidence that can be used to either set rates or determine that future facilities are "used and useful."

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

cannot cure these deficiencies.

B. Avista's K-Factor Study Cannot be Relied Upon to Set Rates

63 Avista's K-Factor Study is deeply flawed in its design and its application, and represents the additional evidence proffered by the Company to support its rate plan.[146/] As explained above, the K-Factor Study was developed using Avista's historical trends to predict the Company's future rate base, operating expenses, and revenues.[147/] In operation, the K-Factor Study aggregates the Company's expenses into four groups; Depreciation, O&M Expenses, Taxes Other than Income Taxes, and Net Plant,[148/] rather than examining Avista's expenses in detail by reviewing all major cost categories.[149/] It then applies the uses the rate of growth in these categories to forecast costs, expected sales and resulting revenues.[150/] The K-Factor Study's design flaws and resulting misrepresentation of expenses are detailed above. For the purpose of argument here, they are summarized below.

64 First, Avista's estimated level of rate base (generated by its EOP Study) is a central component of the K-Factor Study's forecasts.[151/] As noted above, the Commission cannot determine the future cost of these facilities[152/] and their impact on rates without knowing the actual cost of individual projects, the demonstrated benefits to ratepayers, the overall

---

146/ Andrews, Exh. EMA-1T at 7:26-28. ("For Rate Years 2 and 3, an annual "K-Factor" revenue escalator is applied to non-ERM and non-gas cost revenues to determine the Year 2 and Year 3 proposed rate changes.")

147/ Id. at 8: 5-7.

148/ Mullins, Exh. BGM-1T at 14: 13-15.

149/ Id. at 14: 12-13.

150/ Id. at 14: 15-19. ("[T]he 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.")

151/ Andrews, Exh. EMA-1T at 25:14-17.

152/ Including resulting revenues and return.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

prudence of both the decision to build and final cost, and the offsetting benefits from operations.[153] None of these facts are in this record, and for good reason. These specific details are not yet known and will only be known when the facilities are finally built or acquired and put into service.[154]

65 Next, the K-Factor Study's aggregation and escalation of Avista's expenses into broad categories results in a distortion of its future costs and revenues. Specific examples of how the K-Factor Study uniformly escalates future expenses without regard to the Company's declining cost trendlines are described above. Moreover, the K-Factor Study is based only upon forecasts that cannot in this record be audited, tested, or otherwise determined to be reasonable. The Commission sets rates based upon tangible evidence in the record before it – not on a record that simply suggests likely business operations, whether in future plant additions or costs of operation.

C. Staff's Rate Plan Forecasts Do Not Produce Evidence Reliable Enough to Set Rates

66 Staff rate plan is based upon a one-dimensional linear trend analysis that simply projects Avista's historic costs into the future.[155] It makes no attempt to factor in the complexity of Avista's utility operations or to analyze the conditions that would affect the Company's revenues and expenses in the future. Instead, Staff starts with the Company's 2016 test year, adjusts the test year by using end-of-period results for certain capital investments,[156] and then,

---

[153] Docket UE-050684, Order 04.

[154] Docket UE-160228/UG-160229 (C*onsolidated*), Order 06 at ¶ 72. ("The Commission's general practice is not to pre-approve capital projects. The Company, by and large, decides (*i.e.,* controls) what projects it will undertake and when it will undertake them. Prudence determinations are made after the fact, usually after the capital project is complete at which time the Commission can evaluate whether it is used and useful and provides benefits to ratepayers commensurate with its final costs.")

[155] Hancock, Exh. CSH-1T at 34: 18-23.

[156] Id. at 27: 17-23.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

by simple extrapolation, escalates these results through 2021.[157/] Staff makes no attempt to perform an attrition study,[158/] or to test the results of its trend analysis using other means. Further, Staff presents no evidence as to whether its projected expenses are necessary to future utility operations or even reasonable given Avista's future circumstances. It simply assumes this fact to be true because Avista incurred the costs in the test year.[159/] Nor does it attempt to apply any form of "known and measurable" like criteria to its projections of Avista's future costs. Other than its test year analyses and pro forma adjustments, Staff makes no attempt to verify its expense and revenue conclusions. This is a remarkable departure from Commission regulatory standards and stands in stark contrast with the Commission's treatment of near-term pro forma adjustments of test year results.[160/]

67 As testified to by Commission witness Ms. Scanlan and later confirmed by Mr. Hancock at hearing, the Commission's rules and practices require that pro forma adjustments require that costs "pro formed" into the test year must be both "known and measurable"[161/] and verified as being accurate.[162/] There are certain exceptions to these requirements, such as

---

157/ Id. at 34:21-23.

158/ Id. at 8:1-3. ("To be clear, Staff's multi-year rate plan is not based on an attrition analysis and does not include any attrition adjustments.")

159/ Id. at 34: 20-21.

160/ Scanlan, Exh. KBS-1T at 6:12-14. ("Thus, the Commission's standard ratemaking practice is built around two basic components: 1) the modified historical test year, and 2) limited pro forma adjustments."

161/ Hancock, Tr. at 247:25-248:4; Scanlan, Exh. KBS-1T at 10:15-20. The Commission's rule defines pro forma adjustments to "give effect . . . to all known and measurable changes that are not offset by other factors." The rule "highlights two important concepts with regard to pro forma adjustments: 1) known and measurable and 2) offsetting factors.") (citing WAC 480-07-510 (3)(e)(iii)).

162/ Hancock, Tr. at 249:1-10. See, WUTC v. Avista Corporation, Dockets UE-090134 and UG-090135 (consolidated), Order 10 at ¶ 45 (December 22, 2009). ("The known and measurable concept requires that an event that causes a change in revenue, expense or rate base must be *known* to have occurred during or after the historical 12 months of actual results of operations. It must also be demonstrated (*i.e., known)* that the effect of the event will be in place during the 12-month period when rates will likely be in effect. The actual amount of the change must be *measurable.* This means the amount cannot be an estimate, a projection, the product of a budget forecast, or some similar exercise of judgment-even informed judgment-concerning future revenue, expense or rate base. Costs that are documented by actual expenditure, invoice,

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Avista's use of the *Aurora* power cost model to forecast the Company's rate-year power costs.[163] However, the Company's *Aurora* has been used for many years, and has been regarded by the Commission as a reasonable ratemaking tool.[164] This cannot be said about Staff's forecasts.

