MEMORANDUM

March 21, 2016

TO: Chairman Danner
Commissioner Jones
Commissioner Rendahl
Steve King
Mark Vasconi
Greg Kopta (w/attachments)
Sally Brown (w/attachments)
Tom Schooley
Deborah Reynolds

FROM: Lisa Wyse, Records Center

SUBJECT: The Washington State Attorney General's Office, Public Counsel v. Washington Utilities and Transportation Commission;
(UE-150205/UG-150205)
Public Counsel's Petition for Judicial Review
Thurston County Case No. 16-2-01108-34

A Petition for Judicial Review, has been filed in Thurston County Superior Court on March 18, 2016, by Lisa W. Gafken, Attorney General's Office, representing Petitioners listed above. The petition was received by the Commission on March 18, 2016.

CASE TYPE 2

THURSTON COUNTY SUPERIOR COURT

CASE INFORMATION COVER SHEET

Case Number 16-2-01108-34 **Case Title** Washington State Attorney General's Office, Public Counsel Unit v. Washington Utilities and Transportation Commission

Attorney Name Lisa W. Gafken **Bar Membership Number** 31549

Please check one category that best describes this case for indexing purposes. Accurate case indexing not only saves time in docketing new cases, but helps in forecasting needed judicial resources. Cause of action definitions are listed on the back of this form. Thank you for your cooperation.

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- _X_ Administrative Law Review (ALR 2)
- ___ Appeal of a Department of Licensing Revocation (DOL 2)
- ___ Civil, Non-Traffic (LCA 2)
- ___ Civil, Traffic (LCI 2)

CONTRACT/COMMERCIAL
- ___ Breach of Contract (COM 2)
- ___ Commercial Contract (COM 2)
- ___ Commercial Non-Contract (COL 2)
- ___ Third Party Collection (COL 2)

PROTECTION ORDER
- ___ Civil Harassment (HAR 2)
- ___ Domestic Violence (DVP 2)
- ___ Foreign Protection Order (FPO 2)
- ___ Sexual Assault Protection (SXP 2)
- ___ Stalking (STK 2)
- ___ Vulnerable Adult Protection (VAP 2)

JUDGMENT
- ___ Abstract Only (ABJ 2)
- ___ Foreign Judgment (FJU 2)
- ___ Judgment, Another County (ABJ 2)
- ___ Judgment, Another State (FJU 2)
- ___ Tax Warrant (TAX 2)
- ___ Transcript of Judgment (TRJ 2)

OTHER COMPLAINT/PETITION
- ___ Action to Compel/Confirm Private Binding Arbitration (MSC 2)
- ___ Change of Name (CHN 2)
- ___ Deposit of Surplus Funds (MSC 2)
- ___ Emancipation of Minor (EOM 2)
- ___ Injunction (INJ 2)
- ___ Interpleader (MSC 2)
- ___ Malicious Harassment (MHA 2)
- ___ Minor Settlement (No guardianship) (MST 2)
- ___ Petition for Civil Commitment (Sexual Predator)(PCC 2)
- ___ Property Damage-Gangs (PRG 2)
- ___ Public Records Act (PRA 2)
- ___ Restoration of Firearms Rights (RFR2)
- ___ Relief from Duty to Register (RDR2)
- ___ School District – Required Action Plan (SDR 2)
- ___ Seizure of Property from Commission of Crime (SPC 2)
- ___ Seizure of Property Resulting from a Crime (SPR 2)
- ___ Subpoenas (MSC 2)

PROPERTY RIGHTS
- ___ Condemnation (CON 2)
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- ___ Land Use Petition (LUP 2)
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- ___ Quiet Title (QTI 2)
- ___ Unlawful Detainer (UND 2)

TORT, MEDICAL MALPRACTICE
- ___ Hospital (MED 2)
- ___ Medical Doctor (MED 2)
- ___ Other Health Care Professional (MED 2)

TORT, MOTOR VEHICLE
- ___ Death (TMV 2)
- ___ Non-Death Injuries (TMV 2)
- ___ Property Damage Only (TMV 2)
- ___ Victims of Motor Vehicle Theft (VVT 2)

TORT, NON-MOTOR VEHICLE
- ___ Asbestos (PIN 2)
- ___ Other Malpractice (MAL 2)
- ___ Personal Injury (PIN 2)
- ___ Products Liability (TTO 2)
- ___ Property Damage (PRP 2)
- ___ Wrongful Death (WDE 2)

WRIT
- ___ Habeas Corpus (WHC 2)
- ___ Mandamus (WRM 2)
- ___ Restitution (WRR 2)
- ___ Review (WRV 2)
- ___ Miscellaneous Writs (WMW 2)

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Please Note: Public information in court files and pleadings may be posted on a public Web site.

Bob Ferguson
ATTORNEY GENERAL OF WASHINGTON

March 18, 2016 800 Fifth Avenue #2000 • Seattle WA 98104-3188

FILED via ABC LMI
Ms. Linda Myhre Enlow, County Clerk
Thurston County Superior Court
2000 Lakeride Drive, S.W., Bldg No. 2
Olympia, WA 98502

RE: *Washington State Attorney General's Office, Public Counsel Unit v. Washington Utilities & Transportation Commission*

Dear Ms. Enlow:

Enclosed for filing, please find the original copy of the Petition for Judicial Review, a Case Information Cover Sheet, and Proof of Service.

Also included is a voucher in the amount of $240.00 for the filing fee of this Petition. A self-addressed stamped envelope is provided for your convenience in returning the signed voucher.

Please contact me if there are any discrepancies or further information required to process this filing. Thank you.

Sincerely,

LISA W. GAFKEN
Assistant Attorney General
Public Counsel Unit
(206) 464-6595

LWG:kb
Enclosures
cc: Steven King, Executive Director, Washington Utilities and Transportation Commission
Sally Brown, Senior Assistant Attorney General, WUTC Staff
Pat Oshie, Assistant Attorney General, WUTC Staff (via E-mail only)
David J. Meyer, Chief Counsel, Avista Corporation
Kelly O. Norwood, Vice President, State & Federal Regulation, Avista Corporation
Jesse E. Cowell, Attorney for ICNU
Ed Finklea, Executive Director, Northwest Industrial Gas Users (NWIGU)
Chad M. Stokes & Tommy Brooks, Attorneys for NWIGU
Shawn Collins, Executive Director, The Energy Project
Ronald Roseman, Attorney for The Energy Project

PROOF OF SERVICE

I certify that I served a copy of *March 18, 2016, Cover Letter signed by Lisa Gafken, Case Information Cover Sheet, and Petition for Judicial Review with Attachments A and B* on all parties or their counsel of record on the date below as follows:

☒ Sent copies via Hand Delivery/ABC Legal Messenger Process Service:

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Washington Utilities &
Transportation Commission
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☒Sent courtesy copy electronically to e-mail addresses above.

I certify under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED this 18th day of March 2016, at Seattle, WA.

KYM BOSTELLE
Legal Assistant

☐ EXPEDITE
☒ No hearing set
☐ Hearing is set
Date: _____
Time: _____
Judge/Calendar: _____

STATE OF WASHINGTON
THURSTON COUNTY SUPERIOR COURT

THE WASHINGTON STATE ATTORNEY GENERAL'S OFFICE, PUBLIC COUNSEL UNIT, Appellant, v. WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Respondent.	NO. PUBLIC COUNSEL'S PETITION FOR JUDICIAL REVIEW

COMES NOW the petitioner, the Public Counsel Unit of the Washington Attorney General's Office (Public Counsel), by and through Assistant Attorney General, Lisa W. Gafken, and petitions pursuant to chapter 34.05 RCW for judicial review of agency action by the respondent, the Washington Utilities and Transportation Commission (Commission), taken in Order 05 and Order 06 in Commission Docket Nos. UE-150204 and UG-150205 (consolidated). In support of this petition, the petitioner respectfully shows the following as required by RCW 34.05.546:

(1) NAME AND MAILING ADDRESS OF PETITIONER:

Public Counsel Unit
Washington State Office of the Attorney General
800 5th Avenue, Suite 2000
Seattle, WA 98104-3188

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
800 FIFTH AVENUE, SUITE 2000
SEATTLE, WA 98104-3188
(206) 464-7744

(2) NAME AND MAILING ADDRESS OF PETITIONER'S ATTORNEYS:

Lisa W. Gafken, Assistant Attorney General
Public Counsel Unit
Washington State Office of the Attorney General
800 5th Avenue, Suite 2000
Seattle, WA 98104-3188

(3) NAME AND MAILING ADDRESS OF AGENCY WHOSE ACTION IS AT ISSUE:

Washington Utilities and Transportation Commission
1300 S. Evergreen Park Dr. S.W.
P.O. Box 47250
Olympia, WA 98504-7250

(4) IDENTIFICATION OF THE AGENCY ACTION AT ISSUE:

At issue is Order 05 in Commission Docket Nos. UE-150204 and UG-150205. Order 05 is the final order entered by the Commission in consolidated rate setting dockets in which Avista Corporation, d/b/a Avista Utilities, sought rate increases for its electric and natural gas services. Order 05 was served on Public Counsel on January 6, 2016, and a true and accurate copy is attached to this petition as Attachment A. Also at issue is Order 06 from the same consolidated dockets. Order 06 was served on Public Counsel on February 19, 2016, and disposed of several post-order motions, which are described in more detail below. A true and accurate copy of Order 06 is attached to this petition as Attachment B. Together, Order 05 and Order 06 constitute the final orders in Avista's general rate case.

Public Counsel seeks judicial review of five aspects of Order 05 and Order 06. First, the Commission exceeded its statutory authority by setting rates for Avista's natural gas and electric services that include amounts for utility plant and facilities ("rate base") that are not being used to provide utility service to customers. Such rate base is not "used and useful," as required by RCW 80.04.250. Second, the Commission arbitrarily and capriciously disregarded

its newly articulated standard regarding attrition adjustments[1] when it granted an attrition adjustment for Avista's electric operations after finding that the Company did not meet the new standard. Third, the Commission erroneously applied the "end results test"[2] to set rates for Avista's electric operations that are not supported by the record. Fourth, the Commission arbitrarily and capriciously refused to correct its calculation of Avista's electric rates after significant errors were brought to the agency's attention. Fifth, the Commission's calculation of Avista's electric rates lacks substantial evidence.

(5) IDENTIFICATION OF PARTIES IN ADJUDICATIVE PROCEEDINGS THAT LED TO AGENCY ACTION:

Washington Utilities and Transportation Commission, complainant below

Avista Corporation d/b/a Avista Utilities (Avista), respondent below

Washington Utilities and Transportation Commission Staff (Staff)[3]

Public Counsel Unit of the Washington State Attorney General's Office

Industrial Customers of Northwest Utilities (ICNU), intervenor

Northwest Industrial Gas Users (NWIGU), intervenor

The Energy Project, intervenor

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[1] An attrition adjustment is a special form of rate increase designed to offset a company's alleged future earnings erosion. It is effectively an add-on to the rate increase amount that standard rate-setting analysis would produce.

[2] The end results test requires that rates be just and reasonable, although regulatory commissions are not bound to use any particular rate-setting methodology.

[3] In UTC adjudicative proceedings such as these, the Commission's regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as other parties to the proceeding. There is an "*ex parte* wall" separating the Commissioners, the presiding Administrative Law Judge, and the Commissioners' policy and accounting advisors from all parties, including regulatory staff. Order 05 ¶ 3, n.1 (citing RCW 34.05.455).

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(6) JURISDICTION AND VENUE:

(a) This is an action seeking judicial review of the Commission's final orders in Docket Nos. UE-150204 and UG-150205. This court has jurisdiction pursuant to Part V of the Washington Administrative Procedure Act, RCW 34.05.510 through RCW 34.05.598.

(b) Venue is appropriate in Thurston County pursuant to RCW 34.05.514(1)(a).

(c) As required by RCW 34.05.534, Public Counsel has exhausted its administrative remedies. Order 05 was issued by the Commission as its final order, exhausting administrative remedies. Certain parties filed motions for clarification and reconsideration with the Commission within the time limits provided in WAC 480-07-835 (clarification) and WAC 480-07-850 (reconsideration).[4] The post-order motions tolled the time for judicial review,[5] and the Commission issued Order 06 on February 19, 2016, disposing of the motions. Public Counsel files this Petition for Judicial Review within the time limits of RCW 34.05.542(2).

(d) Public Counsel and the Avista ratepayers it represents are and will continue to be adversely affected by Order 05 and Order 06, as described in this petition. Ratepayer interests were among those that the Commission was required to consider. A judgement in favor of Public Counsel in this review would eliminate or redress the prejudice caused by the Commission's action, and Public Counsel has standing to obtain judicial review under RCW 34.05.530.

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[4] Public Counsel and the Industrial Customers of Northwest Utilities (ICNU) filed a Joint Motion for Clarification. Commission Staff filed a Motion for Reconsideration. Both motions were filed on January 19, 2016. Commission Staff also filed a Motion to Reopen on February 4, 2016, and Avista filed a Motion/Petition for a Waiver of Rules to Allow for an Answer to ICNU and Public Counsel's Motion for Clarification and Commission Staff's Motion to Reconsider on January 28, 2016. Order 06 disposed of all post-order motions.

