BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

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

BRIEF ON BEHALF OF COMMISSION STAFF

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I. INTRODUCTION

1 This case is the latest in a long series of annual rate filings in which Avista Corporation ("Avista" or "Company") requests significant revenue increases without adequate support. The Washington Utilities and Transportation Commission ("Commission") meticulously detailed this pattern—marked by inflated annual rate requests that led to much more moderate rate changes—in its final order rejecting the Company's filing just over a year ago ("2016 Order").[1] In that case, the Commission denied the Company's request entirely for three principal reasons: the Company's approach to calculating revenue requirements failed to demonstrate current rates were insufficient; the Company had earned its authorized return for several years in a row; and the Company failed to show that its planned investments were due to conditions or circumstances beyond its control.[2] The Commission's decision should have served as a wake-up call to Avista.

2 The 2016 Order provided Avista with explicit expectations and valuable policy guidance for future rate filings.[3] Three points are worth noting here. First, the Commission's "long-established and well-understood ratemaking practices" require rate filings to start with a historical test year with known and measurable costs, revenues, loads, and other pertinent factors, and it allows for reasonable restating and pro forma adjustments.

3 Second, the Commission expressed an openness to a multi-year rate plan so long as it included "mechanisms that result in a reasonable sharing of risks between shareholders and ratepayers, as opposed to what would have occurred under the [attrition proposals] that would

[1] *Wash. Utils. & Transp. Comm'n. v. Avista Corp*., Dockets UE-160228 & UG-160229, Order 06 at 7-33, ¶¶ 13-58 (Dec. 15, 2016)(hereinafter "Order 06"); *id*. at 37 fn 123.
[2] Order 06 at 44, ¶¶ 73-75; see also *Wash. Utils. & Transp. Comm'n. v. Avista Corp*., Dockets UE-160228 & UG-160229, Order 07 at 5-6, ¶¶ 6-8 (Feb. 27, 2017) (hereinafter "Order 07").
[3] Order 06 at 44-4, ¶¶ 75-82; see also Order 07 at 29-34, ¶¶ 49-56.

place all risk on the ratepayers."[4] Breaking the pattern of annual rate filings "remains an important policy goal."[5]

4 Third, the Commission supported Avista's idea to switch the timing of its rate filings so that customers are not burdened with rate increases during the heating season, and to coincide with the construction season, which would "benefit the Company by reducing regulatory lag."[6] It highlighted that "Avista will continue to control the timing of its general rate case filings and is in a position to shift the timing of its cases from mid-winter to mid-summer."[7]

5 Despite this guidance, in May 2017, Avista again filed for massive revenue increases that are out of step with the evidence it presented. The Company proposes a multi-year rate plan that would increase rates for its electric and natural gas services by nearly $240 million over three years. To support this bloated increase, Avista relies on an approach to calculating revenue requirements that distorts the traditional modified historical test year beyond recognition, relies heavily on projections, and was a challenge to audit for reasons the Company controlled. It also relies on an approach to modeling power costs that lacks transparency and has consistently produced inaccurate results that benefit shareholders. The Company even requests a large increase to its rate of return that is far outside the zone of reasonableness under current market conditions. Avista's approach to filing general rate cases needs to be overhauled.

6 In stark contrast to Avista's proposal, Commission Staff ("Staff") presents a thoroughly analyzed case that appropriately balances the needs of the public to have safe and reliable electric and natural gas services at reasonable rates with the financial ability of the Company to provide such services on an ongoing basis. Indeed, Staff's case merely moderates the Company's

[4] Order 06 at 45-46, ¶ 75.
[5] Order 07 at 33, ¶ 54 footnote 88.
[6] Order 06 at 46, ¶ 78; Order 07 at 33-34, ¶ 56.
[7] *Id*.

outsized request by scaling it back so that it is consistent with the Commission's "long-established and well-understood" ratemaking practices as well as with its policy guidance.

7 To break the pattern of annual rate filings, Staff recommends a multi-year rate plan that establishes rates for Year 1 on a principled historical test year with limited adjustments that include: (1) end-of-period restating adjustments to the test year in light of rising capital costs and low load growth conditions, and (2) pro forma adjustments for all plant additions that meet a recently approved definition of "major" and were in service by the time Staff finished its review. Staff's rate plan then escalates rates annually for two more years based on a rigorous trending analysis and subject to reporting requirements and a sharing mechanism.

8 Of note, Staff's analysis demonstrates that no adjustment to the power cost baseline of the Energy Recovery Mechanism ("ERM") is necessary. Despite its predictions,[8] Avista over-recovered its power costs in 2017, just as it had in six of the seven years prior.[9] Increasing the baseline would likely just continue this pattern. Maintaining the current baseline will allow the ERM to function as design.

9 Staff's analysis also demonstrates that Avista's rate of return should be reduced to appropriately reflect market conditions, the Company's sound financial position,[10] and to account for certain imprudent interest rate hedging costs.

[8] On the same date it filed these dockets, Avista also filed for a Power Cost Rate Adjustment that would increase billed revenues by approximately $15 million, or 2.92 percent, effective September 1, 2017. The Commission rejected this request. *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Docket UE-170484, Order 01 (Aug. 15, 2017).
[9] Gomez, Exh. DCG-1T at 8:14-16; *See* Exh. DCG-2; *see* Johnson, Exh. WGJ-6T at 8, Table No. 3.
[10] On September 14, 2017, Avista and Hydro One filed a joint application for an order authoring Avista's acquisition. *In Re the Joint Application of Hydro One Limited and Avista Corporation for an Order Authorizing Proposed Transaction*, Docket U-170970, Order 02, Prehearing Conference Order at 1, ¶ 1 (Oct. 25, 2017).

10 Finally, Staff demonstrates that the Company's current fuel conversion program should be discontinued: electric ratepayers should not pay for fuel conversions. The only exception is that low-income fuel conversions should continue, but not necessarily through Schedule 91.

11 Overall, Staff's multi-year rate plan calls for moderate annual rate increases that appropriately balance risk between customers and the Company under present market conditions. For electric service, Staff recommends revenue requirement increases of approximately $10 million in year one, $9.5 million in year two, and $9.7 in year three, which amounts to a cumulative total of $58.9 million over the rate plan. For natural gas service, Staff recommends revenue requirement increases of approximately $1.1 million in year one, $2.7 million in year two, and $2.8 in year three, which amounts to a cumulative total of $11.5 million over the rate plan.

12 As with any multi-year rate plan, Staff's approach requires both the Company and its customers to accept some rate risk over the three year period; however, it also provides greater rate/revenue certainty and incentivizes the Company to control its costs. Moreover, Staff's multi-year rate plan will provide a respite from Avista's annual rate filings that is long overdue.

II. MULTI-YEAR RATE PLAN

A. Staff Proposes a Three-Year Plan Built on a Principled Historical Test Year

13 Staff recommends that the Commission authorize a three-year rate plan.[11] Staff's multi-year rate plan (MRP) calls for relatively modest electric and natural gas revenue increases for Years 2 and 3, using a methodology consistent with previous rate plans approved by the Commission. Staff calculated the increases by applying a composite escalator to a Year 1 "base." Staff's Year 1 base is a subset of its Year 1 revenue requirement proposal. As discussed in Section IV of this brief, Staff calculated its Year 1 revenue requirement using a historical test

[11] Staff's principal witness on the multi-year rate plan is Christopher Hancock.

year with principled pro forma adjustments and end-of-period (EOP) rate base accounting.[12] Staff's Year 1 base excludes power costs, gas cost, and other elements inappropriate for escalation.[13]

14 Staff's MRP takes effect on May 1, 2018, and expires on April 30, 2021. Under Staff's plan, Avista must file a general rate case within 12 months after the expiration date.[14] In the future rate filing, Staff expects that the company will identify and support "the largest capital additions" placed in service during the MRP.[15]

15 Staff's MRP balances ratepayer and investor interests more effectively than Avista's competing MRP proposal. The main reason is that Staff's Year 1 base is derived from a principled modified historical test year, whereas Avista's Year 1 base for both electric service and natural gas service is inflated by indiscriminate adjustments for numerous minor capital additions that disturb test year relationships.[16] This difference is critical because unwarranted adjustments in the Year 1 base resurface in both Years 2 and 3, and are further compounded due to the application of fixed escalation factors, thereby cumulatively impacting revenue requirement increases over the course of the rate plan.

16 Staff's reliance on a principled modified historical test year ensures that Avista must manage its operations in Years 2 and 3 under a reasonable level of regulatory lag. In contrast,

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[12] Staff's principal witness on the Year 1 revenue requirement is Kathi Scanlan.
[13] Hancock, Exh. CSH-1Tr at 34:21-35:1; *see* Hancock, Exhs. CSH-2 (isolation of Year 1 electric escalation base) and CSH-3 (isolation of Year 1 natural gas escalation base).
[14] Hancock, Exh. CSH-1Tr at 19:16-19.
[15] Hancock, Exh. CSH-1Tr at 19:18-19; *see id.* at 19:19 n.14 ("Here 'largest capital additions' can be interpreted as any capital project placed in service in which the total expected (or, for complete projects, actual) cost is greater than or equal to 0.5% of the net plant in service in the preceding calendar year. The Commission can exercise its considerable judgment here on what is an appropriate threshold.").
[16] Schuh, Exh. KKS-3T at 16:1-17:7; Andrews, Exh. EMA-10T at 4:20-25; Andrews, Exh. EMA-10T at 11, Table 4. Of note, Avista abandoned its as-filed approach on rebuttal for a novel approach that reduced slightly the adjustments to the test year. No party had an opportunity to respond to the Company's newly proposed approach or to audit the plant additions the Company claims are now in service but that were not in service by the time other parties completed their review of the Company's initial filing.

Avista's MRP inappropriately insulates investors from regulatory lag by inflating the Company's Year 1 base. As Staff witness Christopher Hancock testified, regulatory lag is an important tool for regulators and, by extension, the public.[17] Mr. Hancock explained, "Regulatory lag imposes discipline on utility operations and investment decisions, thus encouraging efficiency."[18]

17 Both MRPs use fixed annual escalators. Accordingly, differences in the calculation of the Year 1 base greatly influence the magnitude of the revenue requirement increases Years 2 and 3.[19]

Proposed Annual Revenue Requirement Increases

Electric

(000's of $)	Year 1	Year 2	Year 3
Staff[20]	10,034	9,520	9,740
Avista (rebuttal)[21]	54,387	13,459	13,882

Natural Gas

(000's of $)	Year 1	Year 2	Year 3
Staff[22]	1,107	2,698	2,784
Avista (rebuttal)[23]	6,630	3,690	3,842

18 Importantly, the *cumulative* impact of Staff's MRP is much lower than the overall impact of Avista's MRP.

[17] Hancock, Exh. CSH-1Tr at 7:14.
[18] Hancock, Exh. CSH-1Tr at 9:11-12.
[19] *See* Hancock, Exh. CSH-1Tr at 28:13-17.
[20] Hancock, Exh. CSH-1Tr at 45.
[21] Andrews, Exh. EMA-10T at 7.
[22] Hancock, Exh. CSH-1Tr at 46; *see also* Exh. CSH-3.
[23] Andrews, Exh. EMA-10T at 7.

Cumulative Impact of Proposed Revenue Requirement Increases

Electric

(000's of $)	Year 1	Year 2	Year 3
Staff	10,034	29,588	58,883
Avista (rebuttal)	54,387	122,233	203,961

Natural Gas

(000's of $)	Year 1	Year 2	Year 3
Staff	1,107	4,912	11,501
Avista (rebuttal)	6,630	16,950	31,112

When compared to Avista's MRP, the cumulative impact of Staff's rate plan is $145,078,000 less for electric service and $19,611,000 less for natural gas service. These striking differences must be kept in mind when comparing Staff's MRP to Avista's. The plans are conceptually similar but entirely dissimilar in practical effect.

B. A Well-Designed Multi-Year Rate Plan can be an Effective Ratemaking Tool

19 A multi-year rate plan is a ratemaking tool that sets rates beyond the rate effective year "by applying a formula or index, or detailed forecasts, for allowable rate changes over the duration of the plan."[24] Under traditional ratemaking, the utility must file a new general rate case to capture the impact of material changes in conditions. An MRP, in contrast, allows the regulator to anticipate and provide for future conditions within a single rate case.

20 If designed with care, MRPs can strike an appropriate balance between ratepayer and investor interests. Staff witness Christopher Hancock explained that MRPs benefit investors by

[24] Ken Costello, National Regulatory Research Institute, *Multiyear Rate Plans and the Public Interest* (October 2016), http://nrri.org/download/nrri-16-08-multiyear-rate-plans/ ("NRRI report"), at p. 1.

increasing the certainty and accelerating the timing of cost recovery.[25] Enhanced cost recovery improves the utility's opportunity to earn its authorized rate of return.[26] The tradeoff is the utility's inability to fully update rates during the course of the MRP—a condition known as regulatory lag.[27] Because future rate increases are fixed, the utility has an incentive to control its costs. As the late Professor Alfred Kahn explained, "Freezing rates for the period of the lag imposes penalties for inefficiency, excessive conservatism, and wrong guesses, and offers rewards for their opposites: companies can for a time keep the higher profits they reap from a superior performance and have to suffer the losses from a poor one."[28]

21 Mr. Hancock explained that ratepayers can benefit from cost-control measures "either through an earnings sharing mechanism, or in subsequent rate case filings that are updated to reflect the efficiencies gained by the utility during the course of the rate plan."[29] Ratepayers can also benefit if the utility uses its enhanced financial position to accelerate investments in infrastructure improvements or in the deployment of beneficial technologies.[30]

22 MRPs also provide rate certainty. Ratepayers (particularly industrial customers) can benefit from this certainty.[31] They can plan their behavior around known changes in future costs.