68 As noted above, Staff's continued support for the "known and measurable" requirements are unwavering – costs must be verified, resulting revenues must be ascertained and accounted for, and any offsetting benefits must be considered.[165] To the latter point, the Commission has opined,

> "[F]or rate base, and for expense or revenue items, pro forma adjustments must be matched with offsetting factors. Offsetting factors, as the term suggests, diminish the impact of the known and measurable event. A mismatch would be created if offsetting factors are not taken into account. That is, the known and measurable change will be overstated or understated, distorting the test year relationships among revenues, expenses, and rate base."[166]

Application of these requirements protect ratepayers from rates that would otherwise include unrealized costs, unrecognized benefits, or unrecognized and "unmatched revenues."[167]

To this very point, Ms. Scanlan concluded:

> "Staff rejects the remainder of [Avista's] forecasted capital additions. The Company's forecasts are just that –forecasts, which have not occurred as transfers to plant. Staff cannot attest that the Company's forecasts accurately reflect actual project costs, the prudence of those final costs, offsetting factors, or whether the

---

contract, or other specific obligation usually meet this test. Costs that are the product of forecasts, projections, or budgets generally will not qualify.") (Emphasis original).

163/ "Power cost models yield expected net power costs by rigorously matching costs and revenues. While these models employ assumptions, estimates, and forecasts as inputs, the modeled results are generally acceptable if the model inputs are reasonable and the modeling is comparable in analytical rigor to what is brought to bear in making normalizing adjustments." WUTC v. Avista Corporation, Dockets UE-090134 and UG-090135 (consolidated), Order 10 ¶ 49 (Dec. 22, 2009).

164/ Kalich, Tr. at 185-190

165/ Scanlan, KBS-1T at 12: 14-16. "Staff does not support extending pro forma treatment to include all minor programs because Staff could not feasibly verify and capture increased revenues or decreased expenses associated with these capital additions."

166/ Dockets UE-090134/UG-090135 (consolidated), Order 10 at ¶46.

167/ Scanlan, KBS-1T at 12: 16-18. "From a risk standpoint, allowing more and more pro forma projects into the fold increases risks to ratepayer of unmatched revenues and costs."

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

project will be used and useful to ratepayers in the rate year. In addition, the Company's forecasts for 2017 and previous general rate case plant transfers to plant *have been substantially inaccurate*…."[168/]

The Commission can recall that Mr. Hancock agreed with Ms. Scanlan that forecasts are not permissible support for pro forma adjustments.[169/] In contrast, Staff's rate plan is based solely on forecasts that would reach out to 2021, and award Avista annual rate increases without regard to the Company's actual costs, revenues, or return. Staff's approach in this circumstance cannot be reconciled with its own testimony and defies logic.

69 ICNU's testimony correctly concluded that there should be no substantive difference in the regulatory treatment for costs pro formed into the rate year or for forecasts proffered to set rates well beyond the rate year. To this point, Mr. Mullins testified

> "… Ms. Scanlan's rationale for rejecting all forecasts of the Company's capital additions, after August 31, 2017, can be fairly applied as a basis to reject Staff's proposed escalation rate in years 2 and 3 of the rate plan, since Mr. Hancock's proposed escalation rate is developed from forecasts—i.e., "by finding the percent growth in rate base that Avista expects over the course of the rate plan."[170/]

Thus, ICNU and Ms. Scanlan correctly identified the problems inherent in using simple forecasts to make rates. Importantly, the inconsistency between Staff's treatment of pro forma cost additions and its rate plan proposal cannot be reconciled.

70 When considering a near-term pro forma adjustment, Staff requires that the costs be known, measurable, verified and adjusted for offsetting benefits. However, if Staff forecasts costs and revenues through 2021, these same protections that guard against overstated costs and

---

[168/] Scanlan, Exh. KBS-1T at 23:1-9 (emphasis added).

[169/] Hancock, Tr. 248: 16-20. See also, Scanlan, Exh. KBS-1T at 11: 4-6. ("In general, the practical implication of the "known and measurable" standard is that forecasts generally do not qualify as pro forma adjustments.")

[170/] Mullins, Exh. BGM-9T at 10:5-9, quoting Hancock, Exh. CSH-1T at 43:11-13.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

understated revenues in the rate setting calculation are ignored in favor of untested forecasts. Staff's ratemaking dichotomy, wherein near-term incurred costs must be "fact tested" to be used in the ratemaking calculus but long-term forecasts of events that may or may not occur in the future can stand without such scrutiny, makes no logical or regulatory sense.[171]

71 In sum, the Commission's adherence to the modified historical test year to set rates is both steadfast and recently defended in Avista's 2016 rate case.[172] It is also true that the Commission is not tied to the use of one methodology to set rates.[173] However, it must apply the ratemaking method it selects to actual and verifiable facts to avoid challenge under the arbitrary and capricious standard.[174] In this case, the Commission can find support for the facts related to Avista's selected test year. These facts can be determined to be known, measurable, and verifiable by the testimony and other evidence presented by these parties. It cannot rely upon the forecasts proffered by Avista and Staff to set rates through 2021 or beyond.[175] To do so, would contort the regulatory principles consistently applied by the Commission, and result in a decision based upon a rate making method without precedent for this Company and Commission.[176]

D. Staff and Avista's Proposed Rate Plans Ignore Apparent and Known Circumstances That Will Materially Alter Avista's Financial Returns

72 Staff and Avista have proffered rate plans largely built upon Avista's historical costs, revenues, and rate base. However, Avista's future portends material changes to its

---

[171] Furthermore, Staff's historical-trend forecasting tool is particularly vulnerable to failure when material, yet unaccounted for, changes to Avista's expense, revenue, and rate base variables materialize in the future.

[172] WUTC v. Avista Corporation. Dockets UE-160228 and UG-160229 (Consolidated), Order 06, Final Order Rejecting Tariff Filing, December 15, 2016.

[173] Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of W. Virginia, 262 U.S. 679 (1923), and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).

[174] See, POWER v. WUTC, 104 Wash. 2nd 798 (Dec. 12, 1985).

[175] Unless ordered by the Commission, Avista is under no obligation to file a rate case in 2021.

[176] Importantly, no attrition study supports the forecasts proffered by Avista and Staff.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

corporate tax rates, depreciation schedules, and ownership. Any one of these, taken alone, would likely have a material impact on Avista's future financial returns.

i. Avista's tax rate changes will materially impact Avista's costs, revenues and returns in the rate year and beyond

73 The tax reductions and other provisions set forth in Tax Cuts and Jobs Act ("TCJA") will have a significant impact on Avista's revenue requirement.[177/] To the Company's credit, the TCJA's tax benefits will be returned to ratepayers by way of an adjustment to Avista's base rates, thus allowing for efficient accounting for all associated and downstream consequences.[178/]

74 In response to Bench Request 1, ICNU submitted its analysis of the TCJA's impacts to Avista's potential rate year financials, concluding that Avista's electric rates should be reduced by $32.4 million and its gas rates should be reduced by approximately $6 million.[179/] Importantly, the TCJA's impacts to revenue requirement are not included in the rate plans proffered by Avista and Staff.