[5] WAC 480-07-835; WAC 480-07-850.

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(7) FACTS DEMONSTRATING THAT THE PETITIONER IS ENTITLED TO OBTAIN JUDICIAL REVIEW:

(a) Petitioner Public Counsel, a division in the Washington State Attorney General's Office, represents the people of the state of Washington before the Commission.[6] Pursuant to this statutory authority, Public Counsel advocates on behalf of residential and small business customers of Washington's regulated electric and natural gas utilities, including Avista's electric and natural gas customers.

(b) Respondent Washington Utilities and Transportation Commission is an agency of the State of Washington established under RCW 80.01.010. The Legislature conferred upon the Washington Utilities and Transportation Commission the duty and power to regulate in the public interest the rates, services, facilities, and practices of all businesses supplying any utility service or commodity in the state for compensation.[7] The Commission must ensure that the rates charged by electric and natural gas companies are fair, just, reasonable, sufficient, and otherwise consistent with the law.[8] The Commission must consider the consumers' interest in paying the lowest reasonable rate for utility service that is also sufficient to cover the utility's prudently incurred and lawful costs and to allow the utility an opportunity for a reasonable return on investment.

(c) Avista is a "public service company," an "electrical company," and a "gas company," as those terms are defined in RCW 80.04.010 and used in Title 80 RCW. Avista is engaged in the business of supplying electric and natural gas utility service to the public for compensation in Washington. Avista's principal place of business is in Spokane, Washington.

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[6] RCW 80.01.100; RCW 80.04.510.
[7] RCW 80.01.040(3).
[8] RCW 80.01.040; RCW 80.28.010(1); RCW 80.28.020.

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Avista provides service to approximately 243,000 electricity and 153,000 natural gas customers in eastern Washington.

(d) **Overview of Order 05.** On February 9, 2015, Avista filed a general rate case requesting rate increases for both its electric and natural gas operations. On rebuttal, Avista reduced its requested increases to $3.6 million for electric and $10 million for natural gas.[9]

Avista calculated its asserted need for a rate increase based on an "attrition" methodology, rather than on the Commission's standard ratemaking methodology. The Commission's standard ratemaking methodology is the "modified historical test year" approach, which is an analysis based on the actual costs incurred by the utility. Under the modified historical test year approach, the Commission determines the need for a rate increase based on the utility's recent *actual* costs, as well as any "known and measurable" changes to those recent historical costs.[10]

By contrast, attrition analysis is a departure from the standard method of setting utility rates. Attrition analysis is based on less reliable projected costs (rather than actual costs) and a projection of the revenues needed to offset alleged future earnings erosion. Because its basis is less reliable, attrition-based increases (i.e., "attrition adjustments") have historically only been allowed by the Commission in extraordinary circumstances.[11]

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[9] Avista initially requested an increase of $33 million for its electric operations and $12 million for its natural gas operations. The reductions in Avista's initial requests were the result of a multiparty partial settlement and changes made to Avista's calculation in its rebuttal filing.

[10] "Known and measurable" is one of the standards by which the Commission measures an expense or rate base item for inclusion in rates. To be known and measurable, an event that causes changes to historical expense, rate base, or revenue must have occurred during or shortly after the test period and will affect the period when new rates go into effect. Also, the amount of change must be measurable and not an estimate or projection. *WUTC v. Avista Corp. d/b/a Avista Util.'s*, Docket UE-090134 and UG-090135, Order 10 ¶ 46 (December 22, 2009); *WUTC v. Pacific Power & Light Co.*, Docket UE-140762, Order 08 ¶ 167 (March 25, 2015).

[11] Until recently, the Commission had not authorized an attrition adjustment for any Washington utility since the mid-1980s. Some attrition adjustments were allowed in the 1970s and 1980s due to identified extraordinary circumstances, usually very high rates of inflation or unusual levels of capital investment.

No party supported Avista's request for a rate increase for its electric service, either as to the amount requested or the methodology used by Avista to calculate its request. Public Counsel and the Industrial Customers of Northwest Utilities (ICNU) challenged Avista's attrition analysis and presented evidence that electric rates should be substantially reduced using the well-established modified historical test year approach. Public Counsel recommended a $30 million reduction and ICNU recommended a $25 million reduction.[12] Additionally, undisputed evidence showed that Avista had over-earned in 2013 and 2014, and would possibly over-earn in 2015.[13]

Commission Staff calculated Avista's rates using both an attrition method and the standard ratemaking method. Commission Staff rejected Avista's attrition methodology and instead offered its own attrition analysis. Based on its attrition analysis, Commission Staff recommended a reduction in rates of $6.46 million.[14] Commission Staff also presented an analysis based on the modified historical test year that resulted in a reduction of $21 million.[15]

Responding to the evidence presented by the other parties, Avista abandoned its original attrition analysis and adopted the Commission Staff's attrition model. Avista recalculated its rate request using the Staff model to be an increase of $3.6 million. Avista was the only party recommending an increase for electric rates.

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[12] Public Counsel and ICNU's recommendations did not include Avista's power cost update. Avista had agreed during the case that the final rate determination would take into account its latest power costs, and those were filed with the Commission in October 2015, during the pendency of the case and after the evidentiary hearing.

[13] Order 05 ¶ 105. "Over-earning" occurs when a utility earns a rate of return in excess of that authorized by the Commission as a reasonable return for its investors. The rate of return is a component in calculating rates charged to customers.

[14] During the post-order process, Commission Staff updated its recommendation to a reduction of $19.6 million, pursuant to its attrition analysis as adopted with modifications by the Commission in Order 05.

[15] Neither of Staff's analyses included Avista's power cost update provided after the hearing.

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After an evidentiary hearing and briefing by parties, the Commission issued Order 05 as its final order. In Order 05, the Commission confirmed that it was departing from prior decades of precedent and would no longer treat an attrition adjustment as an "extraordinary remedy." Instead, the Commission articulated a new standard. Under the new standard, a utility does not have to show extraordinary circumstances, as required in Commission decisions prior to 2012, but a utility must show that the alleged causes of attrition are beyond its control.[16] In other words, the Commission will allow rate increases based on attrition if a utility can show that costs (operating costs or capital expenditures) are beyond its control and are projected to outpace revenues such that the utility would have no opportunity to earn its authorized rate of return.

In Order 05, the Commission applied its new standard to Avista's evidence and concluded that Avista did not meet the test with respect to Avista's electric service.[17] The Commission concluded that Avista had not established that the capital expenditures were outside of its control, or that they were required for safe or efficient operation of its system.[18]

Notwithstanding this finding, the Commission concluded that Avista was entitled to a $28.3 million attrition adjustment. The Commission offset this amount against other evidence showing the need for a $36.4 million rate reduction to yield a net rate reduction for electric service of $8.1 million.[19] Order 05 required Avista to lower its electric rates by $8.1 million.[20]

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[16] The Commission stated in Avista's 2012 general rate case that extraordinary circumstances were not necessary. That case was resolved through a multiparty settlement, opposed by Public Counsel, so the Commission was not called upon to determine the standards or methodologies to apply when a utility seeks an attrition adjustment. *WUTC v. Avista Corp. d/b/a Avista Util.'s*, Docket Nos. UE-120436 and UG-120437, Order 09 ¶¶ 21, 70-78 (December 26, 2012).

[17] For Avista's natural gas service, the Commission held that Avista had met the standard and showed that its capital investments were driven by reasons beyond its control. Order 05 ¶¶ 121, 124.

[18] Order 05 ¶¶ 125-127.

[19] Order 05 ¶ 140.

Even though the Commission held that Avista failed to meet the newly articulated standard, the Commission granted Avista's attrition adjustment relying on the U.S. Supreme Court decisions in *Hope*[21] and *Bluefield*.[22][23] These decisions generally stand for the proposition that a regulator must set rates that are just and reasonable, and if the "end result" is just and reasonable, a regulator is not constitutionally required to use a particular methodology to reach the result. In Order 05, the Commission determined that the larger rate reductions supported by the record absent the $28.3 million attrition adjustment would not meet the standard of *Hope* and *Bluefield*.[24] Public Counsel argues in this appeal that the Commission has misapplied these Supreme Court authorities.

(e) **Overview of post-order motions and Order 06.** Shortly after Order 05 was issued, parties began questioning the basis of the Commission's calculations of the authorized rates. Avista requested that the Commission hold an order conference the day Order 05 was issued to discuss the Commission's calculation of Avista's electric revenue requirement.

ICNU and Public Counsel filed a Joint Motion for Clarification on January 19, 2016, seeking clarification regarding an apparent error in the Commission's calculation of Avista's electric rates. Based on the Commission's adoption of Commission Staff's attrition model with modifications, ICNU and Public Counsel calculated that Avista's electric rates should have been reduced by $19.8 million instead of $8.1 million as ordered by the Commission.

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[20] Avista filed revised tariffs to implement the rates approved in Order 05, and the Commission accepted the revised tariffs. Rates went into effect on January 11, 2016, and are currently being paid by Avista customers.

[21] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944).

[22] *Bluefield Water Works & Imp. Co. v. Public Serv. Comm'n*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).

[23] Order 05 ¶¶ 132-135.

[24] Order 05 ¶ 132.

The largest impact resulted from the Commission's failure to properly account for Avista's updated power costs,[25] which reduced Avista's revenue requirement by $12.3 million.

Commission Staff also filed a Motion for Reconsideration on January 19, 2016. Like Public Counsel and ICNU, Staff found the Commission's calculation of Avista's electric revenue requirement to be in error, pointing out that the Commission had misapplied Staff's attrition model and improperly accounted for the lower power cost. Commission Staff concluded that the correct calculation was a rate decrease of $19.6 million.[26] Additionally, Commission Staff asked the Commission to reconsider its interpretation of *Hope* and *Bluefield*, stating that the result was not supported by the record.

The Commission requested additional information and workpapers regarding Staff's Motion for Reconsideration and conducted a second order conference with the parties. After the order conferences, Commission Staff filed a Motion to Reopen, in which it provided detailed instructions for the Commission on how to correctly calculate Avista's rates using the power cost update and the Staff attrition model as adopted by the Commission in Order 05.[27]

In Order 06, the Commission denied Public Counsel and ICNU's Joint Motion for Clarification and Staff's Motion for Reconsideration, disagreeing that it had improperly

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[25] Avista had agreed during the case that the final rate determination would take into account its latest power costs, and those were filed with the Commission in October 2015, during the pendency of the case and after the evidentiary hearing.

[26] Staff's Motion for Reconsideration initially stated that the correct rate reduction for Avista's electric service was $27.4 million. During the post-order process, an error was identified, and Staff corrected its error before the Commission issued Order 06. After making corrections, Staff concluded that the rate reduction should have been $19.6 million, similar to the amount calculated by Public Counsel and ICNU.

[27] Even without reopening the record as requested by Staff, the Commission could have corrected its mistake based on testimony and exhibits from the Company at the evidentiary hearing, or even based on the power cost update itself. Each of those items discussed or illustrated the power cost update being correctly applied in conjunction with the Staff's attrition model, which Avista adopted on rebuttal.

calculated Avista's rates.[28] The Commission also denied Staff's Motion to Reopen, again denying that any mistake was made. The Commission erroneously concluded that Avista could have been prejudiced by the Commission reopening the record to accept instructions regarding how to correctly use the Staff's attrition model.

(8) REASONS WHY RELIEF SHOULD BE GRANTED:

The Commission committed reversible error in Order 05 and Order 06. In particular, the Commission acted outside of its statutory authority, arbitrarily and capriciously, and without substantial evidence. As a result, Avista's customers are not receiving the benefit of lower rates due to Avista's reduced power cost, a benefit of approximately $12 million, and Avista's shareholders are receiving a windfall. Accordingly, rates set in Order 05 and confirmed in Order 06 are not fair, just, and reasonable.

ASSIGNMENTS OF ERROR

(a) The Commission's Decision exceeds its Statutory Authority because Avista's Electric and Natural Gas Rates were Set Based on Projected Values of Utility Plant and Facilities Not Providing Service to Customers. RCW 34.05.570(3)(b).

Under RCW 80.04.250(1), the Commission may include in rates the value of property that is "used and useful" to provide utility service in Washington. To be used and useful, an asset must be used to provide utility service in this state, and the utility must demonstrate quantifiable benefits to ratepayers for each asset to be included in rates.[29] The capital investment must also be "known and measurable." To be known and measurable, the capital investment must be known to have occurred during the test year or reasonably soon thereafter,

[28] The Commission granted Avista's Motion/Petition and allowed Avista to respond to the motions.
[29] *WUTC v. Pacific Power & Light Co.*, Docket UE-140762, Order 08 ¶ 166 (March 25, 2015).

and the cost must be actually incurred by the utility.[30] Rates set in Order 05 and those confirmed in Order 06 include amounts for capital investments that are not used and useful or known and measurable.