23 Finally, MRPs break the pattern of serial rate case filings. Serial filings are problematic because they tax the resources of both the regulator and interested parties, particularly when the practice is followed by other utilities at the same time. The National Regulatory Research Institute recently recognized that the "opportunity costs" of serial filings include "the beneficial

[25] Hancock, Exh. CSH-1Tr at 13:17-23.
[26] Hancock, Exh. CSH-1Tr at 16:12-17; *see* NRRI Report, supra, p. 17.
[27] Hancock, Exh. CSH-1Tr at 14:10-11.
[28] Hancock, Exh. CSH-1Tr at 9:15-23 (quoting Alfred Kahn, *The Economics of Regulation: Principles and Institutions*, Vol. II, p. 48 (1988)).
[29] Hancock, Exh. CSH-1Tr at 13:20-23.
[30] NRRI Report, supra, p. 16.
[31] Hancock, Exh. CSH-1Tr at 13:19.

activities that participants would otherwise engage in," including "workshops and other investigations that focus on important issues (e.g., utility planning, cyber security, distributed generation)."[32] According to Mr. Hancock, serial filings also compromise the parties' collective ability "to effectively counter the asymmetric knowledge and resources of the utility."[33] Mr. Hancock explained that the "reduced scrutiny given to test year figures is an important element in 'cost-plus' regulation," a phenomenon where the utility is allowed to shift excessive risk to customers by reflexively passing on all costs of providing service, plus a return.[34]

C. There is Recent Commission Precedent for a Multi-Year Rate Plan

24 The Commission approved an MRP for Puget Sound Energy in Dockets UE-121697 and UG-121705.[35] This MRP used "fixed annual escalation factors to adjust PSE's rates" from approximately 2013 to 2015.[36] The escalation factors were developed through "PSE's analysis of actual historical trends in the growth rates of revenues, expenses, and rate base."[37] Public Counsel argued that the future rate increases should be denied because they were not supported by a formal attrition study. The Commission rejected this argument, concluding that PSE's trending analysis was an adequate evidentiary basis for the escalation factors.[38]

25 The Commission was persuaded that PSE's MRP properly balanced ratepayer and investor interests. It commented that PSE and its customers would benefit from rate predictability and cost-control incentives:

> The rate plan provides a degree of relative rate stability, or at least predictability, for customers for several years. The rate plan is an innovative

[32] NRRI Report, supra, p. 8.
[33] Hancock, Exh. CSH-1Tr at 14:15-16.
[34] Hancock, Exh. CSH-1Tr at 10:10-11.
[35] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-121697 & UG-121705, Order 07, Final Order Granting Petition (June 25, 2013) ("PSE 2013 Order")
[36] PSE 2013 Order, p. 74, ¶ 171.
[37] PSE 2013 Order, p. 66, ¶ 149.
[38] PSE 2013 Order, p. 66, ¶ 149.

> approach that will provide incentives to PSE to cut costs in order to earn its authorized rate of return. Moreover, the lack of annual rate filings will provide the Company, Staff, and other participants in PSE's general rate proceedings with a respite from the burdens and costs of the current pattern of almost continuous rate cases with one general rate case filing following quickly after the resolution of another.[39]

It concluded, "The escalation factors provide PSE an improved opportunity to earn its authorized return, but are set at levels that will require PSE to improve the efficiency of its operations if it is to actually earn its authorized return."[40]

26 The Commission approved a 3.0% escalation factor for electric delivery costs and a 2.2% escalation factor for natural gas delivery costs.[41] For approximately half of the costs adjusted under the MRP, PSE used Consumer Price Index (CPI) forecasts less a half percent "productivity factor" for general administration expenses.[42] The Commission noted that the resulting escalation factors for these costs were "significantly lower than PSE's historical level of delivery expenses,"[43] and that PSE would have to "increase the efficiency of its operations during the rate plan stay-out period" to earn its authorized rate of return.[44] Stated differently, the Commission determined that the MRP protected customers "by requiring PSE to improve the efficiency of its operations thus building savings that, over the long term, will keep rates lower than they otherwise might be."[45]

D. Staff's Multi-Year Rate Plan will Result in Just and Reasonable Rates

27 Like PSE's MRP, Staff's proposed MRP locks Avista into relatively modest rate increases. Staff's MRP fairly balances ratepayer and investor interests by improving Avista's

[39] PSE 2013 Order, p. 66, ¶ 150.
[40] PSE 2013 Order, p. 74, ¶ 171.
[41] PSE 2013 Order, p. 74, ¶ 172.
[42] PSE 2013 Order, p. 74, ¶ 172.
[43] PSE 2013 Order, p. 74, ¶ 172.
[44] PSE 2013 Order, p. 74, ¶ 172.
[45] PSE 2013 Order, p. 75, ¶ 173.

opportunity to earn its authorized rate of return while simultaneously imposing a reasonable level of regulatory lag.[46] The level of regulatory lag is set using a Year 1 base derived from a historical test year with EOP rate base accounting and limited pro forma plant additions. As discussed above, this approach "imposes discipline on utility operations and investment decisions, thus encouraging efficiency."[47]

28 Staff's MRP will also "break the current cycle of almost continuous rate cases from Avista."[48] As discussed above, serial rate case filings compromise the parties' collective ability "to effectively counter the asymmetric knowledge and resources of the utility."[49]

29 Finally, the MRP will "provide for a gradual, predictable path for rate changes."[50]

30 Staff and Avista develop revenue requirements for Years 2 and 3 using the following steps:

1. The parties first develop escalators for the following revenue requirement components: (1) Depreciation and Amortization Expense; (2) O&M Expense; (3) Taxes Other Than Income; and (4) Net Plant After ADFIT.

2. Each escalator is multiplied by the share of total revenues (minus power supply revenue) represented by each category of expense to produce weighted-average escalators.

3. The weighted average escalators are summed, then offset by a fifth component, Annual Growth in Sales Revenue.

4. The result is the Composite Escalator.

5. Year 2 revenue requirement increase = Year 1 base * Composite Escalator.[51]

[46] Hancock, Exh. CSH-1Tr at 3:12-13.
[47] Hancock, Exh. CSH-1Tr at 9:11-12.
[48] Hancock, Exh. CSH-1Tr at 3:11-12.
[49] Hancock, Exh. CSH-1Tr at 14:15-16.
[50] Hancock, Exh. CSH-1Tr at 13:19.
[51] *See* Hancock, Exhs. CSH-2 (isolation of Year 1 electric escalation base) and CSH-3 (isolation of Year 1 natural gas escalation base).

6. Year 3 revenue requirement increase = (Year 1 base + Year 2 revenue requirement increase) * Composite Escalator

31 Staff developed its escalators for Depreciation and Amortization Expense and Taxes Other Than Income using historical growth rates. For O&M expense, Staff used industry-wide historical rates of inflation for production, distribution, and transmission plant O&M, as well as historical rates of growth in the cost of employment of utility industry employees.[52] Staff Exhibits CSH-5 (electric) and CSH-6 (natural gas) detail the linear regressions used to develop these three escalators.[53]

32 Staff developed the fourth escalator, Net Plant After ADFIT, using Avista's projections of net plant through the duration of the MRP. This method is "tantamount to authorizing interim recovery of capital costs, while deferring a permanent decision on the prudency of specific capital additions until a later rate case."[54]

33 Public Counsel and ICNU criticize Staff's reliance on projections, arguing that forward-looking ratemaking methods are less reliable than strict reliance on a modified historical test year.[55] It is true that forward-looking methods introduce an element of uncertainty—nobody can predict the future with 100% accuracy. But that is not a reason to adhere dogmatically to the modified historical test year, which comes with its own risks. As mentioned above, modified historical test year ratemaking for a single year of rates may produce undesirable outcomes during a period of serial rate case filings. In such a period, resource limitations allow the utility to exploit information asymmetries, increasing the risk of "cost-plus" ratemaking decisions (when every year is a test year, there is little incentive to control costs). In contrast, an MRP that

[52] Hancock, Exh. CSH-1Tr at 35:9-38:2.
[53] *See* Hancock, Exh. CSH-1Tr at 3:7-8.
[54] Hancock, Exh. CSH-1Tr at 42:19-21.
[55] *E.g.*, Garrett, Exh. MEG-13T at 12:6-7; Mullins, BGM-9T at 9:17-10:4.

relies in part on net plant projections may yield a relatively balanced result, since the utility enjoys modest rate increases but must operate efficiently due to the prohibition on new rate case filings.[56]

34 It's worth noting here that Staff's MRP contains a "guardrail" in the event Avista exceeds its authorized rate of return. If that event occurs, revenue can be returned to customers through Avista's existing earnings sharing mechanism.[57] The earnings sharing mechanism is tied to the Company's decoupling program, which expires on December 31, 2019.[58] Staff's MRP expires on April 30, 2021. Accordingly, the Commission should use its order in this docket to extend the earnings sharing mechanism until April 30, 2021.[59]

35 The following charts show how Staff and Avista developed their respective composite escalators. The Commission will note that the parties agree on some components.

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[56] Hancock, Exh. CSH-1Tr at 15:11-18; *id.* at 17:14-17.
[57] Hancock, Exh. CSH-1Tr at 19:7-9.
[58] *Wash. Utils. & Transp. Comm'n v. Avista Corp. d/b/a Avista Utils.*, Dockets UE-140188 & UG-140189, Order 05, Final Order, p. 11, ¶ 22 (Nov. 25, 2014).
[59] Hancock, Exh. CSH-1Tr at 19:4-6.

Construction of Staff and Avista Composite Escalators – Electric

Escalator Component	**Staff Escalator[60]**	**Avista escalator[61]**	**Staff weighted average escalator[62]**	**Avista weighted average escalator[63]**	**Note**
Depreciation and Amortization Expense	4.70%	9.13%	**0.94%**	1.83%	Staff's escalator uses 2007-2016 CBR data (linear growth rate); Avista uses 2013-2016 CBR data (compound growth rate)[64]
O&M[65] Expense	2.36%	2.36% (rebuttal)	**0.84%**	0.84% (rebuttal)	Avista accepts Staff's escalator on rebuttal.[66] Staff developed its escalator using U.S. Bureau of Labor Statistics price indices[67]
Taxes Other Than Income	5.13%	4.53%	**0.50%**	0.44%	Staff's escalator uses 2007-2016 CBR data (linear growth rate); Avista uses 2013-2016 CBR data (compound growth rate)[68]
Net Plant after ADFIT[69]	3.04%	3.04%	**1.05%**	1.05%	Staff's direct case uses Avista's as-filed escalator. Avista developed its escalator using projected data for 2018-2020 (compound growth rate)[70]
Annual Growth in Sales Revenue (offsetting factor)	-1.02%	-1.02%	**-1.02%**	-1.02%	Staff's direct case accepted Avista's as-filed escalator
Composite escalator			**Staff: 2.32%**	**Avista: 3.14%**	Compare to 3.0% escalator approved for PSE in 2013[71]

[60] Hancock, Exh. CSH-4 (Escalators).
[61] Andrews, Exh. AMA-10T at 40, Table 9.
[62] Hancock, Exh. CSH-4 (Escalators).
[63] Andrews, Exh. AMA-10T at 40, Table 9.
[64] Andrews, Exh. AMA-10T at 42:13-16.
[65] *See* Hancock, Exh. CSH-1Tr at 35:9-39:16.
[66] Andrews, Exh. AMA-10T at 42:5-9.
[67] Hancock, Exh. CSH-1Tr at 35:9-38:2.
[68] Andrews, Exh. AMA-10T at 42:13-16.
[69] *See* Hancock, Exh. CSH-1Tr at 40:1-43:17.
[70] Hancock, Exh. CSH-1Tr at 32:8-12.
[71] PSE 2013 GRC Order, p. 74, ¶ 172.

Construction of Staff and Avista Composite Escalators – Natural Gas

Escalator Component	Staff Escalator[72]	Avista escalator[73]	Staff weighted average escalator[74]	Avista weighted average escalator[75]	Note
Depreciation and Amortization Expense	6.17%	10.93%	1.24%	2.20%	Staff's escalator uses 2007-2016 CBR data (linear growth rate); Avista uses 2013-2016 CBR data (compound growth rate)[76]
O&M[77] Expense	2.03%	2.03%	0.84%	0.84%	Avista accepts Staff's escalator on rebuttal.[78] Staff developed its escalator using U.S. Bureau of Labor Statistics price indices[79]
Taxes Other Than Income	5.41%	5.21%	0.40%	0.38%	Staff's escalator uses 2007-2016 CBR data (linear growth rate); Avista uses 2013-2016 CBR data (compound growth rate)[80]
Net Plant after ADFIT[81]	5.02%	5.02%	1.56%	1.56%	Staff's direct case uses Avista's as-filed escalator. Avista developed its escalator using projected data for 2018-2020 (compound growth rate)[82]
Annual growth in sales revenue (offsetting factor)	-0.84%	-0.84%	-0.84%	-0.84%	Staff's direct case accepted Avista's as-filed escalator
Composite escalator			**Staff: 3.20%**	**Avista: 4.14%**	Compare to 2.2% escalator approved for PSE in 2013[83]

[72] Hancock, Exh. CSH-4 (Escalators).
[73] Andrews, Exh. AMA-10T at 41, Table 10.
[74] Hancock, Exh. CSH-4 (Escalators).
[75] Andrews, Exh. AMA-10T at 41, Table 10.
[76] Andrews, Exh. AMA-10T at 42:13-16; Hancock Exh. CSH-1Tr at 31:15-18.
[77] *See* Hancock, Exh. CSH-1Tr at 35:9-39:16.
[78] Andrews, Exh. AMA-10T at 42:5-9 ("The Company has revised its O&M growth factor component to agree to that proposed by Staff to further try to reach a compromise of positions, and to further minimize the issues in this case. For this case, the level of O&M growth proposed by Staff appears reasonable and provides a sufficient level of incentive for Avista to manage its O&M costs during Rate Years 2 and 3.").
[79] Hancock, Exh. CSH-1Tr at 38:3-39:16.
[80] Andrews, Exh. AMA-10T at 42:13-16; Hancock Exh. CSH-1Tr at 32:4-6.
[81] *See* Hancock, Exh. CSH-1Tr at 40:1-43:17.
[82] Hancock, Exh. CSH-1Tr at 32:8-12.
[83] PSE 2013 GRC Order, p. 74, ¶ 172.

36 For both electric and natural gas service, Staff and Avista agree on three of the five weighted average escalators: O&M Expense, Net Plant after ADFIT, and Annual Growth in Sales Revenue. Staff and Avista disagree on the remaining two components: Depreciation Expense and Taxes Other Than Income.

37 Avista's Depreciation Expense weighted average escalator is greater than Staff's for both electric and natural gas service because Avista relied on a compound growth rate using 2013-2016 data, whereas Staff calculated a linear growth rate using 2007-2016 data. The Commission should use Staff's growth rate because it considers a longer period of time (dating back to when the Company returned to "investor-grade" status in 2007), and also considers many more data points—five times as many, in fact. The method chosen by Avista—a compound annual growth rate—effectively only considers the 2013 data point and the 2016 data point. This approach simply disregards data from all other years.

E. The Proposed Hydro One Merger is Immaterial at this Juncture

38 Public Counsel argues that Avista's proposed merger with Hydro One "militate[s] against an MRP."[84] Staff disagrees, because the proposed merger is being considered independently in Docket U-170970. If the merger yields short-term customer benefits in the form of rate credits, disbursement will be handled in Docket U-170970.[85] Further, there is no guarantee that the Commission will approve the merger.[86]

F. Customers Should Get the Full Benefit of Reduced Federal Taxes

39 On December 22, 2017, The Tax Cuts and Jobs Act ("TCJA") was signed into law. The TCJA amends the Internal Revenue Code to reduce federal tax rates and modify policies, credits,

[84] Garrett, Exh. MEG-13T at 2:14.
[85] Hancock, Exh. CSH-7T at 7:21-8:1.
[86] Hancock, Exh. CSH-7T at 7:12.

and deductions for individuals and businesses. The most notable impact for utilities regulated by the Commission is the reduction of the federal corporate tax rate from 35 percent to 21 percent.