75 The magnitude of the TCJA's tax impacts produce both significant benefits for ratepayers and material changes to Avista's financial results. However, Avista has not yet explained or monetized the collection of impacts created by the TCJA, as applied to its numerous business activities. Once the TCJA's impacts are fully understood, explained, and monetized by Avista, the parties should be allowed the opportunity to review, confirm, or dispute Avista's

---

177/ HR 1 of the 115th Congress, The Tax Cuts and Jobs Act, signed into law on December 22, 2017.
178/ Avista Response to BR 1 (Jan. 12, 2018).
179/ Once built into base rates, the Commission can expect impacts of this general magnitude to persist.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

conclusions. As the record develops, the Commission can and should incorporate known and accepted benefits into rates in this docket.[180]

76 As noted above, Staff sets rates for the rate year using a modified historical test year, adjusted by pro forming into rates certain capital projects. Of course, Staff's test year analysis includes Avista's historic tax costs and liabilities, including any impacts to then-current AFDIT and EDFIT accounts, regulatory fees, state and local taxes based upon revenue, and other financial variable influenced by federal income taxes. Furthermore, Staff used its test year results and the Company's pre-TCJA results to create its trending analysis. Coincident with the TCJA's effective date, Staff's trending analysis drifted even further from the potential reality it intends to portray. This is because the past no longer represents the future in at least one critical and material way– Avista's tax rates dropped from 35% to 21%.

77 Without question, the financial uncertainty created by the TCJA highlights the inherent inability of linear trend projections to capture very real and obvious changes to Avista's future operations. To prove this point, the Commission need only look to the rate plans proffered by Avista and Staff, as neither addresses or could address the TCJA's disruptive impact on Avista's future rates.

78 Notably, Staff has not attempted to correct its linear trending analysis used to support its rate plan. Therefore, the record stands without correction. In the end, it was incumbent upon Staff to make the corrections it believed necessary to link its forecasts to

[180] As expressed in the ICNU/NWIGU response to Bench Request 1, the Joint Parties recommended that known benefits be incorporated into rates in this docket. If necessary, the Commission could reduce rates, subject to refund, to allow known or less complicated rate impacts to go into effect immediately, while using the deferred accounting petition filed by Avista on December 28, 2017, to house the remainder of the benefits.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Avista's actual circumstances. It has failed to do so. For this reason alone, its rate plan should be rejected.

ii. Avista's 2018 depreciation study can be expected to materially impact Avista's costs and revenues

79 The return of investment resulting from depreciation rates determines the major area of cost for most facilities. In turn, the costs returned to the Company via depreciation determines, in significant part, the rates to be charged ratepayers that use those facilities.[181/] When depreciation rates are changed by the Commission, the rates for services will follow. The Commission is required by law to set the rate of depreciation for utility property under its regulation.[182/] Furthermore, it is instructed to set depreciation rates that are "proper and adequate" for the utility's class of property.[183/] Once the Commission determines a utility's depreciation rates to be "proper and adequate," the statute can be read to compel the Commission to take action or face a confiscatory "takings" challenge, under the federal constitution.[184/]

80 Avista has made clear its intention to file a new depreciation study in 2018.[185/] While the date of its filing is not yet certain, the Commission can be assured that the determinations made in its last-filed depreciation study will be revised and conformed to Avista's current rate base. Without question, Avista's new depreciation study will show changes to its depreciation expenses – perhaps significant changes. As pointed out by ICNU, once

---

[181/] In the Matter of the Petition of Gte Nw. Inc., for Depreciation Accounting Changes, UT-961632, 1997 WL 35263563 (Dec. 12, 1997)

[182/] See RCW 80.04.350.

[183/] See RCW 80.04.350.

[184/] U.S. West Communications, Inc. v. WUTC, 134 Wn. 2d 48 at 69-71 (1997) "The Supreme Court has held that the Constitution protects utilities from being limited to a charge for their property serving the public which is so "unjust" as to be confiscatory." (citing Duquesne Light Co. v. Barasch, 488 U.S. 299, 307, 109 S.Ct. 609, 615, 102 L.Ed.2d 646 (1989)).

[185/] Thies, Tr. at 350:2-5.

Avista's new depreciation schedules are approved, the historical trends used by Staff and Avista to forecast future costs become irrelevant.[186] While it cannot be determined at this point whether Avista's depreciation expenses will increase or decrease, what is certain is that its depreciation expenses will change from those used to develop the trending analyses supporting the rate plans.[187]

81 To resolve the apparent conflict between its rate plan and Avista's 2018 depreciation filing, Staff recommends that the Company book its new depreciation rates but not be allowed to recover the costs associated with its new rates, until after the rate plan expires.[188] In the intervening time, rates through the term of the rate plan would be set using the results from Avista's 2012 depreciation study.[189]

82 There is no plausible rationale for Staff's proposed solution. It appears to reflect Staff's reasonable belief that Avista's depreciation filing would, under most circumstances, require the Commission to change rates consistent with the new depreciation schedules. Of course, this too would create a problem for its rate plan, as rate plans and rate changes cannot logically co-exist in the same temporal period. It attempts to fix the blame on the Company for the timing of its current rate case,[190] and even suggests that the Company could have decided to

---

186/ Mullins, Exh. BGM-1T at 16:11-17. ("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.")

187/ Staff has opined that Avista's depreciation rates and resulting costs are expected to increase. See, Hancock, Exh. CSH-7T at 9: 4-6.

188/ Hancock, Exh. CSH-7T at 10:10-23 and 11:1-2. ("Regardless of the Commission's decision on the appropriateness of proposed depreciation rates in such a filing, no change would be made in the Company's revenue requirement, and none would be called for.")

189/ Hancock, Exh. CSH-7T at 10:20-23.

190/ Id. at 11: 4-5.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

file a new rate case when the depreciation study is complete.[191] Neither response directly addresses the real problem - Staff's rate plan fails to address the changed circumstances to be revealed when Avista makes its depreciation filing.

iii. The rate plans proffered by Avista and Staff ignore the potential impacts resulting from the unresolved Avista and Hydro One merger docket

83 On September 14, 2017, Avista and Hydro One filed its joint application seeking Commission approval of their proposed merger.[192] The Commission has set the statutory deadline for its decision on August 14, 2018, subject to a possible four-month extension.[193] Clearly, the Commission's merger decision will be issued during the rate year established by the Commission in this docket.