Public Counsel assigns error to the following paragraphs in Order 05: ¶¶ 5, 62 (with respect to attrition adjustment), 63, 64, 67, 68, 70, 71, 72, 74, 77, 80, 93, 94, 95, 97, 100, 101, 102, 103, 104, 109, 110, 111, 114, 116, 119 (with respect to capital expenditures), 120, 121, 122, 124, 127 (with respect to Mr. Kelly O. Norwood's testimony at hearing), 128, 131, 132, 133, 134, 140, 141 (with respect to granting attrition adjustment), 256 (to the extent it incorporates paragraphs assigned error herein), 267, 268, 269, 283, 284, 285, 286 (to the extent it incorporates paragraphs assigned error herein), 296, 310 (excluding the Settlement), 311, 312, 316, and 317.

Public Counsel assigns error to the following paragraphs in Order 06: ¶¶ 8, 9, 10, 12, and 37.

(b) The Commission's Decision to Allow an Attrition Adjustment for Avista's Electric Rates Is Arbitrary and Capricious. RCW 34.05.570(3)(i).

After articulating its new standard for attrition adjustments in Order 05, and finding that Avista had not met the standard because its projected capital investments were not beyond its control, the Commission arbitrarily and capriciously granted Avista a $28.3 million attrition adjustment.

Public Counsel assigns error to the following paragraphs in Order 05: ¶¶ 5, 78, 79, 80, 100, 101, 115, 127 (with respect to Mr. Norwood's testimony at hearing), 128, 129, 130, 131,

[30] *Id.* ¶ 167.

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132, 133, 134, 135, 136 (with respect to authorizing rates based on the attrition methodology proposed by Staff), 137, 138, 139, 140, 141 (with respect to granting attrition adjustment), 256 (to the extent it incorporates paragraphs assigned error herein), 267, 269, 283, 284, 285, 286 (to the extent it incorporates paragraphs assigned error herein), 296, 297, 310 (excluding the Settlement), 311, 312, 316, and 317.

Public Counsel assigns error to the following paragraphs in Order 06: ¶¶ 8, 9, 12, 10, and 37.

(c) The Commission erroneously interpreted and applied the law when it used *Hope* and *Bluefield* to justify an end result that is not supported by the record and is inconsistent with other rulings made in Order 05. RCW 34.05.570(3)(d).

The Commission misapplied the U.S. Supreme Court cases of *Hope* and *Bluefield* in two instances. First, the Commission misapplied *Hope* and *Bluefield* when it used these authorities to justify its use of an attrition adjustment to set Avista's electric rates, even though the Commission determined that Avista failed to meet the newly articulated standard for attrition. Second, the Commission misapplied the cases when it held that the larger rate decreases for Avista's electric operations supported by the record would not meet the standard of *Hope* and *Bluefield*. The Commission is not granted unfettered discretion under *Hope* and *Bluefield*, but must set just and reasonable rates. Order 05 and Order 06 fail to set just and reasonable rates.

Public Counsel assigns error to the following paragraphs in Order 05: ¶¶ 129, 132, 133, 134, 135, 140, 256 (to the extent it incorporates paragraphs assigned error herein), 267, 269, 283, 284, 285, 286 (to the extent it incorporates paragraphs assigned error herein), 296, 297, 310 (excluding the Settlement), 311, 312, 316, and 317.

Public Counsel assigns error to the following paragraphs in Order 06: ¶¶ 8, 9, 12, 16, 17, 18 (with respect to Staff seeking only clarification and not reconsideration), 23, 27, 28, and 37.

(d) The Commission's Refusal to Correct its Calculation Mistake with Respect to Avista's Electric Service Rates is Arbitrary and Capricious. RCW 34.05.570(3)(i).

In setting rates for Avista's electric service, the Commission made a material $12 million mistake in its calculations. This calculation error harms customers and provides an unjust windfall to Avista. Despite being made aware of its mistake through post-order motions and information filed by Public Counsel, ICNU, and Commission Staff, the Commission refused to correct the calculation. This refusal to correct the calculation mistake was arbitrary and capricious.

Public Counsel assigns error to the following paragraphs in Order 06: ¶¶ 8, 9, 11, 12, 15, 16, 19 (with respect to conclusion on whether it is appropriate to run the power cost update outside the model), 23, 24, 25, 27, 28, 30, 31, 32, 33, 34, 35, 36, 37, 38, and 39.

(e) The Commission's Calculation of Avista's Electric Rates Is Not Supported by Substantial Evidence. RCW 34.05.570(3)(e).

Order 05 lacked sufficient evidence with respect to the $8.1 million reduction in electric rates because the cumulative effect of the Commission's rulings should have resulted in a rate reduction of $19.8 million. The Commission was made aware of the calculation mistake through motions brought by the Commission's Staff, and by Public Counsel and ICNU. Moreover, Commission Staff provided the Commission with detailed instructions on how to run Avista's power cost update with the attrition model as adopted by the Commission.

The Commission refused to accept the detailed instructions and correct its calculation, and the electric rates resulting from Order 05 and Order 06 are not supported by the record.

Public Counsel assigns error to the following paragraphs in Order 05: ¶¶ 5, 127 (with respect to Mr. Norwood's testimony at hearing), 129, 130, 131, 132, 133, 134, 135, 136 (with respect to authorizing rates based on the attrition methodology proposed by Staff), 140, 256 (to the extent it incorporates paragraphs assigned error herein), 267, 296, 297, 269, 283, 284, 285, 286 (to the extent it incorporates paragraphs assigned error herein), 296, 310 (excluding the Settlement), 311, 312, 316, and 317.

Public Counsel assigns error to the following paragraphs in Order 06: ¶¶ 3 (with respect to resolving the issues based on the record), 9, 10, 11, 12, 15, 16, 23, 24, 25, 27, 28, 31, 32, 33, 34, 35, 36, 37, 38, and 39.

(9) PETITIONER'S REQUEST FOR RELIEF:

Pursuant to RCWs 34.05.570 and 34.05.574, Public Counsel respectfully requests relief as follows:

1. For an entry of judgment vacating or setting aside portions of the Commission's Order 05 and Order 06 in total;

2. Identifying the errors contained in Order 05 and Order 06;

3. Finding that the rates approved in Order 05 and reaffirmed in Order 06 are unlawful and not fair, just, and reasonable;

4. Remanding this matter to the Commission for further proceedings consistent with these rulings, including a determination of Avista's revenue requirement for electric and natural gas services;

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5. Finding that ratepayers are entitled to refunds; and

6. For such other relief as the Court deems just and appropriate.

RESPECTFULLY SUBMITTED this 18th day of March, 2016.

ROBERT FERGUSON
ATTORNEY GENERAL

By: _____

LISA W. GAFKEN
WSBA No. 31549
Assistant Attorney General
Public Counsel

ATTACHMENT A

WUTC DOCKETS UE-150204 and UG-150205 (*Consolidated*)
Order 05: Final Order Rejecting Tariff Filing, Accepting Partial Settlement Stipulation, Authorizing Tariff Filings

SERVICE DATE
JAN 06 2016

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	DOCKETS UE-150204 and UG-150205 (*Consolidated*)
Complainant,	)	ORDER 05
v.	)	FINAL ORDER REJECTING TARIFF FILING, ACCEPTING PARTIAL SETTLEMENT STIPULATION, AUTHORIZING TARIFF FILINGS
AVISTA CORPORATION dba AVISTA UTILITIES,	)	
Respondent.	)	

Synopsis: *The Commission rejects the revised tariff sheets Avista Corporation dba Avista Utilities (Avista or Company) filed on February 9, 2015, that would have increased rates for the Company's electric customers by 6.7 percent, raising $33.2 million in additional revenue for Avista, and its tariff sheets that would have increased rates for Avista's natural gas customers by 6.9 percent, raising $12 million in additional revenue for the Company, if either had been approved by the Commission.*

The Commission approves and accepts the partial, multiparty settlement stipulation filed on May 1, 2015, including the proposed capital structure of 9.5 percent return on equity, 7.29 percent rate of return, and 48.5 percent equity component.

Based on the evidence presented, the Commission authorizes and requires the Company to file revised tariff sheets with natural gas rates that will recover $10.8 million, for a 6.3 percent increase in rates. Further, after full consideration of the record, the Commission authorizes and requires Avista to file revised tariff sheets with electric rates that will recover $8.1 million less in revenue, for a 1.63 percent rate decrease.

Paragraph 6 of the Settlement, "Electric Rate Spread/Rate Design," only provides electric rate spread and rate design provisions for a revenue requirement increase. As we order a decrease in Avista's electric rates, this provision of the Settlement is moot. Instead, the Commission adopts an equitable approach to electric rate spread and rate design that apportions a uniform percentage rate decrease across Avista's rate schedules and schedule blocks.

The Commission finds Staff's methodology for electric pro forma plant additions well principled and audited and accepts the pro forma plant additions as Staff has proposed. We also approve Staff's adjustment updating the test year to reflect the results of the 2014 Commission Basis Report.

With regard to the Company's claims of attrition eroding its earnings for both its natural gas and electric operations, the Commission recognizes that Avista has been underearning in its natural gas operations for many years. The Company has engaged in rapid replacement and improvement of gas distribution infrastructure, driven largely by safety and reliability concerns as well as compliance with Commission orders and policies supporting replacement of pipe that has a high risk of failure. We acknowledge that Avista is likely to experience attrition in its natural gas operations in the rate year, and therefore accept Staff's attrition methodology, with a slight change in the escalation rate for the period 2007 to 2014, for the purposes of setting rates for Avista's natural gas operations. The Commission allows a natural gas attrition adjustment in the amount of $6.8 million.

Although the Company has shown a recent balanced financial position on its electric operations, we are concerned this will not continue for the foreseeable future and, absent an attrition adjustment, that the Company may not have an opportunity to achieve earnings on electric operations at or near authorized levels. Thus, we grant an attrition adjustment to the modified test year amounts for Avista's electric service. We make two modifications to Staff's attrition analysis to arrive at the attrition adjustment we authorize today. Similar to the methodology for attrition for natural gas, we modify the escalation rate applied to the 2007-2014 time period. Further, we reduce to zero the escalation rate for distribution plant capital investments and expenses. After these changes to the methodology based on the facts and circumstances of this case, we find the revenue requirement for Avista's electric service should be reduced by $8.1 million, based upon the results of a modified historical test year with known and measurable pro forma adjustments, including an attrition adjustment of $28.3 million.

For operations and maintenance expenses at all thermal plants except Colstrip and Coyote Springs 2, we authorize Avista to use test year actual expenses as the test year expenses are sufficiently reflective of historical data for use in setting rates. With regard to major maintenance at Colstrip and Coyote Springs 2, we find Staff's proposal to normalize major maintenance expenses a reasonable approach to allow Avista to recover these costs.

The Commission also resolves several contested adjustments, including Project Compass. We reject Staff's recommended disallowance of $12.7 million of Project Compass' capital costs relating to the extended timeline and the Project Compass bonus plan. Avista demonstrated that it acted prudently in retaining its contractor to implement Project Compass. The Company considered switching to a different contractor and decided against it since this would have resulted in an extended timeline for the project that would have been more costly. Further, the Commission finds that Avista carried its burden to show that the Project Compass bonus plan was used to motivate employees to complete an essential project and that the bonuses were approved through appropriate channels.

We decline to rule on the prudency of Avista's proposed advanced metering infrastructure in this case because the issue is not ripe for Commission determination. Should the Company choose to do so, it may file an accounting petition requesting deferred accounting treatment of metering costs.

The Commission approves the Company's adjustment increasing 2014 wages and 2015 union wages, but we reject the 2015 non-union increase and the 2016 increases as they are not known and measurable expenses. We reject Avista's proposal to adjust the amount of time its executives allocate to Washington utility work because these projections are similarly not known and measurable.

The Commission approves a plan consistent with Avista's five-year plan to increase funding for the Low-Income Rate Assistance Program by seven percent or twice the percentage increase in the residential electric and natural gas base rates as reasonable. In its compliance tariff filing, Avista is directed to increase funding for Schedule 92 by 7 percent and Schedule 192 by twice the percentage base rate increase for Schedule 101 customers, or 12.6 percent, as well as identify each assistance service available to its customers and their eligibility requirements.

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SUMMARY

1 **PROCEEDINGS:** On February 9, 2015, Avista Corporation d/b/a Avista Utilities (Avista or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its currently effective Tariff WN U-28, Electric Service. The Company requested authority to increase charges and rates for electric service by approximately $33.2 million or 6.7 percent in billed rates. This matter has been designated by the Commission as Docket UE-150204.

2 Also on February 9, 2015, Avista filed revisions to its currently effective Tariff WN U-29, Natural Gas Service. In this filing, Avista seeks to increase rates for natural gas service by approximately $12 million or 6.9 percent in billed rates. This matter has been designated as Docket UG-150205. In Order 01, Complaint and Order Suspending Tariff Revisions and Order of Consolidation, the Commission suspended these tariff revisions and consolidated Dockets UE-150204 and UG-150205 for hearing.

3 **PARTY REPRESENTATIVES:** David J. Meyer, Vice President and Chief Counsel for Regulatory and Governmental Affairs, Spokane, Washington, represents Avista. Lisa W. Gafken, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Division of the Washington State Attorney General's Office (Public Counsel). Patrick J. Oshie, Jennifer Cameron-Rulkowski, Christopher Casey, and Brett P. Shearer, Assistant Attorneys General, Olympia, Washington, represent the Commission's regulatory staff (Staff).[1]

4 Melinda Davison and Jesse E. Cowell, Davison Van Cleve, P.C., Portland, Oregon, represent the Industrial Customers of Northwest Utilities (ICNU). Chad M. Stokes and Tommy A. Brooks, Cable Huston, Portland, Oregon, represent the Northwest Industrial Gas Users (NWIGU). Ronald L. Roseman, attorney, Seattle, Washington, represents The Energy Project.