40 Consistent with the Commission's ratemaking standards, the full benefit of reduced federal taxes should be passed on to customers. To the extent possible, the effects of the changes to tax law should be captured in this general rate case. Any future true-ups that may be needed can be captured through a deferred accounting mechanism and returned to customers via a rebate tariff. Staff details how this should occur in its Response to Avista's Response to Bench Request No. 1.[87]

III. COST OF CAPITAL

A. Introduction

41 Avista proposes a rate of return that is out of step with its performance, its credit worthiness, and with the capital markets. In contrast, the rates of return proposed by the three other parties that presented a cost of capital case are close together and fair. Staff's proposed rate of return of 7.20 percent is right in the middle of the three non-company proposals and appropriately reflects the evidence in this record of market conditions and Avista's sound financial position.

42 Avista has maintained its financial strength while operating with an authorized 7.29 percent rate of return, a 9.5 percent return on equity, and an equity level of 48.5 percent in its capital structure since early 2016.[88] In this case, Avista seeks an extravagant overall rate of return of 7.76 percent, based on an inflated return on equity of 9.9 percent, and a bloated cost of debt that is tainted by imprudent hedging decisions. Staff's rate of return, which reflects a return

[87] Bench Request No. 8 at 95-106.
[88] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, UE-150204 & UG-150205, Order 05 (Jan. 6, 2016) (2016 Avista GRC Order).

on equity of 9.1 percent and a cost of debt that excludes imprudently incurred costs is both fair and consistent with the Commission's principle of gradualism in adjusting a company's return to an appropriate level.

B. Legal Standard

43 A utility's cost of capital is the level of return it requires to service its debt and compensate its equity investors. The commission calculates a utility's cost of capital, or rate of return, in keeping with the principles established in the *Hope*[89] and *Bluefield*[90] line of cases. Determining a utility's annual rate of return is an "exercise of a fair and enlightened judgment"[91] involving "a balancing of the investor and the consumer interests."[92] The return should be sufficient to assure confidence in the financial soundness of the utility and thus allow the utility to maintain its credit and to attract capital.[93] At the same time, the rate of return a commission sets does not guarantee the utility a profit,[94] and a utility is expected to operate efficiently and economically.[95] So long as a commission has fully taken into consideration the various interests of the parties when it calculates the rate of return, a rate that falls with a "zone of reasonableness" will be sufficient.[96]

44 To calculate a utility's cost of capital, a commission must determine the cost of debt, determine the cost of equity, and determine the utility's capital structure. A utility's rate of return (also known as the weighted cost of capital) is the sum of its cost of debt and its cost of equity,

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[89] *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944).
[90] *Bluefield Waterworks & Impr. Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).
[91] *Bluefield* at 692.
[92] *Hope* at 603.
[93] *Hope* at 603; *Bluefield* at 693.
[94] *See Hope* at 603.
[95] *See Bluefield* at 693.
[96] *See Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 88 S. Ct. 1344, 20 L. Ed. 2d 312 (1968).

weighted according to the respective shares of debt and equity in the utility's capital structure. The cost of debt typically is computed based on the actual debt and cost rates of debt the utility has issued. In contrast, the cost of equity is an estimate of the likely return an investor would require to invest in an enterprise with comparable risks.[97] The capital structure used to calculate the rate of return may be a company's actual capital structure, a pro forma capital structure, or a hypothetical capital structure.[98] The important principal is that the capital structure that the commission uses for setting rates must balance the "economy" of lower cost debt with the "safety" of higher cost common equity.[99]

C. Capital Structure

45 Avista seeks to unjustifiably increase the equity level in its capital structure to 50 percent. Currently, Avista's *actual* capital structure contains 48 percent equity,[100] and Avista's *authorized* capital structure incorporates an equity level of 48.5 percent.[101] Avista continues to be able to access capital at reasonable rates and has not shown any need to increase the equity level in its capital structure. Given these conditions, Staff recommends maintaining Avista's equity ratio at 48.5 percent. [102]

46 Mr. Thies, testifying for Avista, contends that increasing Avista's equity level to 50 percent would "solidif[y]" the Company's current credit ratings and "move [Avista] closer" to a

[97] *See Hope* at 602; *Bluefield* at 692.
[98] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-040640 & UG-040641, Order 06, 13, ¶ 27 (Feb. 18, 2005).
[99] *Id.* at 13, ¶ 27.
[100] As of the end of the test year. Parcell, Exh. DCP-1T at 21:7-8; *see* Thies, Exh. MTT-2 at 7.
[101] 2016 Avista GRC Order at ¶¶ 12 and 23.
[102] Note that Staff's proposed capital structure is also a hypothetical capital structure. The hypothetical capital structure is a well-established ratemaking tool at the Commission. *See, e.g.*, Dockets UE-040640 & UG-040641, Order 06 at 13, ¶ 27 ("The Commission has used actual, pro forma, or imputed capital structures to strike the right balance and determine overall rate of return on a case-by-case basis").

higher corporate credit rating.[103] This is nonsensical because Avista's credit ratings are sufficient now to attract reasonably priced capital. Avista has Single A credit ratings on its secured long-term debt.[104] Avista's credit ratings are comparable to other electric and combination utilities and are serving Avista well.[105] In the latter half of 2016, Avista was able to attract capital at an effective rate of 3.54 percent (the coupon rate was actually 1.77 percent) for $175 million of new debt,[106] which is well below the 2016 average of 3.93 percent for Single A-rated utility bonds.[107] This indicates that Avista is able to attract reasonably priced capital, and the Commission does not need to undertake measures to help Avista increase its credit ratings.[108]

47 In this case, Staff recommends including short-term debt in the capital structure to ensure that ratepayers receive the benefits of the lower cost short-term debt that Avista actually employs. Avista presents its overall *cost* of debt as 5.62 percent,[109] which includes its cost of short-term debt of 3.26 percent.[110] Mr. Thies proposes excluding short-term debt as a "rate making 'tool' . . . to arrive at an end result that provides sufficient revenues."[111] His testimony indicates that Avista wishes to calculate all of its debt, short-term as well as long-term, at the higher long-term debt rates in order to arrive at a higher cost of capital. This approach is disfavored. As the Commission has reiterated, "the Commission has traditionally included a component for short-term debt, based on the company's actual capital structure."[112] While it is

[103] Thies, Exh. MTT-1T at 14:9-10.
[104] Parcell, Exh. DCP-1T 16:16-18.
[105] *See* Parcell, Exh. DCP-1T 17:5-11.
[106] Thies, Exh. MTT-2 at 3.
[107] Parcell, Exh. DCP-4 at 2.
[108] Mr. Thies indicates that Avista would like to upgrade its credit rating. Exh MTT-1T at 23:12 - 24:20.
[109] Thies, Exh. MTT-2 at 3. Note that Avista's adjusted weighted average cost of debt includes short-term debt as well as long-term debt.
[110] Thies, Exh. MTT-2 at 4.
[111] Thies, Exh. MTT-1T at 13:14-16.
[112] *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-050684, Order 04, 79, ¶ 224 (April 17, 2006); *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-100749, Order 06, 22, ¶ 43 (Mar. 25, 2011).

unclear whether Avista's treatment of its short-term debt in calculating its capital structure actually affects its cost of capital calculation, Staff includes Avista's actual short-term debt at a ratio of 2.9 percent in its recommended capital structure in keeping with the Commission's practice and to ensure that ratepayers receive any benefit from the lower short-term debt rates.

48 Avista also suggests excluding short-term debt so its capital structure in Washington can be consistent with the Company's current authorized capital structure in Oregon.[113] This proposal does not support a balance of safety with economy and should be rejected.

49 Finally, it is worth noting that Avista's current equity level has remained fairly stationary in recent years.[114] Throughout this period, Avista has maintained its financial strength.[115] There simply is no indication that something is broken and needs to be fixed. In conclusion, the Commission should adopt Staff's proposed capital structure, which maintains the currently authorized equity level and sufficiently balances the Company's and the ratepayers' interests.

D. Return On Equity

50 Interest rates, approved utility rates of return, and the results of the various methodologies that experts employ to estimate required utility returns all indicate that investors currently expect a lower equity return than Avista has requested. In contrast, Staff's recommended return on equity for Avista of 9.1 percent appropriately matches investor expectations with returns required by the investment community.

[113] Thies, Exh. MTT-1T at 13:18-19.
[114] Parcell, Exh. DCP-1T 18:13 - 19:2.
[115] *See, e.g.,* Parcell, Exh. DCP-5; Thies, Exh. MTT-13C at 2:12-16.

1. Market conditions indicate investor expectations of lower returns.

51 Inflation by historical standards, is low, which reflects lower capital costs.[116] Government interest rates and utility bond rates also remain low by historical standards.[117] In fact, these long-term lending rates are "near historically low levels," which indicates investor expectations of lower returns.[118]

52 The trend in federal interest rates indicates that interest rates will remain low.[119] Federal short-term interest rates increased slightly in 2017, but long-term interest rates nevertheless remained low. In fact, long-term federal interest rates generally declined.[120] The rates for long-term utility bonds also decreased in 2017.[121] These bond rates are below the levels before the recession and are "near the lowest levels in the past 35 years."[122] The average interest rate for A-rated utility bonds was 3.93 percent in 2016. The interest rate increased to above four percent in the early part of the following year but, as of September 2017, had declined again, to 3.87 percent.[123] The low level of interest and bond rates, coupled with even further declines, indicate that investors will not be expecting higher returns during the rate effective period.

53 Avista contends that interest rates will increase significantly, but Mr. Parcell invalidates this prediction. Mr. Parcell testifies that there is no consensus in the investment community that interest rates will increase significantly.[124] Moreover, during the time period directly prior to Mr. McKenzie's testimony filing, utility bond rates actually fell.[125] In short, there is no certainty that

[116] Parcell, Exh. DCP-1T at 12:3-5.
[117] Parcell, Exh. DCP-1T at 13:3-4.
[118] Parcell, DCP-1T at 13:3-4.
[119] Parcell, Exh. DCP-1T at 12:19 - 13:3.
[120] Parcell, Exh. DCP-4 at 2, showing 10-year T Bond rates from January to September 2017.
[121] Parcell, Exh. DCP-1T at 14:8-9.
[122] Parcell, Exh. DCP-1T at 14:4-6.
[123] Parcell, Exh. DCP-4 at 2.
[124] Parcell, Exh. DCP-1T at 40:1-2.
[125] Parcell, Exh. DCP-1T at 40:12-16.

interest and bond rates will rise any time soon, if at all. And, judging by the few small increases to the short-term federal interest rate during 2017, any increases over the course of the rate-effective period would be small.

2. The authorized equity returns of other utilities indicate Avista's return should be lower than the return it requests.

54 Along with long-term interest rates, returns on equity authorized by state regulatory bodies have also declined and continue to do so.[126] Both the electric and gas returns exhibit a definite downward trend since 2009. Through the end of 2016, the average authorized return on equity for electric utilities remained at 9.60 percent, and for gas utilities it had fallen to 9.53 percent.[127] The reduction in return on equity that Staff proposes for Avista is consonant with this trend.

55 In Washington the approved rates of return of the other two comparable investor owned energy utilities are both lower than the 9.9 percent equity return Avista is requesting in this case. In December 2017, the Commission approved a settlement that set Puget Sound Energy's return on equity at 9.5. percent. This was a reduction from a return on equity of 9.8 percent, which the Commission set as of 2013.[128] From 2013 to 2017, a low interest rate environment persisted, and authorized utility returns declined. With evidence in the record from multiple experts supporting equity returns below 9.5,[129] the Commission's acceptance of an equity return of 9.5 for PSE illustrates the Commission's principle of gradualism.[130] Under this principle, the Commission

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[126] Parcell, Exh. DCP-1T at 15:1-2.
[127] Parcell, Exh. DCP-1T 15, table.
[128] *See Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-130137 & UG-130138, Order 14 (June 29, 2015) (PSE Remand Order).
[129] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034, Order 08, 30, Table 4 (Dec. 5, 2017) [hereinafter "UE-170033, Order 08"].
[130] *See Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-130043, Order 05, p. 25, ¶ 63 (Dec. 4, 2013) ("the principle of gradualism should apply when setting key factors such as rates of return regardless of the direction of a change") [hereinafter "UE-130043, Order 05"].

more gradually reduces or increases returns. Pacific Power & Light Company (Pacific Power) also has an authorized return on equity of 9.5 percent. The Commission approved this equity return in September 2016.[131] Avista now seeks a return on equity that is not only higher than the equity returns of PSE and Pacific Power, but that is higher even than the equity return that the Commission approved for Avista back in 2012. In 2012, the Commission approved a return on equity for Avista of 9.8 percent.[132] In the market environment of continuing record-low interest rates, declining bond yields, and ever lower approved utility returns, which have persisted since at least 2012, Avista's proposed return on equity of 9.9 percent is outside the zone of reasonableness.

3. Methodologies that analysts use to estimate the cost of equity indicate that Avista's equity return should be lower.

56 Using the DCF methodology, the Capital Asset Pricing Model (CAPM), and the Comparable Earnings method (CE), Staff's expert, Mr. Parcell, concludes that the range for Avista's return on equity extends from 8.70 to 9.50 percent.[133] And the fair return on equity lies at the mid-point of this range, at 9.10 percent.[134] Mr. Gorman, testifying for the Industrial Customers of Northwest Utilities, reaches the same conclusion: 9.10 percent.[135] Mr. Garrett, testifying on behalf of the Public Counsel Unit of the Attorney General's Office, makes a similar recommendation: 9.0 percent.[136] In contrast to the three experts of the non-Company parties, Mr. McKenzie, testifying for Avista, concurs with Avista's proposed 9.9 percent return on equity,[137]

[131] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order 12 (Sept. 1, 2016) [hereinafter "UE-152253, Order 12"].
[132] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-120436 & UG-120437, Order 09 (Dec. 26, 2012).
[133] Parcell, Exh. DCP-1T at 4:10-11.
[134] Parcell, Exh. DCP-1T at 4:12-13.
[135] Gorman, Exh. MPG-1T at 59:18.
[136] Garett, Exh. DJG-1T at 74:22-23.
[137] McKenzie, Exh. AMM-1T at 7:14-15.

which is simply outside the range of reasonable equity returns under current economic and financial conditions. Mr. Parcell explains in his testimony that Mr. McKenzie's conclusions are based on methodologies that overstate the returns on equity for his group of comparable companies and for Avista.[138] Mr. Parcell's testimony thoroughly analyzes Avista's required return on equity and will not be repeated in this brief.