84 The rate plans sponsored by Staff and Avista fail to adequately respond to the potential impacts of the merger case. Staff, for example, views the merger case as having longer-term cost impacts, and therefore would not conflict with its rate plan.[194] While this might turn out to be true, this is no reason to delay the fulfillment of benefits emanating from the Commission's merger case decision. While rate credits could be handled through a tariff rider and conservation tariffs are generally reset outside a general rate case, there are other potential conditions that could require a general rate case to resolve.

85 For example, if the Commission ordered Avista to immediately increase investments in renewable energy facilities, changes to rate base would require the filing of a

---

[191] Id. at 11: 7-9.
[192] WUTC v. Avista, Docket U-170970, Joint Application for an Order Authorizing Proposed Transaction (Sept. 14, 2017).
[193] WUTC v. Avista, Docket U-170970, Order 02 at 10, Appendix B (Oct. 25, 2017).
[194] Hancock, Exh. CSH-7T at 7:5-10.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

general rate case. The same would be true if the Commission required Avista to divest its interest in Colstrip 3 and 4 or to change its useful life for ratemaking purposes. Avista may have assumed these risks when it filed its merger case during the pendency of this docket, but without the rate plan, regulatory changes requiring amendments to rates and tariffs could be handled in a timely and administratively efficient manner. Further, the Commission may find it difficult to unwind merger-based costs or benefits at the end of the rate plan.

86 While tariff impacts related to the merger docket's outcomes are more speculative than the certainties associated with the TCJA and Avista's upcoming depreciation filing, the merger docket is another overlay of predictable change to Avista's future circumstances.

E. Revenue Requirement Summary

87 Avista proposed a rate plan, and Staff made the decision to support the concept. It then developed a flawed forecast-based analysis that defies Commission-established regulatory principles. Avista's rate plan suffers from the same infirmity. Thus, the estimated costs and revenues put forward by Avista and Staff cannot be adequately ascertained, audited, or tested for offsetting benefits. Further, Avista's very healthy revenue and returns show a trend indicating that no rate increase is needed at this time and perhaps in the future. Certainly, Avista should not be "guaranteed" two incremental rate increases in the next three years as recommended by Avista and Staff.

88 Furthermore, the rate plans proposed by Avista or Staff fail to account for certain and significant changes to Avista's businesses. Here, Staff's proposed treatment of the TCJA's significant tax-reduction benefits is less than clear. There is no reason for the Commission to delay incorporating the TCJA's known tax benefits into base rates. In this way, ratepayers will receive now and, in the future, the TCJA's recurring benefits. The TCJA's disruptive impact on

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Avista's rates demonstrates that the record evidence supporting the rate plans misrepresents the Company's current and future cost and revenue requirements.

89 Finally, Staff does not adequately address the rate impacts associated with Avista's 2018 depreciation study filing. Rather than tackling the problem head-on, Staff recommends that the Commission order the Company to book depreciation costs based upon its yet to be determined 2018 depreciation schedules, but not collect these costs in rates. Staff's recommendation is admittedly surprising. Furthermore, it disregards the Commission's duty to set rates that are "just, fair, reasonable, and sufficient."[195/]

90 When fulfilling this duty, the Commission should not ignore the apparent and disruptive changes to Avista's circumstances. The evidence clearly demonstrates that Avista's future rates must change because of the TCJA and its upcoming depreciation study. It is also clear that the forecasts produced by Avista and Staff will become even more unreliable as the impacts of the TCJA and Avista's 2018 depreciation case become fully known. For these reasons alone, Staff and Avista's rate plans should be rejected.

VI. COST OF SERVICE

91 On November 1, 2017, Avista, Staff, the Public Counsel Unit of the Washington Attorney General ("Public Counsel"), the Northwest Industrial Gas Users ("NWIGU"), and the Energy Project ("Settling Parties") filed a Multi-Party Partial Settlement Stipulation ("Settlement") covering certain cost of service, rate spread, and rate design issues teed up in this

---

195/ The Commission's statutory duty does not include an exception for the burden of frequently filed rate cases. Hancock, Exh. CSH-1T at 17:9-17. Furthermore, Avista bears a duty to its shareholders to reasonably operate the business, including the responsibility to recover known costs in a reasonable period after such costs are incurred. It cannot then purposefully ignore such cost recovery when both the costs and the path to recovery are known. When dealing with new depreciation schedules, the Company's path is a filing seeking approval of the new depreciation schedules and a manner of recovery.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

docket.[196] ICNU opposed the settlement believing that it failed to address the chronic under-recovery of electric cost of service from the Schedules 1/2.

92 In the Settlement, the parties agreed to leave existing rate spread allocations and most rate design elements in place, but for minor incremental changes applied to Schedules 1/2 and Schedules 11/12. Specifically, Residential Schedules 1/2 would receive a very small increase approximating "106 percent of all other classes except General Service Schedules 11/12,"[197] and General Schedules 11/12 would receive an increase of approximating 80 percent of all other classes except Residential Schedules 1/2.[198] The Settling Parties did not agree on specific cost of service methodologies in this case, agreeing to reserve all cost of service issues for the generic cost of service collaborative.[199]

A. ICNU's Opposition is Grounded in the Principles of Ratemaking

93 The purpose of an Embedded Cost of Service ("cost of service") study is to empirically determine the utility's cost of serving each of its customer classes.[200] Said another way, a cost of service study shows the Commission "how each customer class contributes to the total system cost."[201] The relationship between classes are generally set forth as the contribution each class makes to a company's return. If the return attributed to a class is equal to a company's overall return, the Commission can conclude that the revenues generated by that class

---

196/ Multiparty Partial Settlement Stipulation.
197/ Id. at ¶ 6. The settlement assumes that rates for all other electric classes would receive "an equal percentage increase in allocated revenue requirement in each year of any approved rate plan."
198/ Multiparty Partial Settlement Stipulation at ¶ 6. In addition, incremental changes were made to the customer charges for Schedules 1/2, Schedules 11/12, and Pumping Service Schedules 31/32. Finally, the demand charges for General Schedules 11/12 and Extra Large Schedule 25 were increased.
199/ Id. at ¶ 5.
200/ Stephens, Exh. RRS-1CT at 5: 1-2.
201/ Id. at 5: 5-6.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

are equal to the cost to serve it.[202] Of course, the inverse would also be true. In this circumstance, where class revenues do not cover the costs of service, it is other ratepayers that must make up the shortfall by paying more in rates than called for by the cost of service study.[203]

94 To perform its duty to set rates that are "just, fair, reasonable, and sufficient," the Commission considers both the revenues required to compensate Avista for its reasonable expenses and return and the revenues required from each class to cover the costs required to provide service to each.[204] Said another way, the determination of overall revenue requirement would have the Commission balance the interests of *the company and its ratepayers*. In contrast, the spread of cost between customer classes requires the Commission to strike a balance *between the customer classes* to justly, fairly, and reasonably spread Avista's revenue requirement among its many classes.