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[1] In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See*, RCW 34.05.455.

5 **COMMISSION DETERMINATIONS:** The Commission authorizes Avista to file revised tariff sheets reflecting an electric revenue requirement decrease of $8.1 million or 1.63 percent and a natural gas revenue requirement increase of $10.8 million or 6.3 percent. The Commission approves and accepts the partial, multiparty settlement stipulation (Settlement), including the 7.29 percent rate of return (ROR), the 9.5 percent return on equity (ROE), and the 48.5 percent common equity capital structure. The Commission finds that paragraph 6 of the Settlement, which addresses electric rate spread and rate design for an increase in the revenue requirement, is moot. We adopt an equitable approach to the Company's electric rate spread and rate design that apportions a uniform percentage rate decrease across rate schedules and schedule blocks.

MEMORANDUM

I. Background and Procedural History

6 On February 9, 2015, Avista filed revisions to its currently effective Tariff WN U-28, Electric Service, and Tariff WN U-29, Gas Service. The Company requested authority to increase charges and rates for electric service by approximately $33.2 million, or 6.7 percent in billed rates. The Company also requested a natural gas rate increase of $12 million, or 6.9 percent in billed rates. The Commission suspended operation of the tariffs and consolidated the dockets for hearing.

7 Avista based its initial request on a test year from October 1, 2013, through September 30, 2014. The filing included proposals for the following:

- An overall ROR of 7.46 percent.[2]
- An ROE of 9.9 percent.[3]
- A capital structure consisting of 48.0 percent equity and 52.0 percent debt.[4]
- An attrition adjustment for both its electric and natural gas operations.

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[2] Morris, Exh. No. SLM-1T at 3:4-5 and 3:20-21.

[3] *Id.*

[4] *Id.*

8 On March 12, 2015, the Commission conducted a prehearing conference before Administrative Law Judge Marguerite E. Friedlander. On May 1, 2015, Avista, Staff, Public Counsel, NWIGU, and ICNU filed a partial, multiparty settlement stipulation (Settlement), which is attached to, and incorporated as Appendix C to this order.[5] The Settling Parties filed testimony in support of the Settlement on July 24, 2015.

9 Staff, NWIGU, ICNU, The Energy Project, and Public Counsel filed response testimony and exhibits regarding the remaining issues on July 27, 2015. On September 4, 2015, the Company filed rebuttal testimony and exhibits, while Staff, ICNU, and Public Counsel filed cross-answering testimony and exhibits on select issues. The Commission held public comment hearings in both Spokane, and Spokane Valley, Washington, on September 15, 2015, and September 16, 2015, respectively. In total, the Commission and Public Counsel received 105 comments regarding the proposed rate increases from Washington customers, with 97 comments opposing the increases, no comments supporting the increases, and 8 comments neither supporting nor opposing.[6]

10 On October 5-6, 2015, the Commission convened an evidentiary hearing at its headquarters in Olympia, Washington, to address the remaining contested issues outside of the Settlement. Chairman David W. Danner, Commissioner Philip B. Jones, and Commissioner Ann E. Rendahl were assisted at the bench by Judge Friedlander. Altogether, the record includes more than 250 exhibits admitted during the evidentiary hearing. The transcript of this proceeding exceeds 600 pages in length.

11 On November 4, 2015, Avista, The Energy Project, NWIGU, ICNU, Staff, and Public Counsel filed post hearing briefs.[7]

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[5] *See* Appendix C following this Order. The Energy Project did not join in the Settlement; however, The Energy Project did not file testimony in opposition to the Settlement.

[6] Exh. No. 6.

[7] Staff filed a Motion for Leave to File Supplemental Argument on Brief (Motion) on December 4, 2015. This Motion was denied on December 8, 2015, by Order 04.

II. Settlement Stipulation

A. Terms and Conditions

1. Summary

12 On May 1, 2015, Avista, Staff, Public Counsel, ICNU, and NWIGU filed a Settlement to resolve certain issues pertaining to the Company's cost of capital, power supply, rate spread, and rate design.[8] The effect of the Settlement reduced Avista's requested electric revenue requirement from $33.2 million to $17 million and its requested natural gas revenue requirement from $12 million to $11.3 million.[9] The Settlement provided for a 9.5 percent ROE and an overall ROR of 7.29 percent.[10] The Company agreed to file an updated power supply adjustment two months prior to new electric rates from this proceeding going into effect.[11] The Company's update to the power supply adjustment was filed on October 29, 2015, and reduced the electric revenue requirement by $12.3 million.[12]

13 The Settlement also provided for a further reduction in power supply costs by $1.5 million at the time that the Company provided its update.[13] The Energy Recovery Mechanism trigger remained at $30 million, and the methodology as well as the proper name for the Retail Revenue Adjustment would not change.[14] The Settlement provided for an equal percentage of revenue increase for purposes of spreading the electric and natural gas revenue requirements.[15]

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[8] Settlement, ¶ 3.

[9] Joint Motion for an Order Approving Settlement, ¶ 2.

[10] *Id.*, ¶ 4.

[11] *Id.*, ¶ 5. The statutory effective date of Avista's general rate request in these combined dockets is January 11, 2016.

[12] *Id.*

[13] Settlement, ¶ 5(c).

[14] *Id.*, ¶¶ 5(d) and (e).

[15] *Id.*, ¶¶ 6(a) and 7(a).

14 The settling parties proposed an electric rate design to address any revenue requirement increase the Commission may approve. However, the Settlement did not offer a proposal in the event of an electric revenue requirement decrease. As for the natural gas rate design, the Settlement recommends the following:

- Natural Gas Schedule 101: The Basic Charge would remain at $9.00 per month, and the revenue spread to the volumetric rates on a uniform percentage basis.[16]
- Natural Gas Schedule 146: The Basic Charge would increase from $500 to $525 per month, and the remaining revenue increase spread on a uniform percentage across all blocks.[17]
- Natural Gas Schedules 111: The monthly Minimum Charge based on Schedule 101 rates (breakeven at 200 therms) would increase and a uniform percentage increase spread to all blocks.[18]
- Natural Gas Schedules 121: The monthly Minimum Charge based on Schedule 101 rates (breakeven at 500 therms) would increase and a uniform percentage increase spread to all blocks.[19]
- Natural Gas Schedule 131: A uniform percentage increase spread to all blocks.[20]

2. Joint Testimony in Support of Settlement

15 Avista, Staff, Public Counsel, NWIGU, and ICNU filed Joint Testimony in Support of the Settlement (Joint Testimony) on July 24, 2015. The Company states that the Settlement balances its interests and the interests of its customers on cost of capital, power cost, and rate spread and rate design issues.[21] Staff asserts that the 7.29 percent

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[16] *Id.*, ¶ 7(b)(i).

[17] *Id.*, ¶ 7(b)(ii).

[18] *Id.*, ¶ 7(b)(iii).

[19] *Id.*

[20] *Id.*

[21] Norwood, Exh. No. 2 at 13:7-8.

ROR is reasonable because it is nearly identical to the 7.30 percent ROR the Commission authorized in Docket UE-140762 for Pacific Power & Light Company.[22] Staff states that the testimony of Avista witness Adrien McKenzie is the only ROR testimony in the record, and it supports the settled capital structure.[23] Staff notes that the Settlement's debt level is near the upper end of the proxy group of 20 comparison utilities provided by Mr. McKenzie, which indicates that the equity percentage in the Settlement is not overly generous.[24] According to Staff, the 7.29 percent ROR recommended by the Settlement is only slightly lower than the ROR set in Avista's last general rate case.[25]

16 Staff is particularly satisfied with the modeling corrections and assumption updates to the power supply component of the Settlement, as well as the continuation of the Energy Recovery Mechanism in its present form.[26] While the parties do not agree on a specific cost of service methodology, the Settlement maintains the electric residential basic charge at $8.50 per month, which Staff asserts is consistent with the Commission's preference for basic charges to reflect only "direct customer costs."[27]

17 Public Counsel contends that the Settlement amounts reflect a trend toward declining ROR and ROE for regulated utilities.[28] Public Counsel asserts that the agreement "represents a fair assignment of revenue responsibility for all customer classes."[29] Additionally, Public Counsel points out that the Settlement provides no increases to residential basic charges for electric and natural gas customers despite Avista's initial filing proposing a substantial increase to both.[30]

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[22] McGuire, Exh. No. 2 at 15:15-17.

[23] *Id.* at 15:16-19.

[24] *Id.* at 16:6-10.

[25] *Id.* at 16:18-17:2.

[26] *Id.* at 17:10-12.

[27] *Id.* at 18:10-15 (citing *WUTC v. Pacific Power & Light Company*, Docket UE-140762, Order 08, ¶ 216 (Mar. 21, 2015) [*PPL Order 08*].

[28] Johnson, Exh. No. 2 at 22:11-12.

[29] *Id.* at 23:8-9.

[30] *Id.* at 23: 12-15.

18 NWIGU supports the Settlement because "the agreement reached on capital costs is consistent with the cost of capital approved for other dual fuel utilities in the region."[31] ICNU argues that the agreement is a reasonable outcome that "allows the Commission to devote its full attention to still contested issues."[32] ICNU insists that the proposed reductions to Avista's authorized ROE and ROR are appropriate.[33]

B. Discussion/Decision

19 Pursuant to WAC 480-07-730(3), a multiparty settlement is an agreement by some, but not all, parties on one or more issues that is offered as their position in the proceeding along with the evidence that they believe supports it. The Commission's rules allow non-settling parties, in this instance, The Energy Project, to offer evidence and argument in opposition to the agreement.[34] The Energy Project, the sole non-settling party, has chosen not to avail itself of this opportunity or even to raise an objection to the terms and conditions of the Settlement.

20 The Commission will approve settlements when doing so is lawful, the settlement terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to the Commission. Ultimately, in settlements, as in fully-litigated rate cases, the Commission must determine that the resulting rates are fair, just, reasonable, and sufficient, as required by state law.

21 Thus, the Commission considers the individual components of the settlement under a three-part inquiry. We ask:

- Whether any aspect of the proposal is contrary to law.
- Whether any aspect of the proposal offends public policy.
- Whether the evidence supports the proposed elements of the settlement as a reasonable resolution of the issues at hand.

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[31] Finklea, Exh. No. 2 at 28:2-4.

[32] Mullins, Exh. No. 2 at 25:18-19.

[33] *Id.* at 26:6-8.

[34] WAC 480-07-730(3).

22 The Commission must reach one of three possible results:

- Accept the proposed settlement without condition.
- Accept the proposed settlement subject to one or more conditions.
- Reject the proposed settlement.

23 We find that the terms and conditions of the Settlement are lawful, supported by an appropriate record, and consistent with the public interest in light of all the information available to the Commission. The capital structure as proposed in the Settlement is balanced in treatment of both the Company and ratepayers. Likewise, the ROE and ROR are within the range of reasonable outcomes and supported by testimony in the evidentiary record.

24 The agreement allowed for correction of erroneous power supply expenses caused by an enhancement of the AURORA$_{XMP}$ model that inadvertently reversed the signs so that a gain was reflected as a loss and vice versa. Avista agreed to adjustments to several power supply expenses that resulted in significantly lowering the overall power supply expenses it requested.

25 With regard to the electric rate design, the settling parties arrived at an approach that would spread any revenue *increase* across the various block rates uniformly, with some additional *increases* in various schedule's basic charges. The settling parties did not, however, provide for rate spread or rate design schemes in the event of an electric revenue decrease. No party addressed this issue during the hearing or on brief. Thus, under the circumstances and given the approaching statutory effective date, we find the reasonable and equitable approach is a uniform percentage electric rate decrease across classes and then a uniform percentage decrease across energy blocks within each class. The Commission will entertain a motion to reopen the record in this proceeding for thirty days following the effective date of the rates resulting from this Order, assuming all parties arrive at a stipulated settlement on a modified rate spread and rate design plan. Otherwise, the Company has indicated it plans to file another request for rate relief early in 2016. Any disagreement with the Commission's approved electric rate spread and rate design may be handled in that proceeding.

III. Contested Issues

A. Pro Forma Plant Additions[35]

26 The Company does not present a revenue requirement built on pro forma plant additions to the test year.[36] Instead, it proposes an attrition adjustment supported in part by its "cross-check" study, which is a budget-based projection of plant additions in the year 2016 on an average-of-monthly-averages (AMA) basis.[37] On rebuttal, the Company adjusts its test year ending September 30, 2014, to include booked plant additions through December 31, 2014.

27 Staff, Public Counsel, and ICNU present pro forma plant additions beyond the test year. Public Counsel and ICNU make revenue requirement recommendations using only the modified test year without an attrition study.[38] Staff adjusts the test year to reflect booked plant additions through December 31, 2014. Using this adjusted test year, Staff constructs a modified test year with pro forma plant additions and then presents an attrition adjustment developed from its attrition study. NWIGU does not develop plant additions to the test year, recommending no gas rate increase. We examine each party's pro forma plant additions in turn.