4. A flotation cost adder is unfair and is not supported by the record.

57 Mr. McKenzie increases his range of equity returns by 10 basis points to reflect flotation costs.[139] This inflation of his range should be rejected because Mr. McKenzie has not demonstrated that there are or that there will be unrecovered flotation costs. Although the Commission's approach has differed in the past, more recently the Commission has not accepted any adjustment to the return on equity for flotation costs where the test year did not include costs of equity issuances and where the evidence did not include expected future flotation costs.[140] Mr. McKenzie has not pointed to specific costs in the test year, nor has he or any other witness demonstrated that there will be stock issuances and associated flotation costs in the rate effective period. If the Commission included these imaginary flotation costs in Avista's test year expenses, the increase to the return on equity would constitute double recovery. Finally, it is worth noting that, if Hydro One Limited's acquisition of Avista is consummated,[141] Avista will not be issuing any more equity and will have no future flotation costs. Given the uncertainty of

[138] Parcell, Exh. DCP-1T at 39:3-5; see generally Exh. DCP-1T at 39-55.
[139] McKenzie, Exh. AMM-1T at 6:1-3.
[140] *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-050684, Order 04, 46, ¶ 122 (April 17, 2006) ("While, in some circumstances, we have permitted adjustments to a Company's cost of equity to reflect issuance expenses or flotation costs, we cannot do so in this case because PacifiCorp did not incur such expenses in the test year, nor does the Company expect to incur such expenses in the future").
[141] See *In Re the Joint Application of Hydro One Limited and Avista Corporation for an Order Authorizing Proposed Transaction*, Docket U-170970.

these costs, the Commission should not award Avista an upward adjustment to its return on equity for flotation costs.

E. Cost of Debt and Interest Rate Hedging

58 In this case, Avista seeks to incorporate $54 million of imprudent interest rate hedging costs into its overall cost of debt of 5.62 percent.[142] These costs are imprudent because Avista executed its hedges without considering underlying market conditions and at times when hedges were of little or no value. Staff has removed these imprudent costs, resulting in a combined cost of debt of 5.41 percent, which reflects a long-term debt cost of 5.54 percent and short-term debt cost of 3.26 percent.[143] Treatment of these hedging costs is important because, if they are incorporated into Avista's average cost of debt, ratepayers will continue to pay excessive debt costs year after year after year.

59 In December 2016, the latter part of the test year, Avista issued $175 million of debt.[144] Although the coupon rate was 1.77 percent, and the effective coupon rate was 3.54 percent, Avista's "all-in-rate," which includes the effect of hedging losses, totaled 5.63 percent.[145] Of the $175 million, Avista only received $121.1 million with the balance, $53.9 million, benefiting the banks on the opposite side of the hedges.[146] The losses that Avista incurred were from interest rate "swaps," that locked in interest rates for a portion of the issue amount at rates that are higher than the rate at which it ultimately priced the bond.[147] There were no gains.[148] Avista seeks to

[142] Thies, Exh. MTT-2C at 2.
[143] Parcell, Exh. DCP-1T at 23:3-6.
[144] Thies, Exh. MTT-2 at 2.
[145] McGuire, Exh. CRM-1T at 8:13-19.
[146] *See* McGuire, Exh. CRM-1T at 8:16-17.
[147] McGuire, Exh. CRM-1T at 9:20 - 10:3 ("Between April 5, 2013, and July 27, 2016, Avista entered into seven separate interest rate swaps . . ., lock[ing] in rates and that ranged from 1.81 percent . . . to 4.33 percent. . . . In August 2016 Avista priced the bond at 1.77 percent and, as a result, Avista suffered a loss on all seven swaps.").
[148] McGuire, Exh. CRM-1T at 10:4-6.

recover these costs from ratepayers by including them in the cost of debt. While Avista's cost of debt reflects hedging losses and gains prior to 2016, Staff challenges only the hedging costs associated with the December 2016 issuance of debt, as this is the first time that Avista has incorporated this issuance into its proposed cost of debt.[149]

60 The purpose of interest rate hedging is to insulate a company from fluctuations in market interest rates.[150] To decide if a hedge is reasonable, a company must evaluate the risk that rates will change. Volatility in interest rates indicates increased risk, and hedging can mitigate this risk.[151] Avista's programmatic hedging program,[152] however, does not consider interest rate volatility.[153]

61 In the Commission's natural gas hedging practices docket, the Commission investigated large hedge losses from gas distribution companies resulting from the same kind of programmatic hedging that Avista employs for interest rates. The Commission stated there:

> It is evident that, at any given moment, some level of hedging is justified, and the level of hedging is informed largely by an assessment of market volatility. Although management of upside price risk is the central function of hedging, deciding when not to hedge (or, perhaps more accurately, when to hedge less) is central to managing ratepayer exposure to hedge losses.[154]

In its interest rate hedging program, Avista did not effectively manage ratepayer exposure to hedge losses. The Company's strategy to manage hedge risk is limited apparently to capping its hedge ratio at 75 percent of the amount of debt to be issued.[155] As Mr. McGuire explains in his

[149] *See* Thies, Exh. MTT-2 at 2.
[150] McGuire, Exh. CRM-1T at 5:23 - 6:2.
[151] McGuire, Exh. CRM-1T at 20:8-13.
[152] *See* Thies, Exh. MTT-3C, Avista's Interest Rate Risk Management Plan.
[153] McGuire, Exh. CRM-1T at 17:8-16.
[154] In the Matter of the Commission Inquiry Into Local Distribution Companies' Natural Gas Hedging Practices, Docket UG-132019, Policy and Interpretive Statement on Local Distribution Companies' Natural Gas Hedging Practices at 11, ¶ 36 (March 13, 2017).
[155] McGuire, Exh. CRM-1T at 17:18 - 18:7.

testimony, Avista's programmatic hedging program led the Company to hedge in a declining market, with low volatility, and when market rates dropped below the program limits rather than rose above them—in other words, exactly when hedging was not indicated.[156]

62 Avista has not shown the prudence of its hedging decisions resulting in a $53.9 million loss. To evaluate prudence, the Commission considers 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 requires evaluation of the Company's decisions not just from the perspective of management but also for the benefit of customers. "The fundamental question for decision is whether management acted reasonably in the public interest, not merely in the interest of the company."[157]

Considering the low interest rate environment and low volatility of interest rates,[158] information that was generally available at the time Avista entered into the interest rate swaps for the December 2016 issuance,[159] a reasonable company management would not have executed hedges. Avista characterizes this perspective as hindsight,[160] but anyone monitoring the interest rate market, which Avista says it does, would have been aware of these conditions.

63 On rebuttal, Mr. Thies points to a forecast in 2013 that interest rates could rise as high as five percent in 2014.[161] He never explains, though, whether or how the Company used this information in its 2013 decision to hedge. Mr. Thies, himself, testifies later that the Company

[156] McGuire, Exh. CRM-1T at 17:2-7, 15:7-12.
[157] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket No. UE-031725, Order No. 14, 34-35, ¶ 65 (May 13, 2004), *citing* Goodman, The Process of Ratemaking, 857.
[158] McGuire, Exh. CRM-1T at 14:20 - 15:10.
[159] *See* Thies, Exh. MTT-6T at 20:16-20 (testifying that the Company monitors news of interest rate market conditions).
[160] Thies, Exh. MTT-6T at 25:14-17.
[161] Thies, Exh. MTT-6T at 20:23-21:2.

does not purport to predict interest rates.[162] In short, it is not clear what information Avista considers pertaining to future interest rates.

64 Mr. Thies criticizes Staff's analysis that interest rate volatility indicates risk.[163] The Commission, however, stated in the natural gas hedging docket that "the level of hedging is informed largely by an assessment of market volatility." In other words, the Commission has recognized that volatility is an indicator of risk.

65 Not only has Avista failed to show that its hedging decisions were reasonable, it also has failed to show that the interest rate swaps for the 2016 debt issuance benefitted customers. Avista claims that the goal of its interest rate hedging program is to "reduce cash flow volatility"[164] and that this benefits customers.[165] Reducing cash flow volatility, however, appears to mean only that Avista has more information about its future costs, not that it has controlled those costs in any way.[166] As Mr. McGuire testifies, "the Company purchas[es] cash flow stability with excessive hedge losses."[167]

It is important to note that Avista continues to hedge, in keeping with its programmatic hedging program. Avista plans to issue a significant amount of debt during 2018 and during the subsequent rate plan period.[168] The Company estimates that it has already hedged 73 percent of the approximately $375 million that it plans to issue in new debt in 2018.[169] Avista has also

[162] Thies, Exh. MTT-6T at 26:7.
[163] Thies, Exh. MTT-6T at 25:6-11.
[164] McGuire, Exh. CRM-1T at 18:11-12.
[165] *See* McGuire, Exh. CRM-1T at 19:1-9.
[166] McGuire, Exh. CRM-1T at 18:9-24.
[167] McGuire, Exh. CRM-1T at 19:8-9.
[168] Thies, Exh. MTT-5C. See also Thies, Exh. MTT-1T at 11, Table No. 1, Long-Term Debt Maturities, 2018-2022. The table shows that the Company has $654.5 million of debt maturing over the next five years, which Mr. Thies confirms on rebuttal. Exh. MTT-6T at 17:16-17. And the Company typically replaces maturing long-term debt with new issuances of debt. Thies, Exh. MTT-1T at 11:13-14.
[169] Thies, TR. 458:7-20.

entered into interest rate swaps for debt it plans to issue during the period of the proposed rate plan.[170] Although Staff supports a rate plan for Avista, this does not mean that Staff accepts any interest rate hedging costs associated with the future debt issuances. The prudence of these costs will need to be evaluated in Avista's next general rate case.

IV. MODIFIED HISTORICAL TEST YEAR

A. Staff Recommends Principled Restating and Pro Forma Adjustments

66 Staff recommends principled and fair adjustments to the historical test year that appropriately balance risk between customers and shareholders under current conditions. Specifically, Staff proposes an EOP restating adjustment, limited to the test year, in light of rising capital costs and low load growth conditions as well as pro forma adjustments for all plant additions that meet a recently approved definition of "major" and were in service by the time Staff finished its review. This approach moderates the Company's proposal by scaling it back to be consistent with the Commission's long-established and well-understood ratemaking practices.

67 The other parties' proposals are far less reasonable. On the one hand, the Company's proposals substantively ask the Commission to allow recovery of capital projects that no other party had an opportunity to review. This amounts to a burden-shifting, "trust us" philosophy of ratemaking that shifts excessive risk to customers by reflexively passing on all costs of providing service, plus a return. On the other hand, the intervenors mostly advocated for strict adherence to traditional regulatory accounting principles that serve to enhance shareholder risk during times of rising costs and stagnant load growth.

68 Staff's approach best balances risk between customers and shareholders by allowing for principled adjustments to the test year for the known and measurable costs of major, in-service

[170] Thies, TR. 335:24 - 336:2.

plant additions while maintaining an appropriate amount of regulatory lag that incents the Company to control its costs.

69 Ultimately, the Commission must answer three questions involving adjustments to the test year:

1. Should the Commission allow an end-of-period ("EOP") adjustment?

70 Staff and the Company answer affirmatively because moving test year balances from AMA to EOP December 31, 2016, more reasonably reflect Avista's plant balances in the rate year. Other parties oppose an EOP adjustment because EOP moves away from the often used regulatory average of monthly averages ("AMA") accounting approach to determine the test year relationships between revenue, expenses, and rate base.

2. How is an EOP adjustment properly calculated and included in rates?

71 Staff recommends an EOP adjustment limited to the 2016 test year. Staff's principled approach reflects traditional EOP definitions and recent Commission precedent.[171] Avista initially proposed an EOP adjustment calculated through December 2017, which is a full year *after* the test year period and several months *after* the other parties filed response testimony. On rebuttal, the Company adopted most of Staff's EOP adjustment, but disputes over depreciation expenses remain problematic.

3. How should the Commission treat Avista's pro forma capital additions for the rate year?

72 Staff again recommends a principled approach that limits the timing and scale of pro forma plant additions. Staff's recommendation applies a recently approved definition of "major" and ensures that the non-Company parties are able to review plant-in-service *before* Avista recovers those investments in rates. The Company's as-filed proposal indiscriminately included

[171] Scanlan, KBS-1T at 26:1-28:7.

all of its projected costs for 2017 in its EOP adjustment; however, it abandoned this approach in its rebuttal testimony and now advocates for a novel "functionalized" approach that still allows for 36 plant additions, one as small as $24,000, and some with in-service dates after the other parties filed responsive testimony.[172]

B. An EOP Adjustment is the Correct Regulatory Tool in this Case

73 An EOP adjustment restates the monthly average of test year plant balances to the actual plant balances on the Company's books at the end of that test year.[173] In times of escalating plant investment, an EOP adjustment captures more of the utility's capital investment for recovery in rates.

74 Staff provides three reasons why a properly calculated EOP adjustment is a mild regulatory tool that can improve accuracy without disturbing test year relationships.[174] First, an EOP adjustment may more reasonably estimate the utility's plant balances in the rate year because EOP plant balances are closer in time to the rate year than average test year plant balances.[175] EOP adjustments are only a six-month advance in timing over regulatory averaging methods.[176] Second, non-company parties can easily review EOP plant balances because the transfers of plant have actually occurred and, thus, are observable and available for audit during the entirety of the general rate proceeding.[177] Lastly, the vast majority of financial reporting requirements rely on end-of-period balances under generally accepted accounting principles ("GAAP").[178]

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[172] Schuh, KKS-3T at 16:17 *and* KKS-4 at 1 (showing $24k plant).
[173] E.g., PSE 2013 GRC Order, ¶ 48.
[174] Scanlan, KBS-1T at 8-9.
[175] Scanlan, KBS-1T at 9:2-4.
[176] Scanlan, KBS-1T at 9:6-7.
[177] *See* Scanlan, KBS-1T at 8:8-17 and 16:3-5.
[178] Scanlan, KBS-1T at 9:16-20.

75 Staff recommends an EOP adjustment in this case because of the rising costs and low load growth conditions currently affecting Avista. As Mr. Hancock explains, Avista's capital expenditures are outpacing the Company's revenue and load growth.[179] Mr. Hancock thus concludes that AMA accounting will understate the level of rate base in service during the rate year at a time when the Company's load growth is likely to be flat or negative.[180] Staff's recommended EOP adjustment appropriately mitigates the Company's exposure to regulatory lag while preserving the Parties' ability to audit plant balances.

76 ICNU, NWIGU, and Public Counsel oppose any EOP adjustment primarily because it does not strictly adhere to the matching principle.[181] Ms. Scanlan and Mr. Hancock agree that AMA plant balance best reflects test year relationships between revenue, expenses, and plant. [182] However, as both Staff witnesses explain, the 2016 EOP plant balances will more reasonably estimate plant in service during the rate year in this case.[183] Mr. Hancock testifies that an EOP adjustment is a measured and fair way to set rates in the current environment of growing capital investment and stagnant load growth.[184] Ms. Scanlan documents that an EOP adjustment to test year balances is a limited and credible accounting approach.[185] Ultimately, Staff determined that the shortcomings of the AMA approach outweigh their benefit under current conditions, and therefore an EOP adjustment is the more reasonable approach in this case.