95 Equivalence between each class's revenue requirement and the revenue they produce suggests that rates are fairly, justly and reasonably spread. Some disparity between the classes can be expected over time. That said, it is the degree of disparity that matters most, followed in importance by how long the disparity has existed. Here, the Settlement's failure to address the residential classes' significant and persistent under-recovery of revenue raises questions about the Settlement's legal support and highlights the inequitable spread of costs between Avista's customer classes.

---

[202] Id. at 5: 6-9.
[203] Id. at 5: 11-14.
[204] Id. at 4:6-7. ("Each customer class should, to the extent practicable, produce revenues equal to the cost of serving that particular class.")

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

B. The Settling Parties Provide Little Evidence to Support the Settlement

96 The Commission's acceptance of a settlement is founded on well-established legal and equitable principles. First, the Commission must conclude that the terms of the settlement are lawful. If yes, then the Commission turns to the evidence supporting the settlement. Here, it must find the evidence to be both appropriate and sufficient to support each of the results sought.[205/] The Commission also looks to the entire record to determine whether the result is "consistent with the public interest in light of all the information" available to it.[206/] Ultimately, it "must determine that the resulting rates are fair, just, reasonable, and sufficient, as required by state law."[207/] The Commission's test places the burden on the Settling Parties to prove that *each element* of the Settlement is the most appropriate outcome under the circumstances presented.[208/] To meet this burden, it is the Settling Parties' responsibility to present appropriate and sufficient evidence through testimony supporting the Settlement. For reasons discussed below, the Settling Parties have not met their evidentiary burden, leaving the Commission an insufficient and incomplete record from which to base a decision.

97 Avista is the only party among the Settling Parties to perform and file a cost of service study.[209/] Staff did not file a cost of service study that could at least inform its judgment on settlement.[210/] Instead, it adopted Avista's cost of service study.[211/] However, the weight

---

205/ Dockets UE-150204/UG-150205 (*consolidated*), Order 05 at ¶ 20.

206/ Id.

207/ Id.

208/ Id. at ¶ 21.

209/ Knox, Exh. TLK-1T. NWIGU and the Energy Project offered nothing more than their statements in support of settlement, having filed no other testimony addressing cost of service.

210/ O'Connell, Tr. 402:11-14. See also, O'Connell, Exh. ECO-1T at 4:8-11. The Commission can reasonably infer from Staff's actions and testimony that it did not *attempt to perform* a cost of service study prior to settlement.

211/ O'Connell, Tr. 402:13-14. This fact was revealed for the first time at hearing.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

given Avista's study by Staff is difficult to ascertain.

98 Staff testified to referring to Avista's study when considering the issues,[212/] but later stated that the "magnitude" of the disparity determined for Schedules 1/2 was "unknown for us at this point, mainly because we have doubts on the accuracy."[213/] These statements are at best difficult to reconcile, especially when coupled with Staff's testimony that it adopted Avista's cost of service study.

99 Staff also testified that its settlement positions were founded "on maintaining the status quo for the cost-of-service matters."[214/] To this point, Staff encourages the Commission to adopt the settlement to "reserv[e] all cost of service questions to the generic proceeding" and "avoid creating additional precedent that could interfere" with it, inferring that the conclusions reached by Avista's cost of service study were of secondary importance.[215/] Importantly, the Settlement testimony filed by Staff makes no claims that the Settlement will result in "just, fair, reasonable, and sufficient rates." As a result, the Commission will find no substantive evidence in Staff's testimony directly addressing this basic ratemaking requirement, let alone how the standard has been met by each of the Settlement's many components.[216/]

100 Like Staff, Avista's rationale for settlement is tied to the prospective outcomes of a future cost of service collaborative.[217/] To this point, the Company's settlement testimony makes specific reference to the collaborative, noting that the parties agree it is "more appropriate

---

212/ Id. at 402:1-5.

213/ Id. at 403:16-21.

214/ Id. at 402:6-14. The Commission can surmise that Staff is referencing the cost of service collaborative and "maintaining the status quo" prior to its resurrection and possible conclusion.

215/ O'Connell, Exh. ECO-1T at 5:4-6.

216/ Staff's testimony does note that the Settlement addresses "over- or under-recoveries" of certain customer classes and would reduce "cross-class subsidization in an incremental way." See O'Connell, Exh. ECO-1T at 8:3-4.

217/ Ehrbar, Exh. PDE-8T at 10:5-8.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

to address, in the ongoing generic collaboration (arising out of Docket Nos. UE-160228/UG160229), cost of service methodologies to be used in future cases."[218/] Later in Mr. Ehrbar's testimony, he comments that the Settlement "must result in rates that are fair, just, reasonable and sufficient …."[219/] However, he provides no explanation as to why the Settlement meets this fundamental standard. He simply expresses his opinion that the Settlement represents the Settling Parties best efforts to arrive "at an end result that satisfies these requirements."[220/] Best efforts or not, the Commission's test requires a tangible demonstration that the resulting rates *are* "just, fair, reasonable, and sufficient." This is a much higher burden than simply using best efforts.