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[35] In its initial case, Avista proposed a pro forma adjustment for Operations and Maintenance (O&M) costs that would be reduced or eliminated in the post-test year period spanning from October 1, 2014, through December 31, 2016. Schuh, Exh. No. KKS-1T at 25:7-9. Avista identified $139,000 in additional O&M offsets after it established its final revenue requirement in this case. Smith, Exh. No. JSS-1T at n.18. These offsets are discussed in detail in the Company's business cases provided as support for its proposed capital additions. Schuh, Exh. No. KKS-1T at 4:18-20. They include, for example, O&M savings related to securing a well water supply for the Kettle Falls Generating Facility, reducing ash abrasion in the facility's ash collector, reducing transmission line losses, and allocating O&M costs for additional parking at the Central Office to all services and jurisdictions. On response, Staff supports the inclusion of these additional O&M offsets in its recommended O&M offsets adjustment. Hancock, Exh. No. CSH-1T at 29:17-19. Consistent with Commission practice and Staff's recommended pro forma capital additions as approved herein, the Commission accepts Staff's recommended O&M offsets adjustment.

[36] Norwood, Exh. No. KON-1T at 28:7-12.

[37] *Id.* at 28:7-15.

[38] ICNU and Public Counsel use the electric plant additions on an AMA basis for test year ending September 30, 2014, while Public Counsel recommends natural gas plant additions on an end-of-period (EOP) basis for the test year ending September 30. 2014.

28 Mr. Christopher Hancock, testifying for Staff, provides a comprehensive review of the Commission rulings on pro forma plant additions and sets forth four criteria for its review.[39] According to his approach, plant additions must be:

- major and discrete,
- known and measurable with any offsetting factors included,
- used and useful, and
- prudently incurred.

29 Mr. Hancock proposes Washington-allocated electric pro forma plant additions of $56.7 million and natural gas pro forma plant additions of $16.2 million.[40] Staff also contests the prudence of $12 million in Project Compass expenses, as discussed later in this Order.

30 For a definition of a major plant addition, Mr. Hancock relies on the recent order resolving Pacific Power & Light Company's general rate case in which the Commission referenced the definition of "major" found in the Commission's rule on budgets.[41] That rule defines "major" as 0.5 percent of net utility plant in service.[42] Using this definition, Staff defines major plant additions as electric plant additions larger than $6.3 million and natural gas plant additions larger than $1.2 million. Staff applies this criterion to the Company's Expenditure Requests (ERs) and selects 14 ERs as meeting the major plant addition threshold.[43] Staff provides extensive review of these projects using a June 30, 2015, cutoff date, not as a bright-line cutoff, but rather because the procedural schedule prevents Staff from auditing book entries beyond June 30.[44] Staff includes in its pro forma plant additions booked amounts less than the dollar threshold of the major plant addition.

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[39] Hancock relies on the Commission's Order in the 2014 PacifiCorp general rate case for guidance for these criterion. *PPL Order 08*, ¶¶ 150, 170.

[40] Hancock, Exh. No. CSH-1T at 21 (Table 4).

[41] *Id.*

[42] *Id.* at 12:1-21. The formula in the WAC is 0.5 percent of Washington-allocated net utility plant in service. WAC 480-140-040.

[43] Gomez, Exh. No. DCG-1T at 13:1-8. These 14 ERs comprise $276.7 million (almost 62 percent) of Avista's total estimate of its as-filed system-level capital additions for 2015. Hancock, Exh. No. CSH-1T at 13:4-17.

[44] *Id.* at 21:8-23:15.

31 On behalf of Public Counsel, Ms. Donna Ramas accepts an increase of approximately $56 million in electric plant and $17.24 million in natural gas plant for the pro forma addition of three capital projects that are in service by May 31, 2015.[45] Due to the on-going nature of the Aldyl-A pipe replacement project, Ms. Ramas states that the Commission could include costs after her cut-off date of May 31, 2015, provided they are fully supported by the Company.[46] Acknowledging that the pipe replacement project does not technically meet her definition of a "discrete" major plant addition, she recommends its inclusion as a measure to address the consistent underearnings for Avista's natural gas operations.[47] In cross answering testimony, Mr. Hancock clarifies that Staff supports the inclusion of Aldyl-A pipe replacement because it is known and measurable, used and useful, prudent, and major, rather than as a mechanism to alleviate attrition.[48]

32 Mr. Bradley Mullins, testifying for ICNU, recommends only one pro forma plant addition, Project Compass. He discusses and rejects five other projects for a combination of reasons. First, Mr. Mullins defines major plant as projects with $10 million in planned costs, stating that it is "a natural threshold in the Company's filing."[49] Mr. Mullins further limits pro forma adjustments by excluding what he labels "blanket" capital additions consisting of many unrelated projects that are not a single discrete project.[50] He rejects pro forma additions where the Company's updates of the project costs have considerable variability.[51] Finally, Mr. Mullins applies the $10 million threshold to booked amounts, excluding plant additions if the booked amounts are below $10 million.[52] Staff criticizes Mr. Mullin's approach as a double application of the major plant definition and as the $10 million threshold having no relationship to the size of the utility.

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[45] Ramas, Exh. No. DMR-1CT at 57:17-58:5. These pro forma plant additions include Clark Fork Protection, Mitigation and Enhancement, Project Compass and Aldyl-A pipe replacement.

[46] *Id.* at 60:15-61:3.

[47] *Id.* at 60:18-61:3.

[48] Hancock, Exh. No. CSH-9T at 4:16-5:7.

[49] Mullins, Exh. No. BGM-1CT at 24:4-10.

[50] *Id.* at 25:22-26:3. Mr. Mullins provides an example of a blanket capital item: Technology Refresh to Sustain Business Process is "for routine replacements of and upgrades to existing applications and hardware." *Id.* at 25:2-3.

[51] *Id.* at 26:4-11.

[52] *Id.* at 27:3-7.

33 Testifying for NWIGU, Mr. Michael Gorman concludes that no change in natural gas rates is justified and therefore does not support any pro forma capital additions to the test year.

34 On rebuttal, Avista witness Mr. Kelly Norwood does not address the standards the intervenors use for determining pro forma plant additions. Instead, he claims intervenors had ample time to audit the planned plant additions through 2016.[53] In rejecting intervenors' modified test year, Mr. Norwood stresses that the modified test year with limited pro forma adjustments will not provide a sufficient revenue requirement.[54] He contrasts the revenue requirement developed with pro forma plant additions to Avista's cross-check study that uses projected budget amounts to produce a considerably higher level of capital addition in the 2016 rate year.[55] Mr. Norwood also supports this conclusion based on the preponderance of the Company's testimony that demonstrates attrition, including citing to Staff's testimony that the Company is suffering attrition.[56]

35 *Decision.* The Commission's long-standing practice is to set rates using a modified historical test year with post-test year adjustments following the used and useful and known and measurable standards while exercising the considerable discretion these standards allow in the context of individual cases.[57] We do not waiver from that approach now. In a rate proceeding with claims of attrition-related earnings erosion, it is necessary to first develop a modified test year upon which the addition of an attrition adjustment may be considered.

36 The post-test year plant additions proposed by Staff, Public Counsel, and ICNU are based upon known and measurable plant additions that occurred during, or reasonably soon after, the test year. Between the test year results and post-test year plant additions, these parties' pro forma studies provide a firm ground for determining the level of revenue requirement.

37 Unlike the Company's cross-check study, the plant additions proposed by other parties are not an estimate, projection, budget forecast, or some similar exercise of judgment – even informed judgment. We decline to rely on broad budget projections. The unreliability of the Company's budget projections is evidenced by the large difference

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[53] Norwood, Exh. No. KON-1T at 12:3-11.

[54] *Id.* at 2:20-27.

[55] *Id.* at 28:7-29:12.

[56] *Id.* at 20:1-23.

[57] *See WUTC. v. Pacific Power & Light Co.*, Docket UE-130043, Order 05, ¶ 198 (Dec. 4, 2013).

between the Company's projections for fourth quarter 2014 and the plant additions actually booked in the fourth quarter.

38 In establishing revenue requirements for electric and gas operations, our first step will be to use a modified historical test year to construct rates. This serves as the benchmark, or for cross-checking purposes, if the Commission chooses to exercise its discretion to apply an attrition adjustment beyond the modified test year amounts. We continue to rely on a modified historical test year because it provides known and measurable costs and rate base amounts to which the attrition adjustment can be added in proportion to the level of attrition the Company is expected to experience.

39 Staff adjusts the test year ending September 30, 2014, to reflect the booked plant additions for the fourth quarter 2014, as reported in the Company's Commission Basis Report. In the context of setting rates under conditions of attrition or regulatory lag, this approach is useful in providing known and measurable information in formulating a revenue requirement.

40 Staff's proposed threshold for major plant additions relies on an established rule, albeit one established in a somewhat different setting. It has, however, the advantage of being proportional to the size of the Company's rate base and therefore relevant to the issue of the financial impact on the Company in the setting of rates. We find it reasonable to set the threshold in proportion to a company's rate base. In the instant case, we find it reasonable to use the one-half of one percent threshold.

41 The parties disagree over a consistent, usable definition of a discrete plant addition. Public Counsel criticizes Staff's pro forma addition of Information Technology Refresh to Sustain Business Process as consisting of multiple, separate projects.[58] We heed Public Counsel's caution regarding the use of non-discrete, blanket capital projects as pro forma plant additions. However, Public Counsel itself recommends an exception to allow the pro forma plant addition of the blanket Aldyl-A pipe replacement project, albeit to address chronic under earning. It is that very task the Commission is faced with here in setting rates. Staff's reliance on and careful auditing of the Company's ERs meet our purpose of providing results for a modified test year that are known and measurable.

42 Staff's definition of major plant results in the inclusion of a significant number of projects representing a large portion of the total plant additions after the test year. Staff proposes to include $56.7 million of electric plant additions and $16 million of natural

[58] Ramas, Exh. No. DMR-26T at 14:1-16:9.

gas plant additions, comprising approximately 41 and 47.5 percent, respectively, of Avista's projected major 2015 plant additions.[59]

43 ICNU's proposed $10 million dollar threshold is not supported by any discernible principle. ICNU does not define what it means by "natural," and we do not find a compelling reason to adopt its threshold. Ms. Ramas does not propose a threshold in conjunction with her proposed major plant additions. NWIGU proposes no plant additions.

44 Staff uses June 30, 2015, as a practical cutoff date in this proceeding, which we find to be reasonable given the circumstances of this case. The rigor with which Staff audited the post-test year plant additions provides us confidence in the known and measurable nature of the plant additions Staff recommends allowing. The rigor of Staff's audits should not be compromised in an effort to reach a cutoff farther past the test year.

45 For each of its identified major plant additions, Staff includes in rate base the dollar amount of plant Avista placed in service as of June 30 even if the amount is below Staff's $6.3 million electric or $1.2 million natural gas threshold for its definition of major plant additions. ICNU argues that projects should not qualify as major plant additions unless the proposed project and the amount placed in service is above the threshold. We do not find such a double application necessary in the circumstances of this case. The booked amounts, thoroughly audited, provide that basis for our purposes in this proceeding.

46 Accordingly, we find Staff's method for pro forma plant additions for both electric and gas operations to be well principled and appropriately audited. We accept the booked amounts for inclusion in rates, namely $56.7 million for electric and $16 million for gas operations. We also approve Staff's adjustment updating the test year to reflect the results of the 2014 Commission Basis Report.

B. Attrition

47 Of all the issues Avista raises and to which the other parties responded in this proceeding, none has more direct bearing on consumer rates than the Company's proposal to include adjustments for attrition to its electric and gas operations. As we discuss further below, attrition occurs when the test-period relationship between rate base, expenses and revenues does not hold under conditions in the rate effective period, such that a utility's expenses or rate base grows more quickly than revenues, and a utility would likely have

[59] Hancock, Exh. No. CSH-1T at 20:9-21:6.

no reasonable opportunity to earn its allowed rate of return. An attrition adjustment is a discrete adjustment to the modified historical test year that the Commission may use when it determines attrition is present.[60]

48 The primary issues we must resolve concerning attrition in this case are 1) the appropriate criteria for determining whether an attrition adjustment is warranted; 2) the appropriate methodology for an attrition study; and 3) whether Avista has met its burden of proof to justify granting an attrition adjustment for both electric and natural gas rates.

49 A rich history of Commission orders dating back to the late 1970's provides useful examples and several criteria for whether to grant attrition adjustments. In addition, this case presents us with the most extensive record of testimony and evidence concerning attrition adjustments since the early 1990's, including detailed discussion of methodology and criteria. We first discuss the history of attrition decisions before turning to the parties' presentations and arguments.

1. Historical Context

a. Attrition Adjustments Prior to 2011

50 From 1978 to 1993, the Commission received and considered requests for attrition adjustments from all electric investor-owned utilities and several natural gas distribution companies in the state. In a number of these cases, the Commission stated that attrition adjustments are designed to address vastly different rates of growth in revenues, expenses, and rate base.[61] While inflation was the single most common rationale for the approval of attrition adjustments during that time period,[62] the Commission also relied on

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[60] When developing an attrition adjustment, parties first provide a revenue requirement analysis based on a modified historical test year. Parties then perform an attrition study to determine the utility's revenue requirement in the rate year. The attrition adjustment is the difference between the revenue requirement provided by the modified historical test year and the revenue requirement provided by the attrition study.