[179] Hancock, CSH-1T at 10-12.
[180] Hancock, CSH-1T at 28:2-5.
[181] Mullins, BGM-1T at 10:11-12:19; Garrett, MEG-1T at 22:11-23:2.
[182] Hancock, CSH-1T at 27:14-13 *and* Scanlan, KBS-1T at 7:19-8:3.
[183] Hancock, CSH-1T at 28:2-5 *and* Scanlan, KBS-1T at 9:2-12.
[184] Hancock, CSH-1T at 29:2:17.
[185] Scanlan, KBS-1T at 9:2-10:2.

C. Proper EOP Restating Adjustments are Limited to Test Year Balances

1. Staff's EOP calculation adheres to established ratemaking standards.

77 An EOP adjustment properly relates only to *test year* plant balances.[186] Capital additions placed in service after the test year are appropriately captured by pro forma adjustments, not EOP adjustments.[187] Avista's initial EOP proposal ignored these long-established and well-understood ratemaking standards.

78 The Company's initial filing relied on an "EOP adjustment" that was, in essence, a budget forecast through December 2017.[188] This thinly veiled budget forecast would add approximately $120 million to rate base, and, due to the timing of its May filing, denied other parties an opportunity to review the majority of those capital additions because they occurred towards the end of the construction season.[189] Avista's initial filing effectively asked the Commission to ignore well-established test year principles and shift nearly all economic risk away from shareholders and on to ratepayers.

79 In contrast, Staff's proposed EOP calculation reflects Commission precedent because Ms. Scanlan adjusts Avista's test year AMA plant balances to match the plant balances at the end of its 2016 test year.[190] The Commission has based EOP adjustments on test year balances as far back as the early 1980s.[191] More recently, it approved test-year EOP balances for PacifiCorp in both 2013 and 2015.[192] In 2013, the Commission also approved an EOP adjustment for Puget

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[186] Scanlan, KBS-1T at 8:5-17.
[187] *See* Order 06, ¶ 81, footnote 149 (UE-160228 and UG-160229).
[188] Scanlan, KBS-1T at 25:6-18.
[189] Scanlan, KBS-1T at 27:3-22 (including Figure 1: EOP electric Rate Base Study) and KBS-1T at 22:6-13.
[190] Scanlan, KBS-1T at 15:19-16:9.
[191] *See Wash. Utils. & Transp. Comm'n. v. Washington Natural Gas Co.,* Cause No. U-80-111, Third Supplemental Order (Sept. 24, 1981)).
[192] UE-130043 Order 05, ¶ 184; *see also* UE-130043, Rebuttal Testimony of Steven R. McDougal, SRM-6T at 26:10-12 (stating that the Company's EOP adjustment is based on end-of-test-year plant balances); UE-152253, Order 12, ¶¶ 164, 173.

Sound Energy.[193] Ms. Scanlan's methodology is consistent with the Commission's established practices.

2. Avista accepted most of Staff's EOP calculation, but disputes over depreciation expenses remain.

80 In its rebuttal testimony, Avista abandoned its initial EOP adjustment and accepted most of Staff's EOP calculation (as discussed in detail below, most of the Company's controversial plant additions are now captured by a novel "functionalized" approach to pro forma adjustments).[194] Avista's acceptance of Staff's EOP methodology, however, excludes Staff's handling of depreciation expenses.[195] On rebuttal, the Company advocates for an increased level of depreciation expense to match increased EOP plant balances.[196] Yet Avista does not even attempt to adjust its revenues or capture cost savings associated with test year plant investment.[197] Consequently, the Company's proposed depreciation expense increase distorts test year relationships.

81 Ms. Scanlan testifies that including depreciation expense adjustments in EOP plant balances is unreasonable.[198] An EOP adjustment concerns only net plant and rate base items, not operating expenses.[199] Including expenses in an EOP adjustment would distort test year relationships between revenues, expenses, and plant in service.[200] The only way to avoid that distortion would be to include all offsetting revenues and cost savings associated with EOP-related transfers to plant.[201] Avista made no such effort, and documenting and verifying those

[193] UE-130137, Order 07 ¶¶ 42-46.
[194] Andrews, EMA-10T at 23:5-10 *and* 32:21-22 ("Avista has eliminated its '2017 EOP Capital Net Rate Base' . . .)
[195] Andrews, EMA-10T at 33:1-3.
[196] Andrews, EMA-10T at 23:8-10.
[197] *See* Andrews, Exhibits EMA-11 and EMA-12.
[198] Scanlan, KBS-1T at 17:8-13.
[199] Scanlan, KBS-1T at 8:7-9:12.
[200] Scanlan, KBS-1T at 17:1-5
[201] Scanlan, KBS-1T at 17:11-13.

revenues and cost savings for each plant transfer is extremely burdensome, if not impossible, for Staff.[202] Ms. Scanlan thus recommends the Commission limit the EOP adjustment in this case to plant balances only.

82 The Commission's decision in a similar dispute supports Staff's position. In its 2013 rate case, Puget Sound Energy ("PSE") sought an EOP adjustment to plant balances *without* any corresponding adjustment to revenues or expenses.[203] Similar to Ms. Scanlan's proposal in the current case, PSE argued that allowing EOP rate base while matching the revenues and expenses in the test year struck the appropriate balance between addressing regulatory lag for capital investments and preserving at least two-thirds of the matching principle.[204] Although the Commission did not expressly address offsetting EOP-related depreciation expenses, the final order adopted that company's proposal.[205]

D. Staff Recommends Pro Forma Adjustments for Major Capital Additions in Service Before Staff Completed Its Review

1. Staff's definition of "major" is reasonable and consistent with precedent

83 The Commission's rules define pro forma adjustments to "give effect to all known and measurable changes that are not offset by other factors."[206] The Commission considers pro forma additions on a case-by-case basis while following the known and measurable and used and useful standards.[207] In practice, the Commission generally requires pro forma plant additions to meet a reasonable definition of "major" and be known to have occurred.[208]

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[202] *See* Scanlan, KBS-1T at 12:9-18.
[203] UE-130137, Rebuttal Testimony of Katherine J. Barnard, Exh. KJB-11T at 2:20-3:2 (May 8, 2013).
[204] UE-130137, Barnard Rebuttal, KJB-11T at 2:3-3:17.
[205] UE-130137, Order 07, ¶¶ 45-48.
[206] WAC 480-07-510(3)(e)(iii).
[207] *Wash. Utils. & Transp. Comm'n. v. Pac. Power & Light Co.*, Docket UE-140762, UE-140617, UE-131384 & UE-140094, Order 08, ¶ 165 (Mar. 21, 2015) [hereinafter "UE-140762, Order 08"].
[208] UE-140762, Order 08, ¶¶ 167, 170.

84 Although the Commission has been clear to avoid any bright line standards and retain its general discretion, recent decisions define the term "major" as relative to the utility's size.[209] In Pacific Power's 2013 general rate proceeding, the Commission allowed a total of four pro forma capital additions that were each over $10 million on a company-wide basis.[210] In Pacific Power's 2014 rate case, the Commission expressly noted that only one of the 30 proposed pro forma additions was "indisputably a major plant addition."[211] The Commission went on to allow a grand total of three pro forma capital additions in that 2014 case, all of which were valued at several millions of dollars on a company-wide basis.[212] As recently as Avista's 2015 rate case, Staff proposed, and the Commission adopted, defining major as $6.3 million for electric plant and $1.2 million for natural gas plant.[213]

85 Staff's recommendations most closely adhere to the Commission's standards and precedent. Ms. Scanlan begins by defining a "major" project as 0.5 percent of the Company's net utility plant.[214] This approach is consistent with WAC 480-140-040 and with Staff's proposals in Avista's two most recent rate cases.[215] Ms. Scanlan explains that net plant is the appropriate measure because (1) it follows the language in the rule, and (2) net plant is the best approximation of the value of plant in service.[216] Ms. Scanlan's approach also follows the Commission's decision in Avista's 2015 rate case.[217]

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[209] UE-130043, Order 05 ¶¶ 198-199; 2016 Avista GRC Order ¶ 40 (UE-150204 and UG-150205).
[210] UE-130043, Order 05 ¶¶ 200-201.
[211] UE-140762, Order 08 ¶ 152.
[212] UE-140762, Order 08 ¶ 172 (allowing pro forma adjustments for the Merwin Fish Collector, Union Gap Substation Upgrade, and Jim Bridger Unit 1 Cooling Tower Replacement). *See also* UE-140762, Exhibit of Natasha C. Siores, NCS-3 at page 8.4.2.
[213] 2016 Avista GRC Order, ¶¶ 30, 45-46 (UE-150204 and UG-150205).
[214] Scanlan, KBS-1T at 18:5-7.
[215] Scanlan, KBS-1T at 18:12-14.
[216] Scanlan, KBS-1T at 19:4-12.
[217] Avista 2016 GRC Order, ¶ 45 (UE-150204 and UG-150205).

86 In contrast, Avista's definition of "major" is both variable and unreasonable. As noted above, the Company's initial filing proposed capturing all pro forma period plant additions in its "EOP study," which was really just a budget forecast.[218] On rebuttal, Avista abandoned its budget forecast in favor of Staff's EOP adjustment; but, it still captured most of its controversial plant additions in pro forma adjustments by applying a novel "functionalized" threshold for "major" projects.[219] By inappropriately adopting a materially new position on rebuttal, the Company denied other parties an opportunity to respond to its unprecedented proposal. For this reason alone, Avista's "functionalized" threshold for pro forma capital additions should be rejected.

87 Under the Company's functionalized approach, the 0.5 percent threshold for major plant addition applies to each category of plant, rather than to overall net plant.[220] This has the practical effect of dramatically lowering the threshold for major projects. Whereas Staff's definition of major plant captures eight pro forma projects valued between about $1.7 million and $11 million,[221] Avista captures thirty-six projects with values as low as $24,000.[222] Thirty-six pro formed projects is dramatically more than anything the Commission has approved in recent history, and a threshold as low as $24,000 in certain situations means that almost any asset that can be capitalized could be considered "major" for ratemaking purposes. The Company's shifting logic does not follow any reasonable interpretation of Commission decisions and has the practical effect of removing any limits to pro forma adjustments.

[218] Scanlan, KBS-1T at 25:6-20.
[219] *See* Andrews, EMA-10T at 32:20-34:4.
[220] Andrews, EMA-10T at 33:8-10.
[221] Scanlan, KBS-1T at 20-21.
[222] Schuh, KKS-3T at 16:17.

88 The Company attempts to legitimize its functionalized proposal by tying the idea to Staff's testimony in the recent PSE case.[223] The Company's inappropriately compares apples to oranges. Staff's analysis in the PSE case relied on a materiality threshold by category of plant, but that analysis resulted in *only five* pro forma projects, each valued in the millions of dollars.[224] All of those pro forma projects were also verifiably in service *prior* to Staff filing testimony.[225] Staff's analysis thus closely tracked the Commission's stated principles and practices that "major" means projects that are genuine outliers in size and cost in relation to the utility's operations. Even ignoring the significant differences between the underlying circumstances in the PSE case and this case, it is important to note that PSE case settled without relying on the functionalized approach.[226] Ultimately, Avista's proposal is unprincipled, untimely, and lacks adequate documentation to support its use in rates.

2. Staff's application of the known and measurable and used and useful standards is fair

89 The Commission has been clear that the application of the known and measurable and used and useful standards is highly dependent on the facts in any given case.[227] The central question is the level of certainty with which a utility can show and document the costs and benefits of a plant addition.[228] The Commission retains flexibility in most cases to exercise informed judgment that responds to the increasingly dynamic economic and financial conditions

[223] Andrews, EMA-1T at 26:12-27:10.
[224] UE-170033, Testimony of E. Cooper Wright, ECW-1T at 2:15-3:2 (June 30, 2017) (citing subject matter PSE witness testimony). For specific figures, *see* UE-170033, Barnard, KJB-5 and KJB-6 and Free, SEF-6.
[225] UE-170033, Wright, ECW-1T at 9:2-5.
[226] *See* UE-170033 & UG-170034, Order 08.
[227] UE-130043, Order 05 ¶¶ 198-199.
[228] *Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, UE-090134 & UG-090135 (consolidated), Order 10, ¶¶ 47-52 (Dec. 22, 2009).

facing the utility industry. The Commission's rules are also clear that the utility carries the burden of proof in general rate proceedings.[229]

90 As Ms. Scanlan testified, the farther any pro forma adjustment is from the test year, the more difficult it is for the non-company parties to review.[230] Staff cannot attest to anything if a project is not in service at the time Staff completes its analysis.[231] Therefore, the less opportunity parties have to review proposed adjustments, the more lopsided the record becomes in the Company's favor.

91 Ms. Scanlan chose August 31, 2017, as the end of the attestation period because it was the last date by which Staff could review Avista's plant transfers.[232] Importantly, the Company's transfers actually have a 15-day delay, meaning that August 31, 2017, plant-in-service figures became available on September 15, 2017.[233] In addition, if Staff issues any data requests about those figures, it typically must wait another two weeks for a response.[234] Ms. Scanlan's choice of cutoff date was, therefore, the last feasible day Staff could review Avista's transfers to plant and still complete testimony by the October 27, 2017, due date.

92 In contrast, Avista requests a cutoff date of October 31, 2017, or four days *after* Staff and the other parties filed testimony.[235] Given the 15-day delay, the transfers to plant were actually not available until about November 15, 2017. The Company's proposal is unreasonable because non-company parties simply cannot examine information that becomes available three weeks after testimony is due. This is particularly true in this case because the Company changed its rationale on rebuttal, at a time when no other party would have an opportunity to respond.

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[229] WAC 480-07-540.
[230] Scanlan, KBS-1T at 22:6-13.
[231] Scanlan, KBS-1T at 14:8-11.
[232] Scanlan, KBS-1T at 22:6-13.
[233] Scanlan, KBS-1T at 14 FN 12.
[234] *See* WAC 480-07-405(7)(a)(ii).
[235] Andrews, EMA-10T at 33:18-34:1.

93 It is also important to note that Avista controls the filing date and, by extension, the approximate procedural schedule in a rate case. If the Company's goal is to include plant balances through October 31, 2017, the procedural solution is for it to file its case later in the year and capture more of its construction season in the review period.[236] The Commission itself advised the Company on this issue just last year, stating that it supported Avista moving its filing date to the mid-summer to capture the Spokane-area construction season for review.[237] Nevertheless, Avista filed this rate case in late May, or just early enough to prevent the entirety of the construction season in the pro forma review period. The Commission should adopt Ms. Scanlan's recommendation to disallow adjustments for plant additions that the parties could not meaningfully review.