101 In the end, it is incumbent upon the Settling Parties to demonstrate that *each aspect* of the Settlement presents a "reasonable resolution" of the issue presented.[221/] While the testimony proffered by the Settling Parties identifies each rate change covered by the Settlement, it does not address why each element was selected for settlement or why each rate spread or design change agreed upon would result in "just, fair, reasonable, and sufficient" rates. For example, the slight rate increase for Schedules 1/2 is not explained, other than by general references to the lack of parity among Avista's class schedules[222/] and rate shock.[223/] The supporting testimony makes no attempt to explain how the small change in rates would reasonably address the apparent and significant shortfall in revenues from Schedules 1/2.[224/]

218/ Id. at 2:22-3:1.
219/ Id. at 11:6-7. Here, Mr. Ehrbar is citing RCW 80.28.010.
220/ Id. at 11:12-13.
221/ Dockets UE-150204/UG-150205 (*consolidated*), Order 05 at ¶ 21.
222/ O'Connell, Exh. ECO-1T at 8:4-6.
223/ Id. at 4:1-2.
224/ And, as discussed further below, in fact, makes virtually no progress toward cost of service at Staff's proposed level of increase.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Instead, Staff testified that the "Settlement doesn't contemplate any revenue requirement attached to it."[225/] Of course this cannot be true, as the primary purpose of a cost of service study is to spread the Company's revenue requirement among its various classes. Finally, and like the Company, Staff pointed to preserving cost of service issues to the collaborative as the settlement's intention.[226/] The Settlement's justifications are discussed below.

102 First, the testimony referencing rate shock is not reasonable. If the recommended revenue requirement (2.04 percent), even including the Settlement allocation for Schedules 1/2, borders rate shock, then Avista's proposed 12.47 percent rate increase for year one[227/] would do *six times* the harm.[228/] To this point, Staff's testimony on revenue requirement makes no reference to rate shock, even though its own rate plan would increase electric service rates by over $30 million.[229/] In the end, an unsubstantiated claim of rate shock should not act as bar to setting "just, fair, reasonable, and sufficient rates."[230/] The lack of parity claim made by the Settling Parties is even less compelling.

103 Next, the Settlement testimony never explains why the slight increase for Schedules 1/2 is the Commission's most reasonable option to resolve the lack of parity between Avista's customer classes, especially when Avista's own testimony shows that the current rate of return for the residential customers is *less than 3 percent*.[231/] Even if the Commission were to include Avista's proposed 13.3 percent increase for these Schedules, they would still fall 33 basis

---

[225/] O'Connell, Tr. at 405: 24-25.
[226/] Id. at 408:23-409:9.
[227/] Andrews, Exh. EMA-1T at 14:13-14.
[228/] Avista even admits that raising the rates of Schedules 1/2 by 13.3 percent, as called for in its cost of service study, would not create rate shock. See, Stephens, Exh. RRS-13 at 9.
[229/] Hancock, Exh. CSH-1T at 44:14.
[230/] If a 2 percent increase caused rate shock, then many general rate decisions would be subject to challenge.
[231/] Ehrbar, Exh. PDE-4 at 2. See also Knox, Exh. TLK-1T at 3, Table 1.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

points below parity and generate only a 5.19 percent rate of return.[232] Without question, the Settlement's small increase (106 percent of the overall base increase) is nowhere near what would be required to bring Schedules 1/2 to parity. As a result, Avista's other class schedules will pay more of the system's overall cost, while Schedules 1/2's contribution to system costs could fall even further from parity, on a revenue basis.[233] Given the evidence presented in this docket, it would be entirely reasonable for the Commission to take meaningful steps addressing the "significant" under-recovery from Schedules 1/2 in order to diminish the existing detrimental impact to Avista's other schedules. The Settlement does not accomplish this goal.

104 Finally, the Settlement's intent to preserve cost of service issues to the collaborative does not outweigh the Commission's duty to set "just, fair, reasonable, and sufficient" rates. ICNU's testimony shows that Schedules 1/2 would require a 29% increase to bring to parity, using Avista's cost of service study.[234] The Settlement's allocation of cost to these Schedules would do little or nothing to correct their significant deficiency in cost recovery. To this point, ICNU explained that the percentage of increase called for by the Settlement would not make a material difference today or in the future and could require as many as 118 similar rate increases (and anyone's guess as to how many years) to bring Schedules 1/2 to parity.[235] Clearly, the Commission's ratemaking duty cannot be sidelined by the Settling Parties' intent to continue a collaborative on cost of service issues likely into 2019 or beyond.[236]

---

[232] Ehrbar, Exh. PDE-4 at 2

[233] Mr. Stephens testified that the Settlement's rate increase could result in Schedules 1/2 falling even farther from parity, considering the revenues generated. Stephens, Exh. RRS-12T at 8:3-12.

[234] Stephens, Exh. RRS-12T at 6, Table 1.

[235] Stephens, Exh. RRS-12T at 8:13-20 and at 9, Table 2. Mr. Stephens uses Staff's recommended overall rate increase of 2.04 percent to perform his impact calculation.

[236] Stephens, Exh. RRS-12T at 14:14-21.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

105 In summary, the Commission's record is largely confined to the cost of service studies presented by Avista and ICNU. Both highlight the under-recovery of Schedules 1/2,[237] and form the evidentiary backdrop against which the Settlement must be judged. The Settling Parties' testimony supporting the Settlement adds little to the record pertaining to the electric utility. Simply said, the Settling Parties make no attempt to explain why each proposed rate or rate design change would be reasonable and result in "just, fair, reasonable, and sufficient" rates. It is not sufficient to simply state that the Settlement is "in the public interest." Certainly, it is not "in the interest" of those customer classes who would be paying more of Avista's system costs than allocated by the Company's own cost of service study. The Settling Parties make no attempt to explain or defend this fact.

106 For the above reasons, the Settling Parties have not met the evidentiary requirements needed for approval. The Commission should reject the Settlement's electric rate and rate design provisions, and either retain the status quo or take progressive and material steps to end the chronic under-recovery of Schedules 1/2 by increasing rates for these classes in an amount that would bring them to parity in a reasonable period.

C. ICNU's Cost of Service Study Fairly Allocates Avista's System Costs

107 For the sake of brevity, ICNU will not attempt to reiterate all aspects of its cost of service testimony. Instead, it will focus upon the results and reasons behind the results proffered to the Commission.

108 The Commission can observe a number of similarities in the conclusions reached by the cost of service studies performed by ICNU and Avista. First, both studies show

[237] See, for example, Stephens, Exh. RRS-1CT at 33, Table 4; see also Knox, Exh. TLK-1T at 3.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

significant under-recovery from Schedules 1/2 (Residential Service) and Schedules 41/49 (Lighting Service). Both studies show significant over-recovery from Schedules 11/12 (General Service), and sizeable over-recovery from Schedules 21/22 (Large General Service). The studies' conclusions are, however, materially different for Schedules 31/32 (Pumping Service) and Schedule 25 (Extra Large General Service).

109 For the most part, the methodology used by Avista to perform its cost of service study is reasonable,[238/] except for two important cost allocation methods pertaining to the Company's production plant and transmission resources.[239/] These differences are explained below.