[61] See *e.g.*, *WUTC v. Washington Natural Gas*, Docket UG-920840, 4th Supp. Order at 29 (Sept. 27, 1993); *WUTC v. Washington Water Power*, Cause U-82-10/11, 2nd Supp. Order, at 31 (Dec. 29. 1985); *WUTC v. Pacific Power and Light*, Cause U-83-33, 2nd Supp. Order, at 29 (Feb. 9, 1984); *WUTC v. Washington Water Power*, Cause U-84-28, 2nd Supp. Order at 19-20 (Jan. 10, 1985); *WUTC v. Pacific Power and Light*, Cause U-86-02, 2nd Supp. Order at 32-33 (Sept. 19, 1986).

[62] *WUTC v. Washington Natural Gas*, Cause No. U-80-111, 3rd Supp. Order (Sept. 24, 1981); *WUTC v. Puget Sound Power and Light*, Cause *No.* U-81-41, 2nd Supp. Order (Mar. 12, 1982);

the following criteria or bases, in part or in whole, in deciding whether to grant attrition adjustments:

- Severe challenges to the utility's financial integrity,[63]
- An exceptionally large amount of production plant construction,[64]
- Increasing expenses and decreasing sales,[65]
- Higher costs of future securities issues,[66] and
- The lack of a reasonable opportunity for a utility to earn its allowed rate of return.[67]

51 In 1993, in the last case in which the Commission addressed attrition until 2012, the Commission rejected Washington Natural Gas' request for an attrition adjustment in its general rate case, stating that attrition adjustments should only be made in "extraordinary circumstances" when "without such an adjustment, the company would have no reasonable opportunity to earn its authorized rate of return."[68]

WUTC v. Pacific Power and Light, Cause U-82-12/35, 4th Supp. Order (Feb. 2, 1983); *WUTC v. Washington Water Power*, Cause U-84-28, 2nd Supp. Order (Jan. 10, 1985); *WUTC v. Pacific Power and Light*, Cause U-84-65, 4th Supp. Order (Aug. 2, 1985); *WUTC v. Pacific Power and Light*, Cause U-86-02, 2nd Supp. Order (Sept. 19, 1986); *WUTC v. Washington Natural Gas*, Docket UG-920840, 4th Supp. Order (Sept. 27, 1993).

[63] *WUTC v. Washington Water Power*, Cause U-81-15/16, 2nd Supp. Order (Nov. 25, 1981); *WUTC v. Puget Sound Power and Light*, Cause U-82-38, 3rd Supp. Order (July 22, 1983).

[64] *WUTC v. Washington Water Power*, Cause U-81-15/16, 2nd Supp. Order (Nov. 25, 1981); *WUTC v. Washington Water Power*, Cause U-82-10/11, 2nd Supp. Order (Dec. 29. 1985); *WUTC v. Puget Sound Power and Light*, Cause U-82-38, 3rd Supp. Order, at 29 (July 22, 1983); *WUTC v. Washington Water Power*, Cause U-84-28, 2nd Supp. Order (Jan. 10, 1985).

[65] *WUTC v. Washington Natural Gas*, Cause U-82-22/37, 3rd Supp. Order (Dec. 29, 1982).

[66] *WUTC v. Washington Water Power*, Cause U-81-15/16, 2nd Supp. Order (Nov. 25, 1981); *WUTC v. Pacific Power and Light*, Cause U-81-17, 2nd Supp. Order (Dec. 16, 1981); *WUTC v. Puget Sound Power and Light*, Cause U-81-41, 2nd Supp. Order (Mar. 12, 1982).

[67] *WUTC v. Washington Water Power*, Cause U-82-10/11, 2nd Supp. Order, at 31 (Dec. 29. 1985).

[68] *See WUTC v. Wash. Natural Gas*, Docket No. UG-920840, 4th Supp. Order at 30 (Sept. 27, 1993).

b Contemporary Treatment of Attrition

52 The Commission did not address attrition again in the context of a general rate case until 2012. While Puget Sound Energy (PSE) did not request an attrition adjustment in its 2011 general rate case, Staff raised the issue and suggested that PSE should have prepared an attrition study to support an attrition adjustment. The Commission observed that attrition adjustments were "available to utilities during the early 1980's in an environment of exceptional inflation and high interest rates [, and are] equally available today if shown to be a needed response to the challenges posed by PSE's current intensive capital investment program to replace aging infrastructure."[69] The Commission further noted in its order that:

> Earnings attrition is not an issue new to regulation nor are various regulatory solutions to the problem. The phenomenon is well documented and examined in regulatory texts. It has been addressed variously by state utility commissions since the early 1960s. The formal definition of "attrition" in the context of utility ratemaking is limited to circumstances in which key assumptions that underlie ratemaking theory fail to hold in reality. Regardless whether an historical or budgeted test-period is used, the relationship between rate base, expenses and revenues is used to represent the future and to set prospective rates adequate to allow a reasonable return. Ratemaking rests on the key assumption that the test-period relationships will accurately represent relationships in the future. If this assumption fails, cost of service may increase more rapidly than revenues and the rates approved based on test period conditions may not be adequate to achieve the allowed level of return under future conditions.[70]

The Commission has since discussed the issue of earnings attrition and how to address it in the last two general rate cases brought by Avista.

53 In Avista's 2012 general rate proceeding, a central element of the Company's proposed increase to rates was, largely, its contention that it was unable to achieve its authorized

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[69] *See WUTC v. Puget Sound Energy*, Dockets UE-111048/UG-111049, Order 08, ¶ 489 (May 7, 2012) [*PSE Order 08*].

[70] *PSE Order 08* at ¶ 490 (original footnotes omitted).

rate of return as a result of attrition.[71] In joint testimony supporting a settlement of all contested issues in that case, the Company and Staff specifically stated that the settlement's revenue requirement for electric and natural gas operations were based on attrition.[72] The settlement also established a multi-year rate plan.

54 In its order approving the settlement the Commission stated:

> The Commission finds, on the basis of the evidence presented, that consideration of attrition in setting rates for 2013 is appropriate. However, the attrition is caused substantially by Avista's ongoing capital investment program, and we have no absolute assurance that Avista will complete the projects described in its plan for 2013.[73]
>
> While we find the arguments of some of the settling parties persuasive that attrition will continue into the very near future, including the 2014 calendar year, we are basing our temporary approval of the 2014 rates on the Company's representations of these continued capital investments.[74]
>
> The record evidence supports a finding of attrition in the near term; however, we refuse to endorse either of the different attrition methodologies employed in this case. Instead, we will take the issue up in a subsequent inquiry to explore the issue further. The Commission accepts the remainder of the Multi-Party Settlement Stipulation (Settlement), including the stipulated return on equity (ROE) and capital structure; noting, however, that the overall trend for ROEs has been edging downward.[75]

55 Although the Commission approved the agreement including its inherent elements reflecting the Company's and Staff's position on attrition, the Commission was also cautious in explaining its approval, noting:

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[71] *See WUTC v. Avista Corp.*, Dockets UE-120436 and UG-120437 (consolidated), Order 09 and Dockets UE-110876 and UG-110877 (consolidated), Order 14, (Dec. 26, 2012) [*Avista Orders 09 & 14*].

[72] Although other parties, including Public Counsel and ICNU, supported the settlement they did not specifically concede to whether the agreed-upon revenue requirements account for the effects of attrition.

[73] Avista Orders 09 & 14, ¶ 10.

[74] *Id.*, ¶ 11.

[75] *Id.*, ¶ 12.

> Historically, the Commission has approved attrition adjustments in the context of litigated rate cases, although the Commission has not ruled on such an adjustment in recent years. Such a context permits a thorough review of the evidence necessary for an appropriate adjustment. In the context of this Settlement, however, we have not had the opportunity either to articulate the appropriate standards by which to assess a proposed attrition adjustment nor evaluate thoroughly the evidence in support of such an adjustment. Here, both the Company and Staff performed attrition studies to project 2013 rates. We agree with the Company and Staff that the proposed 2013 rate increase is based significantly on attrition.[76]
>
> Much of the attrition is based on continued capital investment by Avista. The Company has put forth its 2013 capital construction plan, and its representation that it will continue to make such needed investments in upcoming years. However, we deem it desirable to monitor the Company's progress in achieving its plan for capital expenditures so that the ratepayers can be assured that the rate increase designed to assist the Company in making those investments can continue to be justified.[77]
>
> While the Company and Staff have each submitted attrition studies that justify the 2013 increase, they did not submit such studies for the 2014 increase, which also is justified substantially on anticipated continued attrition. Rather, they argue that the trends of attrition from 2013 will continue through 2014, thereby justifying a further rate increase. For the purposes of this Settlement, we accept the trending analysis from both Staff and Avista. *However, we make clear that the testimony and trending data offered in support of the proposed rate increase for 2014 are substantially less precise than we would require in a fully-litigated rate case.*[78]

56 Notwithstanding its decision to approve a settlement that intrinsically addressed some parties' perspective on an adjustment for attrition, the Commission articulated caution about any express or implied endorsement of a particular basis, such as use of budgeted capital expenditures or expense escalation rates, beyond the test year as a means of support, in whole or in part, for projected attrition claims. In particular, while considering

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[76] *Id.*, ¶ 70.

[77] *Id.*, ¶ 71.

[78] *Id.*, ¶ 72 (emphasis added).

attrition claims beyond the first year of a multi-year rate plan and the inherent opacity of approving a settlement, the Commission noted:

> In conditionally approving the Settlement, we are not endorsing the specific attrition methodologies, assumptions, or inputs used in this case. Indeed, Commission Staff witness Kathryn Breda cautioned us about using her analysis as the model for future attrition decisions. Though we agree with Commission Staff that an attrition adjustment should not be limited to circumstances where the utility can demonstrate extreme financial distress, as advocated by Public Counsel, we intend to clarify the conditions wherein attrition should be considered when setting rates. As noted above, the Settlement has limited our opportunity to do so here.[79]

57 Subsequent to Avista's 2012 general rate proceeding and implementation of a multi-year rate plan, the Commission authorized PSE to implement a decoupling mechanism and rate plan that included an implicit attrition adjustment. There the Commission noted:

> As in the Avista case, we determine that the trending analysis on which PSE bases the rate plan escalation factors supports their approval as an appropriate measure to address earnings attrition going forward. That is, PSE's analysis of actual historical trends in the growth rates of revenues, expenses, and rate base to estimate the erosion in rate of return caused by disparate growth in these categories that PSE will experience absent application of these escalation factors supports the adjustments.
>
> Finally, again as in Avista, there are other factors that support the "end result" in terms of rates that will be established, in part, based on the rate plan escalation factors. 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 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.[80]

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[79] *Id.*, ¶ 73. (original footnotes omitted).

[80] *WUTC v. Puget Sound Energy*, Dockets UE-121697/UG-121705 & UE-130137/UG-130138 (consolidated), Order 07, ¶¶ 149-150 (June 25, 2013) (footnotes omitted) [*PSE Order 07*].

58 The Commission continued:

> The use of fixed annual escalation factors to adjust PSE's rates is a viable approach to reduce the impacts of regulatory lag and attrition during a multi-year general rate case stay-out period. The escalation factors provide PSE an improved opportunity to earn its authorized return, but are set at levels that will requires PSE to improve the efficiency of its operations if it is to actually earn its authorized return. This is a critically important consideration underlying our approval of the rate plan.[81]

59 Avista initiated a general rate proceeding in 2014 that also hinged in part on the Company's attrition claims.[82] As before, and despite contemporaneous implementation of a multi-year rate plan intended to ameliorate claimed earnings deficiencies, Avista maintained that it was experiencing attrition and that the decline in earnings was expected to be an ongoing condition beyond its control. In support of its claim, the Company prepared an attrition study that produced an historical trend of its expenses, revenue and rate base and the impact of that trend on its earnings to derive its alleged revenue deficiency.

60 In response testimony in that proceeding, Staff adopted a similar trending method identifying projected expense levels that Staff proposed the Commission use to set rates. Public Counsel strongly opposed Avista and Staff's trending methodologies, suggesting that the attrition studies' results are due to the Company's own internal decisions to accelerate capital expenditures. ICNU also opposed the use of attrition by pointing out that the Commission had not approved a methodology nor had the Company satisfied its burden necessary to justify a change in the Commission's normal practice of setting revenue requirements.

61 Presented with a full settlement that did not resolve all contested issues, the Commission reached no conclusion regarding attrition:

> Since the parties do not agree that an attrition adjustment is included within the Settlement or whether an attrition adjustment is appropriate at all, we do not deliberate on the merits of any position on the issue presented in this case.[83]

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[81] *Id.* ¶ 171.

[82] *See WUTC v. Avista Corp.*, Dockets UE-140188 and UG-140189 (consolidated), Order 05 (Nov. 25, 2014).