D. Miscellaneous Adjustments

1. Investor Supplied Working Capital

94 Staff and Avista disagree on two portions of the Company's investment-supplied working capital ("ISWC") adjustment.[238] First, the two parties disagree on how to classify four accounts for purposes of the ISWC calculation. Staff witness Ms. Erdahl advocates a straightforward test of whether the account is classified as interest bearing.[239] If the account is interest bearing, Staff excludes that account from working capital.[240] The Company's position is discretionary. Ms. Andrews argues that Avista should be able to exclude accounts where the interest rates are too low.[241] Ms. Andrews also points to Idaho-specific regulatory issues to support the Company's

[236] UE-160228, Order 06 ¶ 78 (Dec. 15, 2016).
[237] UE-160228, Order 06 ¶ 78.
[238] *Compare* Testimony of Betty A. Erdahl, BAE-1T *and* Andrews, EMA-10T at 51-58:11.
[239] Erdahl, BAE-1T at 3:19; Andrews, EMA-10T at 53:7-20.
[240] Erdahl, BAE-1T at 13:3-17.
[241] Andrews, EMA-10T at 53:10-12.

classification..[242] Staff witness Ms. Erdahl's approach avoids the slippery slope of defining a "low" interest rate and is based on Washington's ratemaking treatment, not Idaho's.

95 Second, the two parties disagree on how ISWC figures should be allocated among Avista's operations. Ms. Erdahl again applies the more straightforward approach, advocating for an allocation based on rate base.[243] Ms. Erdahl's recommendation is consistent with approved ISWC treatment for the other two large investor-owned utilities in Washington, and ensures that the working capital attributed to Washington ratepayers is, on the whole, proportional to the value of assets that working capital supports in service for those same Washington ratepayers.[244] The Company again argues for a more discretionary approach, with Avista-designated, account-by-account classifications.[245]

2. Restate Property Tax Adjustment

96 On rebuttal, Avista agreed with Staff witness Ms. White's restating property tax adjustment.[246] The Company did, however, catch a calculation error in one of Ms. White's workbooks.[247] Ms. White acknowledged the error in oral testimony.[248] The Commission should thus accept Ms. White's adjustment with the minor correction provided by Ms. Andrews.

3. Miscellaneous Incentive and Director Expenses

97 On rebuttal, the Company accepts all but one of Staff witness Ms. Joanna Huang's proposed adjustments.[249] The remaining adjustment restates debt interest due to parties' different

[242] Andrews, EMA-10T at 53:14-20.
[243] Erdahl, BAE-1T at 10:20-12:7.
[244] Erdahl, BAE-1T at 10:21-11:8.
[245] *See* Andrews, EMA-10T at 54:17-56:3.
[246] Andrews, EMA-10T at 46:6-17.
[247] Andrews, EMA-10T at 46:17.
[248] White TR. 283-284.
[249] *Compare* Andrews, EMA-10T at 45 (Table 11) *and* Testimony of Joanna Huang, JH-1T.

costs of debt.[250] The parties agree on the remainder of Ms. Huang's adjustments and the Commission should adopt those adjustments.

V. POWER COSTS

98 The Commission should not adjust power costs in this case, nor should it change the ERM baseline. A comparison of Avista's authorized and actual power costs in recent years reveals a pattern of overestimated power costs. Avista claims that this recent history of collecting more revenue than it ultimately needed is due to good luck.[251] So many lucky rolls of the dice, however, indicate that the dice are loaded. This would be less of a problem if Avista's power costs were transparent and auditable, but they are not. As it stands, Avista has not met its burden to demonstrate that it requires revenue to recover increased power costs.

A. Avista Over Estimates Its Power Costs

99 Since 2011, in every year but one, Avista has collected more in authorized rates than its actual power costs.[252] And the amount of over-collection is significant. During this period Avista retained a net total of $24.7 million in over-collected power costs.[253] This works out to an average of $4.1 million per year.[254] Avista has been able to retain this significant amount because of the deadbands and the sharing bands in the ERM[255] and because it has received numerous increases to the baseline that consistently overestimated power costs. While it is true that the overestimation led to deferrals for the benefit of customers as well,[256] it is important to understand that, if power costs had been estimated more accurately in the first place, this money

[250] *Compare* Andrews EMA-10T at 58:17-59:1 *and* Huang, JH-1T at 16:14-17:5 (Restate Debt Interest)
[251] Kalich, Exh. CGK-3T at 27:14-15.
[252] Gomez, Exh. DCG-1T at 8:14-16; *See* Exh. DCG-2; *see* Johnson, Exh. WGJ-6T at 8, Table No. 3.
[253] Gomez, Exh. DCG-1T at 8:15-17.
[254] *Id.* at 8:15-17.
[255] Gomez, Exh. DCG-1T at 5, Table 1.
[256] *See* Gomez, Exh. DCG-1T at 8:17.

would never have been collected and would not have been "shared" with Avista.[257] Another problem is that deferral balances for customers have been used to "pay down" rate increases that were driven, in part, by Avista's inaccurate power cost forecasts. Consequently, customers still are paying inflated power costs yet never receive any actual rebate.[258]

100 Avista explains the over-collection as due to falling natural gas prices and power prices and "simple good luck" with hydro and power plant availability.[259] However, Puget Sound Energy, a much larger electric and gas utility, is able to forecast power costs that are considerably closer to its actual costs.[260] Avista's consistent overestimation, compared to PSE's forecasts, indicates that there is a systemic problem with Avista's power cost forecasting.

101 Mr. Johnson argues that the over-collection is just a normal variation given that in earlier years Avista's actual power costs were significantly higher than authorized amounts.[261] The comparison of earlier periods of the ERM with recent years is inapt. The earlier years of the ERM reflect the fallout from the Western Energy Crisis in 2000 and 2001.[262] Together with poor hydro conditions and high wholesale electric market prices, the energy crisis created a "perfect storm" that took Avista's power costs beyond normal power cost variation.[263] From July 2000 through December 2001, Avista accrued approximately $218 million in deferred energy costs. [264]

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[257] Gomez, Exh. DCG-1T at 11:12-13; 8:3-3 ("if the baseline is consistently set too high, customers will overpay for power costs and the Company will receive and undeserved windfall").
[258] Gomez, Exh. DCG-1T at 11:17-21.
[259] Johnson, Exh. WGJ-6T at 12:6-8.
[260] Gomez, Exh. DCG-1T at 13:3-5 ("While PSE is exposed to similar hydro production and gas price variability risk on its system, its annual variances from authorized power costs in its PCA mechanism are less than one percent.")
[261] Johnson, Exh. WGJ-6T at 4:1-3; 8, Table No. 3.
[262] *See* Gomez, Exh. DCG-1T at 6:5-12.
[263] Gomez, Exh. DCG-1T at 6:7-9.
[264] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Docket No. UE-011595, Fifth Supplemental Order, 13, ¶ 28 (June 18, 2002) (2002 ERM Order). The Commission allowed the Company to recover 90 percent of the deferred energy costs though a rate surcharge. 2002 ERM Order at 13, ¶¶ 28-29.

In June of 2002, the Commission approved the ERM for Avista.[265] Due to the circumstances of the "perfect storm," the first seven years of the ERM reflect extraordinary costs, which simply are not representative of power cost conditions in the past seven years. Averaging ERM results over the full period of the ERM is misleading. The meaningful period is from 2011 on.[266] A quick look at this period shows consistent overestimation of power costs. A seven year period is more than enough time to improve the accuracy of Avista's forecasting method.

B. Avista's Power Costs Are Not Transparent

102 Whatever Avista's intentions, the result of its use of the Aurora model is that the Company's power costs are not auditable.[267] Avista asserts that some of its changes to the model inputs resulted from a Commission proceeding or were agreed to by Staff who have since left the Commission.[268] Even if that is the case, the Company's power cost forecasting has reached an impasse. The data show that Avista's forecasting is consistently overshooting the mark.[269] And now that this pattern has become established, it is vital that Staff, and potentially other parties, audit power costs. In order for that to occur, the Company must present a power cost case that is transparent.

103 Mr. Gomez testifies that Avista added "numerous dispatch and operating assumptions" to the model and heavily modified data that comes preloaded in Aurora.[270] He also provides examples of these assumptions and changes that Avista failed to adequately explain or justify.[271]

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[265] 2002 ERM Order at 16, ¶ 40. The ERM was restructured in 2006. *In Re Petition of Avista Corporation For Continuation of the Company's Energy Recovery Mechanism, With Certain Modifications*, Docket UE-060181, Order 03 (June 16, 2006). The second sharing band was modified in 2008. *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-080416 & UG-080417, Order 08, 23, ¶¶ 52 and 55 (Dec. 29, 2008).
[266] *See* Johnson, Exh. WGJ-6T at 8, Table No. 3.
[267] Gomez, Exh. DCG-1T at 35:10-16; *see* Gomez, TR. 293:25 - 294:3.
[268] *See* Kalich, Exh. CGK-4T at 8:14-21.
[269] Gomez, Exh. DCG-1T at 9:2-6.
[270] Gomez, Exh. DCG-1T at 14:10-12.
[271] *See* Gomez, Exh. DCG-1T at 14:10-15.

These examples include using unreasonable rate year load estimates;[272] using an inaccurate hourly load shaping methodology;[273] using forced outage rates for some resources based on assumed values;[274] using inconsistent variable operating and maintenance values;[275] using arbitrary "marginal cost adders" to change the dispatch schedule of a resource;[276] changing model settings such as "Dispatch Settings";[277] and miscalculating the value of wholesale power contracts in out-of-model adjustments.[278] Mr. Kalich goes through each of these examples in his rebuttal testimony and explains its use with reference to the model, but that is not the point. Mr. Gomez included these items in his testimony merely as examples of the overall problems of transparency and accuracy. As Mr. Gomez testified, the transparency issues in the model are "numerous."

104 There are other problems with transparency, as well as accuracy, in Avista's power cost forecasting. One of these is that Avista does not appear to use Aurora to actually model power costs. Although the Company claims that its power costs are based on normalized conditions and not on a forecast,[279] Avista appears to manipulate the model to match forward market prices, thus, thwarting the basic goal of the Aurora model which is to forecast market prices.[280] Another example of an auditing challenge is the fact that Avista provided the wrong load information in

[272] Gomez, Exh. DCG-1T at 14-16.
[273] Gomez, Exh. DCG-1T at 16-18.
[274] Gomez, Exh. DCG-1T at 18-11.
[275] Gomez, Exh. DCG-1T at 22-23.
[276] Gomez, Exh. DCG-1T at 23-27.
[277] Gomez, Exh. DCG-1T at 32-33.
[278] Gomez, Exh. DCG-1T at 33-34.
[279] Kalich, Exh. CGK-4T at 11:5-7.
[280] Gomez, Exh. DCG-1T at 28:4 - 29:2; Gomez, TR. 293:9-24 ("Well, the first thing is that the Company actually has to use the model . . . [a]nd . . . the Company even says that the values within the model don't matter because we're shaping the model to the external forecasts of quarterly Mid-C power costs").

its workpapers.[281] This was ultimately discovered by Staff in discovery after the rebuttal round of testimony. Explanations in the rebuttal round or after of how Avista is using the model are too little too late.

105 Attempting to elude Avista's burden of proof, Mr. Kalich criticizes Staff for not running the model and presenting its own power cost case. As Mr. Gomez explained at hearing, however, running the model himself would not have made sense.[282] Because the model inputs are not transparent, the result of a Staff model run would be just as skewed as the Company's result. In Mr. Gomez's words, "the model . . . has so many changes that are undocumented and problems with it that any result or any alternate revenue requirement or power cost baseline number that Staff would create would probably be inaccurate also."[283] Without power cost inputs and settings that are transparent and auditable, access to the model is not useful.

106 Mr. Kalich suggests that Staff and Public Counsel rejected models runs that they requested in discovery because those requested model runs resulted in higher power costs.[284] As Mr. Gomez wrote in his response testimony, however, Staff's analysis of the Aurora values is not intended to lower Avista's revenue requirement in this case. Staff is not concerned with keeping power costs artificially low; rather, Staff seeks transparency so that it can adequately audit Avista's power costs.

[281] Kalich, Exh. CGK-6X (For example, Avista stated: "The tabs referenced above [in Mr. Kalich's workpapers titled 'Load Table 2017-19'] . . . were inadvertently included within Mr. Kalich's excel workbook. These tabs were not, however, used within the Company's requested power cost calculation in his proceeding.").
[282] Gomez, TR. 292:5-24.
[283] Gomez, TR. 292:16-20.
[284] Kalich, Exh. CGK-4T at 4:10 - 6:2.

C. Avista Has Failed to Show That Its Power Costs Have Increased

107 In this case, Avista seeks recovery of an additional $19.7 million in power costs. Avista bases its case for increased power costs primarily on the expiration of a contract with Portland Gas and Electric (PGE).[285] According to Avista, the PGE contract accounted for approximately $16 million of net revenue, the loss of which the Company characterizes as a "Net Cost."[286] The PGE contract expired in 2016.[287] Since then, an entire calendar year has passed. On January 12, 2018, Avista made its December 2017 ERM filing, which reports the 2017 year-end status of the ERM balances.[288] According to the filing, Avista's "actual net power supply costs were lower than authorized net power supply costs for the Washington jurisdiction by $6,219,740."[289] In other words, although Avista is no longer receiving revenue from the PGE contract, it collected $6 million more than its authorized power costs in 2017. Of this $6 million, Avista pocketed $4.5 million, and the remainder was added to the ERM deferral balance, which is currently just under $23 million.[290] This clearly indicates that Avista does not need additional revenue from ratepayers to cover the loss of the PGE contract because it has been offset by other factors.

108 Mr. Johnson argues that the "costs" from the expired contract should not flow through the ERM because the ERM is designed only for variable power costs.[291] This argument is misplaced, however, and confuses costs and revenues. Avista's case apparently is that, because the Company will no longer receive some $16 million per year from the PGE contract, it will need to collect that amount from ratepayers. Losing one revenue source, however, does not automatically mean that total power costs will increase. To show that the Company needs a rate increase to

[285] Kalich, Exh. CGK-3T at 4:16-20 ("Its expiration explains nearly 81 percent of the difference").
[286] *See* Kalich, Exh. CGK-3T at 5, Table No. 1; 24:16-19; *see* Kalich, Exh. CGK-3T at 10:14-15.
[287] Kalich, Exh. CGK-3T at 24:14,
[288] Johnson, Rev. Exh. WGJ-7X, filed Jan. 18, 2018.
[289] Johnson, Rev. Exh. WGJ-7X at 11.
[290] *See* Johnson, Rev. Exh. WGJ-7X at 12.
[291] Johnson, Exh. WGJ-6T at 15:9-11.

make up for these lost contract revenues, Avista first needs to prove that there are actual power costs totaling that amount. This Avista has not done. The Aurora model results cannot be relied on and, from the year-end ERM filing that shows Avista is $6 million ahead for 2017, it is evident that the power cost baseline does not need to be ratcheted up. Adjusting the ERM baseline up at this point would interfere with the operation of the ERM and likely would exacerbate Avista's over-collection of power costs.