110 The Company uses a production plant allocation method that over-weights energy over demand. As a result, Avista's methodology allocates only a "small part (37.65%) on the customers' contribution to peak demand for each month of the year and in much larger part (62.35%) on the basis of energy."[240/] This same peak classification and allocation approach is used for the Company's transmission facilities.[241/] ICNU believes that, by over-weighting energy over demand, Avista's methodology under-recovers the costs related to meet system demand.

111 It is well understood that system peak demand generally necessitates the acquisition of new production plant capacity.[242/] To meet peak demand, Avista will use the production resources necessary to follow load.[243/] For system peak events, "all of Avista's

---

238/ Stephens, Exh. RRS-1CT at 9:7-8.
239/ Id. at 10:7-9.
240/ Id. at 9:9-12.
241/ Id. at 10:8-9.
242/ Id. at 10:3-4. ("It is the demand for power, not the energy flow itself that determines when additional capacity is needed.")
243/ Id. at 24:16-21.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

production resources are likely to be in use … and most likely to be operating at their maximum capacities."[244] These resources come at a cost, and, as ICNU explained, these costs should be "classified and allocated to the customer classes according to each class's demand during the peak months."[245] Thus, the costs would be directly assigned to the cost causers. But, this is not how Avista's model assigns cost.

112 Avista assigns costs using a "peak credit" ratio that "utilizes the system load factor to determine the proportion of the production function that is demand-related."[246] To assign peak demand, it then uses a 12 CP (coincident peak) model to determine the "average class contributions to the 12 monthly peaks for the year ended September 30, 2016."[247] As a result, Avista allocates 37.65 percent of system cost to peak demand and 62.35 percent of system cost to the energy delivered.[248]

113 The inherent problem with Avista's model is that system demand, the cost driver for system capacity additions, does not peak every month of the year. Avista is historically has been a winter peaking utility, but it has more recently experienced high system loads during the summer months.[249]

114 As shown by ICNU, Avista experienced three high demand months in the summer of 2016 that exceeded the demand in all winter months except December.[250] 2016 was not an anomaly. Looking back to 2011, Avista's highest loads occurred only three times or fewer.

---

[244] Id. at 9:17-19 (emphasis added).
[245] Id. at 9:16-17. See also, id. at 14:1-3 and 15:10-26.
[246] Id. at 10:17-18.
[247] Id. at 11:2-3.
[248] Id. at 10:18-20.
[249] Knox, Exh. TLK-2 at 3:19-22.
[250] Stephens, Exh. RRS-1CT at 11:23-12:2 and Figure 1

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Table 1 below demonstrates this fact.[251/]

TABLE 1
Number of Months In Which Peak Demands Were Near Annual Peak Demands[252/]

Year	Within 5% of Peak	Within 10% of Peak
2011	2	4
2012	3	6
2013	1	3
2014	1	4
2015	3	5
2016	2	5

115 The evidence presented by ICNU demonstrates that Avista's 12 CP allocation methodology fails to reasonably represent the timing and intensity of the utility's system peak loads.[253/] Without question, Avista has swung from a winter peaking utility to a bi-modal utility, experiencing peak months in both summer and winter months.[254/] Moreover, Avista does not deny the utility's movement in this direction.[255/]

116 Avista's bi-seasonal demand strongly suggests that Avista should discontinue use of its 12 CP methodology. As the evidence shows, use of the 12 CP methodology is most fitting when the utility's "monthly peaks lie within a narrow range."[256/] Certainly, Avista's peaks fall outside this criterion, with Avista's highest peak month demand being 46% higher than the

---

251/ Id. at 16:4-7. See also, Stephens, Exh. RRS-3.
252/ Including the peak month.
253/ "A 12 CP method is more typically used when demands are relatively steady over the course of a year and do not exhibit significant peaks, which drive the need for new capacity." See Stephens, Exh. RRS- 1CT at 12: 3-5.
254/ Stephens, Exh. RRS-1CT at 11: 20-22.
255/ Ehrbar, Exh. PDE-17X at 1 (Response to ICNU DR 118).
256/ Stephens, Exh. RRS-1CT at 13:10-13, citing, in part, from the NARUC Manual.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

lowest peak month demand.[257/] Further, industry literature supports ICNU's conclusion that a 2 CP or multi-peak methodology would better represent the true costs to be allocated to customers.[258/] This is because Avista's "system peak demands … drive the need for additional capacity," and its resulting cost.[259/] In sum, Avista's current peak credit methodology fails to adequately represent Avista's current system conditions and the costs required to meet system demand. ICNU's solution would do both.

117 Responding to the load conditions facing Avista in recent years, ICNU recommends that a Summer and Winter Peak methodology[260/] be used to allocate production costs.[261/] Specifically, ICNU's recommends using the "average of each class's proportionate shares of demands during the January and December peaks …."[262/] to populate the winter demand allocator; giving it a "50% share in developing the overall allocator."[263/] The months of June, July, and August would be used to populate the summer demand allocator, giving it a 50 percent share of the overall allocator as well.[264/] In essence, ICNU recommends that the

---

257/ Id. at 13:14-16, 14:6-10.

258/ Id. at 15:1-6. ("To summarize, when monthly peak demands are quite similar during the entire year, a 12 CP method may be supported by industry literature. But when, as here, a substantial variation in peak demands is seen throughout the year, there is more support for production plant allocation based only on those peaks within a narrow range of the highest peak, or on the summer and winter peaks only.").

259/ Id. at 9:19-20.

260/ Id. at 2:28-31. ("The Summer and Winter Peak allocator is also more strongly supported in the National Association of Regulatory Utility Commissioners ('NARUC') Electric Utility Cost Allocation Manual ('NARUC Manual')").

261/ Stephens, Exh. RRS-1CT at 25:21-26:1. The recommended method would utilize "coincident peaks in the summer and winter months, as a better measure of the demand component for allocating production costs. This is a better method than Avista's proposed 12 Coincident Peak ('CP') measure, since Avista's load exhibits significant peaks in the summer and winter periods and much lower peaks in the spring and fall." See Stephens, Exh. RRS-1CT at 2: 23-31.

262/ Id. at 26:10-12.

263/ Id. at 26:12-13. December and January would be given equal shares of the 50% allocator used for winter months.