[83] *Id.*, ¶ 49.

c Commission Treatment of Attrition

62 From the discussion above, it is clear that, historically, the two most common sources of earnings attrition in Washington are abnormal or excessive inflation and exceptional and prolonged levels of plant additions. A discrete attrition adjustment, in the manner offered by the Company and Staff, is but one of a number of possible methods the Commission could authorize to address a demonstrated trend of under earning. Outside of the context of a discrete attrition adjustment, the Commission has been open to and employed other mechanisms to address regulated utility contentions of earnings deficiency. Such mechanisms include:

- Pro-forma adjustments of test-year data to reflect known and measurable changes in conditions or costs incurred subsequent to the end of the test-year.
- Use of plant accounts (rate base) measured at the end, or subsequent to the end of the test-year rather than the test-year average.
- Inclusion of construction work in progress (CWIP) in rate base providing a return on investment prior to when the new plant goes into service.
- Upward adjustment to the equity share in the capital structure.

63 Notwithstanding these means to address the test year relationship of costs and revenues into the future for purposes of setting rates, the Commission has, both directly and indirectly, approved attrition adjustments in previous rate proceedings including multi-year rate plans, considering the specific circumstances of those cases.

64 In the PSE's 2011 rate proceeding, the Commission provided a reasoned path for a utility to pursue an explicit attrition adjustment where there is a clear and well-established demonstration that attrition exists for reasons clearly beyond the direct control of a company. In 2013, the Commission approved a proposal by PSE to implement decoupling, an expedited rate filing and a rate plan that included an escalation factor characterized as an attrition adjustment.[84] The Commission did so recognizing that attrition and rate plans would remain a central element of subsequent rate proceedings.

65 In both the 2012 and 2014 Avista rate proceedings, the parties were able to reach some agreement on rates. In those proceedings, the Commission was not required to endorse

[84] *PSE Order 07*, ¶¶ 146, 149-150.

any specific methodology for establishing rates using an attrition adjustment. Although we are presented with a multiparty partial Settlement on other issues in this proceeding, it is clear there is no agreement on the extent to which Avista suffers from attrition in either its electric or gas operations, nor is there consensus between the Company and Staff on the exact method for determining the extent of any reasonable attrition adjustment. As a result, and unlike the recent rate proceedings, we must conduct a closer examination of the evidentiary record in determining whether and how to authorize an attrition adjustment.

66 With that background and context in mind, we turn to the facts and circumstances of this proceeding in considering whether any adjustment for the effects of attrition is warranted at this time.

2. Positions of the Parties

a. Avista

67 In direct testimony, Mr. Scott Morris leads Avista's presentation of its need for an attrition adjustment. He states that the primary reason the Company requests a rate increase in this case is because its growth in net plant investment and operating expenses outpaces its growth in revenue.[85] He presents trends showing the growth of the combined electric and natural gas actual and forecasted spending for plant additions and operating expenses over a 14-year period.[86] He argues that net plant is growing at a much faster pace than sales, thus creating a mismatch between the ratio of plant investment to revenues in the test period and the ratio of plant investment to revenues in future years.[87] Mr. Morris asserts that Avista's "obligation to serve customers with safe, reliable service, and maintain a high level of customer satisfaction demands continued investment in facilities, as well as utility operating expenses necessary to accomplish these objectives."[88]

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[85] Morris, Exh. No. SLM-1T at 10:12-14.

[86] *Id.* at 11.

[87] *Id.* See also pages 6, 8, and 9 showing graphs of the steady rise of inflation adjusted electric plant investment, the decline in use-per-customer since the late 1970's, and the increase in retail rates that also began in the late 1970's.

[88] *Id.* at 10:14-17.

68 Based on Mr. Morris's testimony of these trends, Avista presents an attrition study for electric and natural gas operations through the testimony of Dr. Grant Forsyth, and an attrition adjustment to its modified test year developed in Ms. Elizabeth Andrews' testimony.[89] The Company buttresses its attrition adjustment with a pro forma plant additions "cross check analysis" presented by Ms. Jennifer Smith and Ms. Karen Schuh.[90]

69 Mr. Norwood presents Company-wide earnings from its Commission Basis Reports (CBRs) over the 2008-2014 timeframe showing that, from Avista's perspective, the Company earned less than its authorized ROE until 2013.[91] Mr. Norwood states that the Company's level of earned ROE for 2013 and 2014 of 9.5 and 9.9 percent, respectively, is the result of revenue increases approved by the Commission and that the increases reflect some recognition of attrition.[92] The earned ROEs for both years were very close to the Company's authorized ROE of 9.8 percent.[93]

70 In support of the Company's attrition claims, Dr. Forsyth presented a study that develops a revenue requirement using normalized CBRs to determine trends in expenses and rate-base additions after the removal of normalized net power supply costs for electric customers and purchased gas costs for retail natural gas customers. The trends are used to construct escalation rates for various types of accounts such as administrative and general expenses, operations and maintenance (O&M) expenses, and rate base.[94]

71 On direct, Dr. Forsyth presents the use of a compounding growth rate factor (CGF) in the attrition study.[95] Further, Dr. Forsyth uses 2007-2013 as the time period for determining escalation rates. He presents data spanning 2001 to 2013, pointing out what he calls a "kink point" in 2007 showing an increase in the rate of plant additions.[96] Concluding that the rate of plant additions from 2007 through 2013 is generally similar and represents the

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[89] Forsyth, Exh. No. GDF-1T; Andrews, Exh. No. EMA-1T.

[90] Smith, Exh. No. JSS-1T; Schuh, Exh. No KKS-1T.

[91] Norwood, Exh. No. KON-1T at 16:11-20.

[92] *Id.* at 15:18-22.

[93] *Id.*

[94] Andrews, Exh. No. EMA-1T at 13:12-14:1.

[95] However, on rebuttal Avista abandons the use of the CGF and adopts Staff's recommendation to use a least-squares linear regression for calculating growth trends.

[96] Forsyth, Exh. No. GDF-1T at 4:15-5:15.

expected future rate of plant investment, he recommends the 2007-2013 time period for use in Avista's attrition study.[97]

72 Based on the time period data that Dr. Forsyth advocates, he develops plant escalation rates. However, rather than use the escalation rates from Dr. Forsyth's analysis to escalate plant amounts from 2014 to 2016, Ms. Andrews uses an escalation rate based on Avista's projected budgeted plant additions included in its pro forma cross check study. As Ms. Andrews explains, the Company's budgeted rate of plant additions from 2014 to 2016 is higher than the annual growth rate derived from the 2007-2013 time period in the attrition study, requiring, in her opinion, the use of an escalation rate based on the rate of Avista's planned plant additions from 2014 to 2016.[98]

73 Finally, Avista uses load projections rather than attrition derived growth rates for its projected revenue growth. Avista's load growth assumptions project an increase in electric revenue growth of 1.31 percent and a decline in natural gas revenue growth of 0.99763 percent in 2016.[99]

b. Staff

74 Staff's witness, Mr. Christopher McGuire, testifies that Avista's electric and natural gas operations suffer from attrition that is severe enough to require an attrition adjustment. Mr. McGuire presents his own attrition study, which is based on the structure of Avista's attrition study submitted on direct, but includes a number of significant methodological differences. Mr. McGuire states that the Company is experiencing attrition predominantly due to large capital investments in distribution plant.[100] While Mr. McGuire questions whether Avista has justified its level of capital investment, Mr. McGuire supports

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[97] *Id.* at 4:15-5:19. On rebuttal, Avista holds to the use of this historical time period for purposes of trending rate base and expenses forward to 2016. By the close of the case, both Avista and Staff use historic data in their respective attrition analyses from normalized CBRs to develop trends, or escalation factors, that are applied to restated test year amounts to escalate expenses and rate base to the 2016 rate year. Avista and Staff use the 2014 CBR ending December 31, 2014, to restate the test year that otherwise ends September 30, 2014, essentially using the 2014 CBR as a basis for escalating costs to 2016 levels. Avista and Staff also use load forecasts to derive retail revenue levels for 2016.

[98] Andrews, Exh. No. EMA-1T at 29:1-32:5.

[99] *Id.* at 32:16-17; 33:15-16.

[100] McGuire, Exh. No. CRM-1T at 20:11-16.

Avista's need for an attrition adjustment and discusses the Commission's decisions in previous cases supporting an attrition adjustment.[101]

75 Mr. McGuire asserts that Avista's initial attrition study is obsolete due to changes resulting from the Settlement and the identification of significant errors. He states:

> [A]lthough the Company refers to its case as an "attrition" case, it is in reality a re-branded future test year case. Rather than perform an objective trending analysis to ascertain prevailing rates of growth in the business, Avista developed future test year results for both a) net plant and b) depreciation/amortization, and then circularly calculates its "attrition" growth rates to reproduce those future test year results. Avista in no way actually uses Dr. Forsyth's calculated attrition growth rates for net plant and depreciation/amortization in its attrition studies. If Avista had used Dr. Forsyth's (i.e. the Company's own witness's) growth rates for net plant and depreciation/amortizations, the revenue requirement increases are only $404,000 for electric service and $8,220,000 for natural gas service.
>
> It's worth emphasizing here that the Company's *entire* proposed electric revenue requirement increase is due to rejecting Dr. Forsyth's growth rates for net plant and depreciation/amortization and instead using speculative future test year levels for those two items.[102]

76 Mr. McGuire uses the 2009-2014 time period as the basis of his attrition analysis rather than the Company's 2007-2014 time period. In his written testimony, Mr. McGuire asserts that changes to weather normalization methodology made in the years 2007 and 2008 makes the data from those years incompatible with the data from 2009-2014.[103] At hearing he concedes that the 2007-2014 time period closely represents the attrition the Company is likely to experience from 2014 to 2016, and that there is very little difference between his original time period and the Company's.[104]

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[101] *Id.* at 5:13-20; 29:9-33:15.

[102] *Id.* at 45:6-19 (emphasis and underlining in original).

[103] McGuire, Exh. No. CRM-1T at 37:19-38:2.

[104] McGuire, TR 462:10-463:18; 481:9-15.

77 Mr. McGuire also replaces the Company's budget estimates for the fourth quarter of 2014 with booked actuals from the Company's CBR.[105] Further, Mr. McGuire rejects the Company's use of a CGF and instead uses least-squares linear and quadratic regression for calculating growth trends.[106] Mr. McGuire asserts that for electric service, the data across the period 2009-2014 is largely linear and CGF functions used by the Company are in no way related to the shape of the underlying data.[107]

78 Staff asserts that the escalation rate from Avista's attrition study, based on the 2009-2014 time period, is not representative of Avista's current growth rate for O&M expenses.[108] Staff believes that Avista's current O&M expense growth rates are lower as a result of cost-cutting measures instituted after 2012.[109] To reflect the recent changes, Staff developed an escalation rate that is the arithmetic average of the one-year trend in O&M expense from 2013 to 2014 and the Company's O&M escalation rate of 3 percent presented in its direct testimony.[110]

79 Staff's 2013-2014 trend analysis resulted in a 1.82 percent growth rate for electric O&M expense and a 1.34 percent growth rate for natural gas O&M expense.[111] Averaged with the Company's growth rate of 3 percent, this produces Staff's proposed O&M expense growth rate of 2.42 percent for electric and 2.17 percent for natural gas.[112]

80 Staff's attrition study at the time it filed responsive testimony produces an attrition allowance of $14.7 million for the electric revenue requirement and $5.4 million for the natural gas revenue requirement.[113]

81 Mr. McGuire notes that Avista's growth in net plant investment is driven largely by growth in distribution plant.[114] While he does not dispute the prudence of any individual

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[105] McGuire, Exh. No. CRM-1T at 48:13-18.

[106] *Id.* at 50:6-9.

[107] *Id.* at 49:19-50:9; 51:3-4.

[108] *Id.* at 39:9-14.

[109] *Id.* at 39:9-14.

[110] *Id.* at 40:8-17. Arithmetic average is the equal weighting of each term that is being averaged.

[111] *Id.* at 40:3-5.

[112] *Id.* at 40:12-17.

[113] *Id.* at 8:16-17; 43:14-17.

[114] *Id.* at 20:14-15. (Emphasis removed).

distribution plant investments presented in this case, Mr. McGuire questions the need for the Company to "invest heavily" in distribution plant because the Company has not provided evidence supporting the need to maintain or improve reliability.[115] He raises this issue as a policy matter, questioning whether it is appropriate to continue authorizing significant increases in distribution system capital investments year after year, for the purposes of enhancing system reliability absent a demonstration by the Company of quantifiable benefits to ratepayers.[116]

82 Staff witness Mr. David Gomez argues that Avista has not demonstrated that its growth in capital spending is just and reasonable and results in facilities that are both efficient and adequate.[117] He proposes that the Commission require expanded capital reporting for Avista, to justify its increased capital spending and demonstrate how this spending benefits ratepayers.[118] Avista is currently required to file semi-annual reports of its capital expenditures, CWIP balances, and transfers to plant as a condition of the Settlement in its last GRC.

83 Further, Staff witness Mr. Cebulko argues that the information obtained through Avista's annual electric service reliability report,[119] its Voice of the Customer survey and the J.D. Power Customer Satisfaction Index is inadequate for Staff to determine whether Avista provides reliable electric service.[120] Mr. Cebulko reports that Staff is developing an econometric model that takes into account service territory attributes such as population density, number of line miles, average age of distribution infrastructure and weather severity to determine "meaningful, company-specific [reliability] benchmarks" for Avista.[121] Staff recommends that the Commission order this study, and that it be

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[115] *Id.* at 23:4-11.