D. Conclusion on Power Costs

109 The Commission should leave power costs at current levels and leave the ERM baseline where it is. If the Commission approves a rate plan for Avista, Staff recommends that the Commission maintain the ERM baseline until a) Avista's next general rate case or b) the total credit balance owed to ratepayers, currently at $22.96 million,[292] falls below $10 million, whichever occurs sooner. Avista objects to this proposal, contending that the Company potentially would have to absorb too high an amount of power costs.[293] Avista fails to recognize the ERM is a two-way street. Of note, the Company is no longer proposing a power supply adjustment during the rate plan.[294] If the Commission approves a rate plan and power costs spike, Staff's proposal would provide Avista with equitable relief. The Commission should adopt Staff's proposal.

VI. FUEL CONVERSION PROGRAM

110 How do you get more customers to hook-up to your natural gas system? Pay them. How much? As much as you can. Who pays? Electricity-users. This is Avista's fuel conversion program in brief. In detail, the fuel conversion program consists of incentives funded through

[292] Johnson, Rev. Exh. WGJ-7X at 12.
[293] Johnson, Exh WGJ-6T at 16:1-13.
[294] Johnson, Exh WGJ-6T at 15:15-17.

Avista's electric conservation rider, Schedule 91, and given to residential customers that switch to natural gas for heating purposes, and also to multifamily dwelling developers (not ratepayers) to encourage them to build developments with facilities for natural gas heating. It must be discontinued. Electric ratepayers should not pay higher rates to fund the expansion of Avista's natural gas business when this purpose is being achieved through other, overlapping programs.

A. Fuel Conversions Should Be Removed from the Electric Conservation Rider

111 The Commission's authority to determine fair, just, and reasonable rates extends to Avista's conservation tariffs and its electric conservation rider, Schedule 91.[295] Avista proposes to increase the amount recovered from electric ratepayers through the electric conservation rider.[296] The burden of proof is on Avista "to show that such increase is just and reasonable."[297] The Company, far from supporting its proposed increase for its fuel conversions funded through the electric conservation rider, has provided overwhelming evidence that such an increase is unjust, unfair, and unreasonable.

112 It is unreasonable for *electric* ratepayers to pay for others to heat their home with already less-expensive natural gas. Also, the scale to which Avista wants to increase its fuel conversion program is unreasonable. Lastly, Avista's contention that fuel conversions are "conservation" is incorrect, sets a dangerous precedent, and is, ultimately, ineffectual towards the question of whether any funds should be recovered through the electric conservation rider.

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[295] RCW 80.04.130(1); RCW 80.28.010.
[296] *In the Matter of Avista Corp.'s 2018-2027 Ten-year Achievable Conservation Potential and 2018-2019 Biennial Conservation Plan*, UE-171091, 2018-2027 Ten-year Achievable Conservation Potential and 2018-2019 Biennial Conservation Plan (Nov. 1, 2017); *In the Matter of Avista Corp.'s 2018-2027 Ten-year Achievable Conservation Potential and 2018-2019 Biennial Conservation Plan*, UE-171091, Open Meeting Memo, 3, *see* Table 2 (Dec. 20, 2017) [hereinafter "UE-171091 Open Meeting Memo"].
[297] RCW 80.04.130(4).

1. It Is Unreasonable to Charge Electric Ratepayers for Fuel Conversions

113 Natural gas is cheaper. And it's not close. Avista's residential customers pay significantly less to heat their homes with natural gas than electricity. The economics presented by the parties support no other conclusion.

114 The Company's witness, Mr. Christie, provided evidence that customers pay between 1.5 and 3.0 times more to heat their homes with electricity than with natural gas.[298] Specifically, a customer with a home 2,000-square-feet in size, which is an approximation of the average home in Avista's service territory,[299] would pay 2.9 times more to heat their home with electricity than with natural gas.[300] A customer with a home 500-square-feet in size would pay 2.74 times more;[301] and, with a home 4,000-square-feet in size, 3.18 times more.[302] In fact, Mr. Christie could think of no situation, based on his knowledge and experience, where it would be more economical to heat with electricity than with natural gas.[303]

115 Using Avista's approximation of the average customer's home and usage in its service territory, a customer would save $1,007.84 annually by heating their home with natural gas instead of electricity.[304] This amount would be less, with a smaller home, but more with a larger home.[305] This savings is important to customers. Both the Company and Public Counsel agree. Mr. Christie testified that "[i]f you're a customer and you can experience more than a two-thirds' reduction in your—in your heating expense, and especially given our climate and our

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[298] Christie, Exh. KJC-2T at 16:14-15.
[299] Christie, Exh. KJC-6X at 1; TR at 209:21 - 210:19; TR at 217:23 - 218:2.
[300] Christie, Exh. KJC-6X at 1.
[301] Christie, TR at 332:4-5, 10-11.
[302] Christie, TR at 332:3-4, 9-10.
[303] Christie, TR at 220:19-23.
[304] Christie, Exh. KJC-6X at 1, subtracting $536.41 (annual cost to heat home with natural gas) from $1,544.25 (annual cost to heat home with electricity); TR at 216:7-12.
[305] Christie, TR at 210:14-19; *see* TR at 332:3-5, 9-11.

demographics of our customers, many of our customers would find that **tremendously valuable**."[306] Ms. Carla Colamonici, on behalf of Public Counsel the advocate for residential customers, testified that this greater than $1,000 savings was significant for ratepayers.[307]

116 Heating with electricity is already more expensive and, now, Avista wants to increase the electric conservation rates by charging electric ratepayers for fuel conversions. The $1,000 savings from switching provides **tremendous value** to customers, value that recurs annually. Under Avista's current program, a customer that switches to natural gas will save this $1,000 in the first year and electric ratepayers will pay that customer another $2,250. As updated by the Company's 2018-2019 Biennial Conservation Plan ("BCP"), the fuel conversion program provides incentives for customers to switch from "Electric to Natural Gas furnace and Water Heater" of $2,250 and from "Electric to Natural Gas Direct Vent Wall Heat" of $1,300.[308]

117 The fuel conversion program provides a large, but unreasonable, benefit to those customers who choose to switch, and to the Company.[309] Not surprisingly, the Company gains additional natural gas customers. This is nowhere more evident than with the multifamily "market transformation" incentives. These incentives award $3,500 per unit to a developer for installing natural gas facilities in new multifamily complexes.[310] A single developer was even awarded $917,000 from the electric conservation rider's multifamily "market transformation"

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[306] Christie, TR at 216:17-22 (emphasis added).
[307] Colamonici, TR at 445:2-4.
[308] *In the Matter of Avista Corp.'s 2018-2027 Ten-year Achievable Conservation Potential and 2018-2019 Biennial Conservation Plan*, UE-171091, 2018-2027 Ten-year Achievable Conservation Potential and 2018-2019 Biennial Conservation Plan, Appendix A, 9 (Nov. 1, 2017). This is a change from the incentives previously offered, which used to provide a separate incentive for switching to a natural gas furnace and a natural gas water heater. "For this biennium, the Company will incentivize water heaters as a combination rebate with conversions to natural gas furnaces." *Id.*
[309] *See* Snyder, Exh. JES-1T at 19:3-8.
[310] UE-171091 Open Meeting Memo at 4-5.

funding for installing natural gas facilities in 262 new multifamily units.[311] These multifamily complexes add to, and become part of, Avista's natural gas system. In total, the budget for this program would cost electric ratepayers $1,897,000 annually.[312]

118 Importantly, no party presented evidence, beyond mere speculation,[313] of any benefit to electric ratepayers.[314] In two recent decisions, the Commission determined that electric customer departure and the resulting load loss can shift costs to remaining customers, and therefore a transition fee may be necessary to hold remaining electric customers harmless.[315] Here, remaining electric customers are paying fellow electric ratepayers to depart and also incurring any of the resulting cost shifts that potentially occur from that loss of load. In 2017, these payments cost electric ratepayers $2,812,843 through October, and are budgeted to cost electric ratepayers $2,471,450 annually in 2018-2019.[316] Moreover, the fuel conversion program is exacerbating the very conditions that Avista claims give rise to its unorthodox requests for rate relief—it is driving up electric costs while undermining electric load growth. The costs of the fuel conversion program are unreasonable without a verifiable corresponding benefit to electric customers.

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[311] *Id.* at 5.
[312] *Id.* $3,794,000 over the 2018-2019 biennium.
[313] Public Counsel speculated that electric ratepayers would benefit from paying customers to switch to natural gas heating because it is "a cost-effective resource and the deferral of infrastructure costs such as generation, transmission, and distribution costs." Colamonici, Exh. CAC-1T at 14:3-6.
[314] *See* Colamonici, TR 449:1-24.
[315] *Wash. Utils. & Transp. Comm'n. v. Pac. Power & Light Co.*, Docket UE-161204, Order 06 (Oct. 12, 2017); *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UE-161123, Order 06 (Jul. 13, 2017).
[316] Christie, Exh. KJC-5X at 2; UE-171091 Open Meeting Memo at 4. $4,942,900 over the 2018-2019 biennium.

119 The fuel conversion program is neither fair nor reasonable. Electric ratepayers should not pay for incentives that benefit natural gas ratepayers and help grow the Company's natural gas business. Instead, such incentives should be funded by natural gas ratepayers, if at all.[317]

2. The Scale of Avista's Fuel Conversion Program Is Unreasonable

120 The Company's fuel conversion program is no longer just another demand side management ("DSM") program in the conservation rider. It is taking over. Residential and multifamily "market transformation" fuel conversions account for more than 42 percent – nearly half – of the funds budgeted for DSM programs.[318]

121 The fuel conversion program has grown out of control. Historically, non-conservation programs have been recovered in the conservation rider as long as they remained small, had a minimal impact on the rate of the rider, provided a public benefit, and were unlikely to be supported by the utility without recovery through the conservation rider.[319] In 2009, the incentives given totaled $92,150.[320] The size of the program continued at a small level, having minimal impact on the conservation rider through 2014.[321] Since then, the program has ballooned past $1,000,000 in 2015 to $2,812,843 through October 2017.[322] It is no longer a small program in need of support through the conservation rider. In fact, its growing utilization and success in adding more customers to Avista's natural gas system indicates that it is more appropriate to be recovered in general rates, or some other funding source.[323]

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[317] Snyder, Exh. JES-1T at Avista has not made any proposal to continue the fuel conversion program through incentives recovered from natural gas rates.
[318] *See* UE-171091 Open Meeting Memo at 3 (Dec. 20, 2017); Snyder, Exh. JES-1T at 21:5-13. $3,214,000 for Residential Program; $2,066,000 for Low-income Program; $6,943,000 for Non-Residential Program; $9,037,000 for Fuel Conversion Programs.
[319] Snyder, Exh. JES-1T at 18:8-20, 23:3-6.
[320] Christie, Exh. KJC-5X at 2.
[321] *Id*.
[322] *Id*.
[323] *See* Snyder, Exh. JES-1T at 18:18-20; Christie, Exh. KJC-5X at 2.

122 The *electric* conservation rider is no longer an appropriate funding source. When the scale of the fuel conversion program was small, the impact to the electric conservation rider was insignificant. As the program has grown, electric ratepayers have paid an increasing amount towards funding fuel conversions.[324] Now, with an expected budget in 2018-2019 of $4,942,900 for residential fuel conversions and $3,794,000 for multifamily "market transformation" conversions, the scale of the program presents an amount to be paid by electric ratepayers that is far beyond reasonable.[325]

3. Fuel Conversions Are Not Conservation

123 It is unnecessary for the Commission to address the issue of whether fuel conversions are conservation for two reasons. First, Avista does not count fuel conversions towards its Energy Independence Act ("EIA") conservation target in its biennial conservation plan. Avista, therefore, is only requesting that fuel conversions be considered conservation for purposes of cost recovery through rates in Schedule 91, its conservation rider. It is entirely within the Commission's authority to determine what rates are not fair, just, or reasonable, and should be excluded from the Company's conservation rider. Second, Staff's recommendation, that the fuel conversion program be removed from the electric conservation rider, stands on the economic principles that electric ratepayers should not pay for fuel conversions. Both reasons support going no further than examining the economic reasoning for excluding fuel conversions from Avista's electric conservation rider, but Staff presents the incompatibility of fuel conversions with "conservation" here for completeness.

124 Fuel conversions are not conservation, and concluding otherwise would set a dangerous precedent. According to the EIA, utilities are required to "pursue all available conservation that

[324] *See* Christie, Exh. KJC-5X at 2.
[325] UE-171091 Open Meeting Memo at 4.

is cost-effective, reliable, and feasible," "using methodologies consistent with those used by the Pacific Northwest electric power and conservation planning council."[326]

125 Using fuel conversions as "conservation" is not consistent with the methodologies used by the NWPCC. The Northwest Power and Conservation Council ("NWPCC") has never included fuel conversion as a form of conservation.[327] As Avista's witness Mr. Christie quotes,[328] the NWPCC does not consider fuel switching "conservation," even though switching to natural gas can be "more economically efficient."[329] The same situation is presented before the Commission, now: using natural gas to heat homes is cheaper in Avista's service territory. But this fact does not make switching to natural gas "conservation."

126 Utilities are obligated to pursue all conservation that is cost-effective, reliable, and feasible. Obligating utilities to pursue *fuel conversions* as part of this requirement would be inconsistent with regulatory principles and the Commission's authority to regulate investor-owned utilities. If fuel conversions were required as part of pursuing all conservation, an electric-only utility would be required to charge its electric customers a fee to be paid to customers that chose to cease taking electric service and, instead, take natural gas service. Such a charge would be unfair, unjust, and unreasonable. And so it is, here, too.

127 The EIA defines conservation as "any reduction in electric power consumption resulting from increases in the efficiency of energy use, production, or distribution."[330] Fuel conversions reduce electric power consumption by terminating the use. For example, when a customer replaces a light bulb with an energy-efficient LED-bulb, this results in conservation. But when

[326] RCW 19.285.040(1).
[327] Snyder, Exh. JES-1T at 16:12-14.
[328] Christie, Exh. KJC-2T at 13:13-22.
[329] Northwest Power and Conservation Council, *7th Power Plan*, Appendix N: Direct Use of Natural Gas, N-4 (May 26, 2016) available at https://www.nwcouncil.org/media/7149904/7thplanfinal_appdixn_duofnatgas.pdf.
[330] RCW 19.285.030(6); WAC 480-109-060.

that customer unscrews the light bulb and lights a candle, it is not conservation because the customer is no longer using the electric facility. Avista has presented evidence of the economic advantages of using natural gas, but not evidence that fuel conversions are equal to conservation.

128 The Commission has the authority to "address cost recovery issues" of utilities in complying with the EIA.[331] Avista's request is for recovery of funding through the electric conservation rider for fuel conversions. The Commission should reject Avista's request to consider fuel conversions as conservation for the recovery of the costs of implementing the program.