264/ Id. at 26:13-16. June, July, and August would also be given equal shares of the 50% allocator used for summer months.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

Commission utilize 5 coincident peaks for production plant, using Avista's high summer and winter load months. This allocator would provide the Commission a more accurate representation of the capacity required by Avista to serve each customer class, and thus result in a more accurate allocation of production costs. As set forth in Table 2 below, ICNU shows how use of its Summer/Winter methodology would impact the results of Avista's peak credit methodology.[265/]

TABLE 2

Production Allocation Comparison

Class	Summer/ Winter	12 CP
Sch 1/2	54.97%	49.43%
Sch 11/12	10.03%	10.25%
Sch 21/22	20.00%	22.21%
Sch 25	13.48%	16.05%
Sch 31/32	1.25%	1.89%
Sch 41/49	0.28%	0.18%
Total	100.00%	100.00%

118 Finally, ICNU recommends that Avista's transmission costs be allocated using a 12 CP methodology. As noted above, Avista allocates the costs of its transmission system using the same peak credit methodology used to allocate its production system costs, assigning 37.65 percent to peak demand and 62.35 percent to energy.[266/] Avista's peak credit methodology is

265/ Id. at 27, Table 2.
266/ Id. at 10:8-9.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

highly unusual,[267/] conflicts with how the transmission system is used and Avista's own tariff for transmission service,[268/] and the Company's history, wherein Avista previously allocated transmission costs on a 100 percent demand basis.[269/]

119 Without question, transmission facilities do not independently provide service to customers. They are connected to production plants and designed to carry the generating capacity expected from those generating units. In other words, Avista's transmission system has been built to meet the peak demand of its customers, without regard to the variable flow of energy used daily to balance loads. Importantly, this purpose has been confirmed by Avista.[270/]

120 Once built, the fixed costs of these transmission facilities do not fluctuate with their use.[271/] Because variable energy flow has no commensurate impact on transmission costs whatsoever, even if Avista's 62.35 percent allocation to energy were accepted for production plant, it makes no logical or regulatory sense for transmission plant, calling into question the rates set using the Company's peak credit methodology. To cure the mismatch between cost causation and cost allocation, ICNU proposes that a 12 CP demand measure be used to allocate 100 percent of Avista's transmission costs, even if the Commission adopts the peak credit approach for production plant.[272/]

121 First, as explained above, the 100 percent demand allocator reflects the purpose and use of Avista's transmission plant. Moreover, Avista currently "utilizes a 12 CP billing

---

267/ Id. at 28:11-13. ("I am not aware of any case outside of Washington where a utility has classified or allocated traditional transmission costs on the basis of energy to any degree, let alone 68%. I see no justification for classifying transmission costs in this manner.").

268/ As explained below.

269/ See WUTC v. the Washington Water Power Co., Cause No. U-83-26, Fifth Suppl. Order, 1984 WL 1022551 (Jan. 19, 1984).

270/ Ehrbar, Exh. PDE-1T at 11:20-21. See also, Stephens, Exh. RRS-1CT at 29:16-19.

271/ Stephens, Exh. RRS-1CT at 29:10-13.

272/ Id. at 32:17-22; see also, Stephens, Exh. RRS-8.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

method for network transmission service," for service provided under its FERC Open Access Transmission Tariff.[273/] Finally, "the vast majority of transmission costs are fixed" and not variable.[274/] Thus, allocating transmission costs based upon energy fails to recognize the true system costs of providing transmission service. For these reasons, the Commission should reject the Company's peak credit methodology for allocating transmission costs and adopt ICNU's 12 CP recommendation.

D. Summary

122 The Commission should reject the Settlement's provisions related to the electric utility's rate spread and rate design. The evidence in support of settlement provided by the Settling Parties does not justify the Settlement's results, particularly when considering the overwhelming and unrebutted evidence presented by Avista and ICNU that Schedules 1/2 are not close to covering Avista's cost to serve them. To this point, the cost of service studies performed by Avista and ICNU show that Avista's return from Schedules 1/2 is calculated to be 2.98 percent and 2.37 percent, respectively.[275/] When compared with Avista's 5.37 percent overall requirement, the Settlement's slight movement to parity for these Schedules would require Avista's other customer classes to make up the difference. This result is entirely unfair, unjust and unreasonable, and is exacerbated by the Settling Parties' willingness to extend the substantial subsidies now extended to these Schedules. The Commission can rectify this situation by rejecting the Settlement's electric service provisions and moving Schedules 1/2 closer to parity.

273/ Stephens, Exh. RRS-1CT at 30:6-8.
274/ Id. at 29: 13.
275/ Id. at 33, Table 4.

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

123 As to Avista's cost of service study, ICNU has shown that the 12 CP peak credit allocation methodology used by the Company for production plant fails to effectively allocate costs among the customer classes. To this point, Avista's methodology does not reflect the Company's current operating circumstances, wherein it experiences peak and near peak demand in both summer and winter months. Applying its 12 CP methodology to production plant, Avista's peak credit method unjustifiably assigns the ratio of demand and energy to all months of the year and allocates costs without regard to actual conditions.

124 Further, Avista's transmission cost allocation method is heavily weighted to energy, applying the same peak credit ratio assigned to production plant. As a result, the largely fixed costs of its transmission plant are treated as if these costs would vary commensurate with the amount of energy transmitted from generator to load. This, of course, is not true. Transmission plant costs do not vary with the energy the line is carrying. Thus, Avista's peak credit methodology inaccurately assigns transmission costs to high energy use Schedules and improperly favors Schedules that use less.

125 In summary, ICNU's proposed cost of service study reasonably addresses the problems associated with Avista's peak credit methodology. The rate spread and rate design positions proffered by ICNU reflect its recommended cost of service study and should be adopted by the Commission.

VII. CONCLUSION

126 For the reasons expressed above, ICNU recommends that the Commission either deny rate relief to Avista in this docket or adopt ICNU's revenue requirement. In either circumstance, the Commission should incorporate into rates the benefits afforded by the TCJA. ICNU also recommends that the Commission reject the rate plans proffered by Avista and Staff,

DAVISON VAN CLEVE, P.C.
333 S.W. Taylor, Suite 400
Portland, OR 97204
Telephone: (503) 241-7242

concluding that both are based upon expense and revenue forecasts that cannot be audited and verified in this docket. Finally, ICNU recommends that the Partial Multi-Party Settlement be rejected for electric service.

Dated in Portland, Oregon, this 22nd day of February, 2018.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.

<u>/s/ Patrick J. Oshie</u>
Patrick J. Oshie, WSB No. 17796
Riley G. Peck
333 S.W. Taylor, Suite 400
Portland, Oregon 97204
Telephone: (503) 241-7242
Facsimile: (503) 241-8160
pjo@dvclaw.com
rgp@dvclaw.com
Of Attorneys for the Industrial
Customers of Northwest Utilities