B. Funding for Low Income Fuel Conversions Should Continue

129 There is one exception to the elimination of the fuel conversion program: low income fuel conversions. Staff has identified at least two options for continuing funding for low income fuel conversions. One is to continue funding low-income fuel conversion through the conservation tariff rider.[332] The other is to recover funding through Avista's Low Income Rate Assistance Program ("LIRAP") under tariff Schedules 92 and 192.[333] The former option would require retaining approximately $296,000 in Avista's budget for the 2018-2019 biennium for low income fuel conversions.[334] The latter would require an increase to LIRAP funding under the tariff for Schedules 92 and 192 of approximately $296,000.[335] Staff believes the latter approach, funding low income fuel conversions may be more appropriate because it avoids any confusion about the fate of the fuel conversion program's existence in the conservation rider, but would encourage the Commission to adopt either option, without preference.[336]

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[331] RCW 19.285.050(2).
[332] Snyder, TR at 271:4-6.
[333] Snyder, TR at 271:8-9.
[334] *See* Snyder, TR at 270:7-19.
[335] Snyder, TR at 272:1-5.
[336] *See* Snyder, TR at 270:20 - 271:9; TR at 275:20 - 276:3; UE-171091 Open Meeting Memo at 7.

130 Low income customers need financial help in order to make improvements. By definition, low income customers have limited means. Providing for assistance to low income ratepayers for fuel conversions will provide these customers with the economic advantages that Avista has presented in support of its fuel conversion program.[337] Not only will this aid help low income customers reduce their current bills, it will also reduce their future bills as the $1,000 in yearly savings presented by Avista will benefit the customer for years to come.[338] Such assistance is consistent with the State's intent to provide assistance to low income customers.[339]

131 The scale of the low income fuel conversion program is acceptable. As Staff testified, it is acceptable to support small programs through the conservation rider.[340] A low income fuel conversion program the size of $296,000 would be small and have minimal impact on the rates in the rider.

C. The LEAP Pilot Program Should Continue, Conditionally

132 Staff supports the continuation of the Line Extension Allowance ("LEAP") pilot program, with the resolution of the noted deficiencies that need improvement.[341] LEAP is different and distinct from Avista's fuel conversion program. It is funded by natural gas ratepayers, not electric ratepayers. It provides a new natural gas residential customer, which would include an electric-only customer switching from electricity to natural gas for heating purposes, an allowance of $4,500 to cover the cost of the natural gas line extension to the customer's property. If the cost of providing the line extension to the customer's property is less

[337] Christie, Exh. KJC-2T 16:14-15; Exh. KJC-6X at 1; TR at 332:3-5, 9-11. In its 2018 Annual Conservation Plan, Avista proposes to fully fund low income conversions to natural gas furnaces at $5,196 and natural gas water heaters through rebates at its avoided cost of energy, $587. UE-171091 Open Meeting Memo at 7, n. 7.
[338] *See* Christie, Exh. KJC-6X at 1.
[339] *See* RCW 80.28.068.
[340] Snyder, Exh. JES-1T at 18:8-20.
[341] Snyder, Exh. JES-1T at 2:19 - 3:12.

than $4,500, the remainder of this amount can be put towards a rebate for a natural gas furnace or water heater.

133 LEAP currently overlaps with the fuel conversion program. Where it overlaps, a customer could receive the $1,000 in savings from switching, $2,250 for the combination of a natural gas furnace and water heater from the fuel conversion program, *and* the $4,500 for the line extension (the excess of which can also be put towards a furnace or water heater).

134 The overlapping of benefits results in an excessive and unnecessary amount of incentives being contributed to a ratepayer that chooses to switch from electric to natural gas heating. This is why Staff believes that the continuation of LEAP be conditioned upon the discontinuation of the fuel conversion program.

VII. THE COST OF SERVICE, RATE SPREAD, AND RATE DESIGN SETTLEMENT

A. The Commission should approve without conditions the cost of service, rate spread, and rate design settlement as it is consistent with the Commission's approval criteria

135 The Commission may approve a settlement that is (1) lawful, (2) consistent with the public interest given the information available to the Commission, and (3) supported by an appropriate record.[342] The multiparty cost of service, rate spread, and rate design settlement before the Commission satisfies these criteria.

136 Initially, the settlement is lawful. The settlement produced a record containing Avista's cost-of-service studies (COSSs),[343] and the Commission has consistently approved the methodologies underlying those COSSs.[344] Those COSSs inform the settlement's rate spread.

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[342] *Wash. Utils. & Transp. Comm'n v. Avista Corp. d/b/a Avista Utils.*, Dockets UE-080416 & UG-080417, Order 08, 9, ¶¶ 16-17 (Dec. 29, 2008).
[343] *E.g.*, O'Connell, Exh. ECO-1T at 5:1-2, Finklea, Exh. EAF-1T at 3:21-4:13.
[344] UE-140762, Order 08, 81, ¶ 190; *Wash. Utils. & Transp. Comm'n v. Nw. Nat. Gas Co.*, Docket UG-080546, Order 04, 5-6, ¶¶ 18-20 (Dec. 26, 2008).

That rate spread and the accompanying rates balance ratepayer and shareholder interests in a way that produces fair, just, reasonable, and sufficient, and therefore lawful, rates.[345]

137 Further, the settlement is consistent with the public interest in three ways. First, the Commission has stated its preference to maintain the cost-of-service status quo for utilities until it addresses cost-of-service issues in the cost-of-service generic proceedings.[346] The settlement accomplishes this by using Avista's COSSs to inform the rate spreads in these dockets, just as COSSs applying those methodologies have informed Avista's rate spreads for decades. This avoids the possibility of multiple, significant changes to Avista's cost-of-service methodologies, which would create the undesirable possibility of rate instability.[347] This also allows the Commission to make cost-of-service determinations in a non-adversarial proceeding where the relevant stakeholders can fully inform the Commission, producing the best possible outcome.[348]

138 Second, the settlement addresses cross-class subsidization in an incremental way. No party contests that Avista's residential schedules under-contribute and that its general service schedules over-contribute.[349] The settlement moves those schedules toward cost-of-service parity in a measured way,[350] respecting the principles of gradualism[351] and avoidance of rate shock.[352]

139 Third, the settlement balances the needs of Avista and the needs of its customers. The settlement provides for greater certainty of fixed-cost recovery for Avista through higher basic

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[345] RCW 80.28.010; Ehrbar, Exh. PDE-8T at 10:1-4, 11:6-14.
[346] UE-170033, Order 08, 6, ¶ 19, 111, ¶¶ 331-32, 126, ¶ 378, 138, ¶429 (Dec. 5, 2017).
[347] *See In re the Investigation on the Commission's Own Motion into the Propriety & Adequacy of Certain Depreciation Rates of U.S. West Commc'ns, Inc. & the Charges, if any, that Should be Ordered to Such Depreciation Rates*, Docket UT-951425, Fifth Supplemental Order, at 4 (Aug. 15, 1997) (calling rate stability an "important" Commission goal and expressing a desire to minimize rate changes).
[348] O'Connell, Exh. ECO-1T at 5:5-9; Finklea, Exh. EAF-1T at 3:21-4:8.
[349] *E.g.*, Stephens Exh. RRS-1TC at 34: Table 4.
[350] O'Connell, Exh. ECO-1T at 3:21-22, 8:3-4; Collins, SMC-3T at 4-5.
[351] UE-140762, Order 08, 84, ¶ 197, 85-86, ¶ 202.
[352] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-100749, Order 06, 109, ¶¶ 315-316 (Mar. 25, 2011).

charges.[353] It also results in smaller basic charge increases than those Avista originally sought, protecting vulnerable ratepayers,[354] and it expands the choices available to Avista's natural gas customers while ensuring that other customers are held harmless from the creation of the new schedules.[355]

140 Finally, an adequate record supports the settlement. Avista's COSSs, which no settling party contested, are in the record to inform the settlement's rate spread.[356] And the settling parties have each offered testimony as to why the settlement's cost of service, rate spread, and rate design terms are lawful and in the public interest.[357]

B. The Commission should reject ICNU's cost of service, rate spread, and rate design proposals as inconsistent with Commission decisions and the public interest

141 ICNU, the lone non-settling party, asks the Commission to reject the settlement in favor of its electric COSS, rate spread, and rate design proposals. Staff therefore offers a few words on those proposals.

1. ICNU's cost of service testimony ignores long-settled Commission cost-of-service principles

142 ICNU asks the Commission to upend nearly 40 years of cost-of-service practice[358] despite the existence of the generic proceedings, which the Commission instituted specifically to deal with cost-of-service issues. ICNU bases these requests on Mr. Stephens's opinion that peak demand drives investment in production and transmission plant,[359] as well as his opinions about

[353] O'Connell, ECO-1T at 9:13-15.
[354] O'Connell, ECO-1T at 9:13-15.
[355] O'Connell, ECO-1T at 9:19-20; Ehrbar, Exh. PDE-8T at 9:8-19; Finklea, Exh. EAF-1T at 6:13-18.
[356] Knox, Exh. TLK-3; Miller, Exh. JDM-3.
[357] O'Connell, Exh. EOC-1T, Collins, Exh. SMC-3T, Finklea, Exh. EAF-1T, Ehrbar, Exh. PDE-8T.
[358] *See Wash. Water Power Co.*, Cause Nos. U-82-10 & U-82-11, Second Supplemental Order, at 36-37.
[359] *E.g.*, Stephens, Exh. RRS-1T at 2:16-22, 32-34.

the data to use for allocating costs amongst Avista's customer classes.[360] The Commission should reject ICNU's invitations.

143 The Commission requires that any cost of service study reflect the purpose for which a utility invests in production plant.[361] Mr. Stephens concedes that utilities supply energy at times other than at peak demand,[362] and he essentially acknowledges that utilities invest in plant to reduce the cost of providing electricity at those off-peak hours.[363] There is thus at least a recognition that utilities should classify production plant in part on energy.

144 The Commission also requires that any cost of service study reflect the reason that a utility invests in transmission plant.[364] Mr. Stephens essentially ignores the arguments for classifying some portion of transmission plant on an energy basis. These include the contention that utilities invest in transmission plant to ensure reliability and resiliency,[365] meaning to ensure that energy is delivered when required by a customer. These also include the argument that utilities sometimes construct transmission plant to allow for a reduction in energy costs, such as when they locate production plant in remote areas to reduce fuel transportation costs.[366]

145 The arguments for classifying production and transmission investments on a partial energy basis are not frivolous. The Commission, in fact, accepted them with regard to Avista nearly 40 years ago.[367] If the Commission is going to revisit or undo those determinations, or decide the proper data for allocating production and transmission costs amongst customer

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[360] *E.g.*, Stephens, Exh. RRS-1T at 2:23-31.
[361] *Wash. Water Power Co.*, Cause Nos. U-82-10 & U-82-11, Second Supplemental Order, at 36.
[362] Stephens, TR. at 431:20-22; *accord* O'Connell, Exh. ECO-6T at 11:8-19.
[363] Stephens, TR. at 431:23-432:12; *accord* O'Connell, Exh. ECO-6T at 11:14-19.
[364] *Wash. Water Power Co.*, Cause Nos. U-82-10 & U-82-11, Second Supplemental Order, at 37 (noting that transmission plant classification should apply the same principles as classification of production plant).
[365] O'Connell, Exh. ECO-6T at 17:1-4.
[366] O'Connell, Exh. ECO-6T at 10-13; *see* Stephens, TR. at 434:2-436:4
[367] *Wash. Water Power Co.*, Cause Nos. U-82-10 & U-82-11, Second Supplemental Order, at 36-37.

classes, it should do so in the fuller discussions that will take place in the generic proceeding,[368] not in this docket.

2. ICNU's rate spread testimony likewise ignores Commission approved principles

146 ICNU advocates a rate spread that, depending on the Commission's revenue requirement determination, may allocate any increase in revenue requirement solely to Avista's residential classes.[369] That proposed rate spread completely disregards perceptions of fairness and equity[370] because one class would literally bear responsibility for all changes in the revenue requirement. The Commission should reject it in favor of adopting the settlement rate spread, which accomplishes ICNU's goal of reducing cross-class subsidization in a manner consistent with Commission guidance on rate spread.

3. ICNU's rate design proposals are either inconsistent with public policy or not ripe for Commission adjudication

147 Finally, ICNU's proposals to either allow its members to opt out of Avista's conservation program or require Avista to create a self-directed conservation program are unacceptable.

148 ICNU justifies the opt-out program with a cost-benefit analysis that ignores the significant benefits the program provides, specifically the deferral of investment in production plant.[371] This utterly distorts the underlying analysis.[372] Regardless, the opt-out would impair Avista's ability to pursue least-cost, carbon-free resources (conservation) and the Commission should reject it as inconsistent with public policy.[373]

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[368] *See* O'Connell, Exh. ECO-6T at 5:18-6:15; Finklea, Exh. EAF-1T at 3:21-4:8.
[369] O'Connell, Exh. ECO-6T at 17:15-17.
[370] O'Connell, Exh. ECO-6T at 17:20-18:9.
[371] Snyder, Exh. JES-12T at 2:16-8.
[372] Snyder, Exh. JES-12T at 2:11-3:8.
[373] *See* WAC 480-109-010 through -999.

149 As to the self-directed conservation program, ICNU has not yet presented its proposal, or a proposal modeled on Puget Sound Energy's self-directed conservation program, to Avista's full Energy Efficiency Advisory Group. [374] The Commission should not short-circuit the process it has approved for vetting proposals like this and instead allow the relevant stakeholders the chance to review any proposal before it does so.[375]

VIII. CONCLUSION

150 This case is the latest in a long series of annual rate filings in which Avista requests significant revenue increases without adequate support. Just over a year ago the Commission rejected the Company's rate request entirely and provided explicit expectations and valuable policy guidance for future filings. Despite this guidance, Avista quickly filed for massive revenue increases that are out of step with the evidence it presented. Avista's approach to filing general rate cases needs to be overhauled.

151 To break the pattern of annual rate filings, Staff recommends a multi-year rate plan that moderates the Company's outsized request by scaling it back so that it is consistent with the Commission's long-established and well-understood ratemaking practices. Staff's thoroughly analyzed case appropriately balances the needs of the public to have safe and reliable electric and natural gas services at reasonable rates with the financial ability of the Company to provide such

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[374] Snyder, Exh. JES-12T at 5:15-6:7; *accord* Snyder, TR. at 275:7-9; *see Stephens*, Exh. RRS-1T at 2 fn. 53 (implying that ICNU has not brought its proposal to Avista's full Energy Efficiency Advisory Group).
[375] Snyder, Exh. 5:13-6:7.

services on an ongoing basis. The Commission should reject Avista's proposal and establish rates consistent with Staff's multi-year rate plan.

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Respectfully submitted,

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