[116] *Id.* at 20:16-20. See also Cebulko, Exh. BTC-1T at 6:10-18.

[117] Gomez, Exh. No. DCG-1TC at 61:2-4. RCW 80.28.010(2) states that a utility "shall furnish and supply such service, instrumentalities and facilities as shall be safe, adequate and efficient, and in all respects just and reasonable."

[118] *Id.* at 62:10-63:18.

[119] The annual reliability report provides two metrics representing the duration and frequency of outages, System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI). SAIDI is calculated by dividing the total number of minutes of customer interruption by the total number of customers. SAIFI is calculated by dividing the total number of customer interruptions by the total number of customers served.

[120] Cebulko, Exh. No. BTC-1T at 4:5-11; 7:1-2.

[121] *Id.* at 2:18-20; 7:22-23; 8:4-14.

expanded to include benchmarks for reliability, distribution O&M, and distribution net plant in service for all utilities.[122]

84 On brief, Staff argues that the Company has provided a narrative of its budgeting process, but does not explain why its budgets are growing at an increasing rate, or demonstrate that these increased costs are required to maintain or improve reliability. Staff argues that the Company's case for incurring ever-increasing costs to replace aging infrastructure for reliability purposes is "vague and unpersuasive."[123]

c. Other Parties

85 Public Counsel's witness Ms. Ramas rejects the assertion that Avista's electric operations are suffering a level of attrition requiring an attrition adjustment. Instead, Ms. Ramas proposes an electric revenue requirement based on the September 30, 2014, test year using an AMA approach with pro forma adjustments. For natural gas operations, she recognizes that the Company has consistently earned below its authorized return and therefore recommends the Commission authorize use of an end-of-period (EOP) approach for setting the revenue requirement for gas operations based on a test year ending September 30, 2014.[124] Ms. Ramas also critiques both the Company's attrition study presented in its direct case and Staff's attrition study presented in responsive testimony. Public Counsel proposes a 5.9 percent reduction in electric rates based on an AMA test year ending September 30, 2014, and adjustments for electric pro forma gross plant additions of $55.9 million.[125]

86 For ICNU, Mr. Mullins testifies that Avista's electric operations are not suffering from attrition and instead asserts that the Company has been over earning. Rather than directly critiquing Avista's attrition study, Mr. Mullins proposes an alternative approach by developing rates using the test year ending September 30, 2014, on an AMA basis with one pro forma plant addition. He then presents a number of regulatory policies and principles to argue against the Commission using attrition to set rates. ICNU further rejects the use of an attrition adjustment for determining electric revenue requirements, contending that the Company's attrition study is both unwarranted and unreliable. ICNU insists that a traditional pro forma analysis is the only reliable evidence for establishing a

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[122] McGuire, Exh. No. CRM-1T at 24:17-18.

[123] Staff's Brief, ¶ 24.

[124] Ramas, Exh. No. DMR-1T at 64:11-19.

[125] *Id.* at 5:12-14.

revenue requirement.[126] ICNU's proposed electric rates do not include any plant additions beyond calendar year 2014, except for Project Compass, and use calendar year 2014 AMA rate base balances.[127] ICNU's proposed revenue requirement is a $24.755 million or 4.95 percent reduction to current electric rates.[128]

87 ICNU argues the Company is in a pattern of overspending.[129] ICNU quotes the Company's response to a data request where it specifically acknowledges that the "CPG [Capital Planning Group] approves or declines [capital expenditure] requests based on managing a total budget amount."[130] ICNU challenges the Company's claim that it considers the degree of overall rate pressure faced by its customers. ICNU states that when asked how it considered impacts on ratepayers, the Company only referred to a spreadsheet containing Avista's Consolidated Statements of Income.[131]

88 Testifying for NWIGU on natural gas operations, Mr. Gorman also opposes the use of attrition to set rates in Washington. However, if the Commission accepts the use of attrition, Mr. Gorman proposes several adjustments to Avista's attrition study. He rejects Ms. Andrews' reduction in sales for 2016 as not based on an acceptable normalization study, or forecast of billing units with a number of customers.[132] Mr. Gorman asserts that the Company's escalation factors for plant additions should be adjusted to reflect a mid-year 2016 test year, instead of an end of the year construct. Mr. Gorman also asserts that the Company's escalation of gross plant must tie directly to its projections for increases in depreciation and amortization expense. Finally, Mr. Gorman proposes that the escalation of O&M expenses be to mid-year 2016.[133] This reduces the Company's escalation of O&M expenses from 2.25 years to 1.5 years. Mr. Gorman's adjustments to Avista's attrition study reduce Avista's revenue requirement for natural gas operations by approximately $5.3 million.[134]

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[126] Mullins, Exh. No. BGM-1CT at 2:13-15; 3:3-6.

[127] *Id.* at 4, Table 1.

[128] Mullins, Exh. No. BGM-6 at 3:15.

[129] ICNU's Brief, ¶ 7.

[130] *Id.*, ¶ 10 (citations omitted).

[131] *Id.*

[132] Gorman, Exh. No. MPG-1T at 17:19-22.

[133] *Id.* at 18:1-6.

[134] *Id.* at 18:20-26.

d. Avista's Rebuttal Position

89 On rebuttal, Avista abandons the attrition study filed in its direct testimony and instead adopts Staff's proposed attrition study and methodologies, with several changes. These changes include:

- Removing the cost of employee pension and post-retirement medical benefits (net benefits) from the historical data used to determine escalation rates for electric O&M costs.
- Combining the result of using its 2007-2014 time period with Staff's use of the 2013-2014 time period for determining escalation rates for its electric O&M costs.[135]
- Holding to using its 2007-2014 time period for determining the natural gas O&M escalation rate, rather than adopt Staff's 2009-2014 time period.

90 Avista justifies its proposed removal of net benefits from the time period data by claiming those costs are too volatile.[136] Removing net benefits from the escalation rate for electric O&M expense has the largest impact on the attrition allowance, increasing it by approximately $7.3 million.[137] In contrast, Avista's use of its 2007-2014 time period instead of a 2009-2013 time period only results in a $224,000 increase in the electric attrition allowance and a $670,000 *decrease* in the natural gas attrition allowance.[138]

91 As a consequence of removing net benefits and adopting Staff's arithmetic averaging of escalation rates from two time periods, Avista proposes a 5.16 percent escalation rate for electric O&M expense.[139] The Company constructs this growth rate from the arithmetic average of a growth rate derived from the 2007-2014 time period, and the one-year

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[135] Staff uses 3 percent as a stand-in for the 2009-2014 period.

[136] The cost of net benefits fell dramatically between 2013 and 2014. Andrews, Exh. No. EMA-5T at 31:1-8.

[137] *Id.* at 33:4-6.

[138] *Id.* at 18, Table 5.

[139] The Company points out that the average of its proposed electric and natural gas O&M escalation rates is 4.26 percent, slightly lower than the Company's current financial forecast of the annual increase in O&M from 2014 to 2016 of 4.45 percent for the combined electric and natural gas systems. *Id.* at 34:16-17 and 32:1-20.

period 2013-2014. In effect it removes Staff's use of the 3 percent growth rate and replaces it with the growth rate from the 2007-2014 time period.[140]

92 The Company also adopts on rebuttal Staff's modeling of an increase in natural gas revenue growth in 2016.[141] Further, Ms. Andrews refutes Mr. Gorman's claim that Avista's gas operations slightly over earned in 2014.[142] Ms. Andrews contends that the Company's operations under earned in 2014 by $6.2 million, with an ROR of 5.76 percent on a normalized basis.[143] She points out that the 2014 results reflect the January 1, 2015, rate increase as if it had been in place for the entire 2014 test period.[144]

93 In addition to clarifying its methodology for an attrition study, the Company points to testimony supporting its capital spending.[145] Avista provides a description of the capital planning and reprioritization process.[146] Ms. Schuh describes the capital budgeting process as beginning with individual business cases that are:

> a summary document that provides support and analysis for a capital project or program. Components of a business case include: the project description, project alternatives, cost summary, business risk, financial assessment, strategic assessment, justification for the project (e.g., mandatory, resource requirements, etc), milestones, key performance indicators.[147]

94 Ms. Schuh states that after the business cases pass the Financial Planning and Analysis group, the Capital Planning Group meets to review the submitted business cases and

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[140] *Id.* at 30:13-14; 32:7-16. In its direct testimony, Avista derived and rejected the use of an escalation rate based on the use of 2007-2014 time period data. Now it returns to that time period data but removes net benefits.

[141] *Id.* at 30:11-14.

[142] See Gorman, Exh. No. MPG-1T at 3:4-6.

[143] Andrews, Exh. No. EMA-5T at 37:16-38:5.

[144] *Id.*

[145] Norwood, Exh. No. KON-1T at 8:6-9; 9:10-29; 11:6-12. Company witness Mr. Scott Kinney provides details related to generating plant capital additions, Company witness Mr. Bryan Cox for transmission plant, Mr. James Kensok for information technology, and Ms. Schuh for common plant and other capital investment.

[146] *Id.* at 9:12-29.

[147] Schuh, Exh. No. KKS-1T at 4:14-20.

"prioritize funding to meet the capital budget targets set by senior management."[148] Ms. Schuh also provides numerous individual business case summaries.[149]

95 Avista questions Mr. Cebulko' s proposal for a "complex and intensive" study to compare Avista with other utilities. Company witness Mr. La Bolle states that Avista has provided Staff with "more-than-ample evidence that demonstrates that its plant investments, both on an individual and collective basis, are reasonable, justified and prudent,"[150] and that "there is no indication that the Company's past or present reliability performance is of concern."[151] Mr. La Bolle recommends that Staff and interested parties develop an understanding of the Company's Asset Management Program before requiring additional reports or studies.[152]

3. Discussion and Decision

96 In this proceeding, Avista again requests rate increases for both electric and natural gas operations based on its claim that its earnings continue to be eroded by the effects of attrition. The Company does not proffer a revenue requirement using the Commission-approved standard for post-test year plant additions as known and measurable changes to a historical test year. Instead, the Company presents a test year modified to include projections of capital spending based on its budget as a cross-check to its attrition-derived revenue requirement.

97 Staff also provides a detailed and rigorous attrition analysis as a means of informing the Commission about attrition-related tendencies in the Company's anticipated financial condition in the rate year. As discussed above, Staff witness McGuire rejects the Company's escalation methodology and applies a historical least-squares linear regression trending analysis to determine the escalation rate for an attrition study. As we note above, on rebuttal, the Company accepts this methodology for establishing escalation rates with several changes.

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[148] *Id.* at 5:6-7.

[149] Schuh, Exh. No. KKS-5.

[150] La Bolle, Exh. No. LDL-1T at 26:11-13.

[151] *Id.* at 26:5-6.

[152] Smith, TR 502:1-12.

98 While supporting and arguing for an attrition, Mr. McGuire supports other Staff witness' concerns about the level of Avista's investments in its distribution systems, stating:

> Without knowing where Avista should be in terms of its reliability performance, it is not possible to know whether improved "reliability" is a remotely acceptable cause for significant and continued investment in distribution system enhancements. It is entirely possible that, given the unique characteristics of Avista's service territory, it has already invested far too heavily in distribution system enhancements.[153]

99 Mr. McGuire further states that "Avista is simply investing too heavily in distribution infrastructure for Staff and the Commission to continue to operate blindly when trying to determine whether that investment is providing worthwhile benefit to the Company's ratepayers."[154]

100 Although Avista has requested and applied several regulatory mechanisms to address earning deficiencies and regulatory lag, including its Energy Recovery Mechanism (ERM), Purchased Gas Adjustment, and End-of-Period accounting, Avista continues to assert that Commission reliance on a modified historical test period with pro forma adjustments will not produce a revenue requirement that is sufficient to allow the Company a reasonable opportunity to earn its allowed return in 2016 and beyond.[155] The Company acknowledges that the Commission has not directly authorized an attrition adjustment to set rates since the 1980s but argues it remains a viable tool today to address the shortcomings of a historical test period subject to limited pro forma adjustments.[156]

101 Mr. McGuire recognizes that rates calculated using a modified historical test year will generate revenues that will "fall short" of those necessary to provide Avista "with a reasonable opportunity to earn a fair rate of return" in a rate year.[157] He observes that Avista has been experiencing very low load growth over the last several years, and if that load growth continues at a slow pace, the Company is not going to be able to generate the

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[153] McGuire, Exhibit No. CRM-1T at 24:5-11.

[154] *Id.* at 24:19-21.

[155] Avista's Brief, ¶ 3.

[156] *Id.*, ¶ 11.

[157] McGuire, Exh. No. CRM-1T at 28:8-10.

revenues necessary to cover the expenses moving forward.[158] Avista uses load projections showing moderate electric and natural gas revenue growth.[159]

102 Avista requests the Commission authorize large adjustments to its electric and gas revenue requirements based on its analysis extrapolating historical levels of capital investment and expense to the rate year, arguing that the trend in such information effectively proves attrition conditions prospectively. The Company also points to reliability and its obligation to serve customers as the predominant factors driving its projected or budgeted capital investment program,[160] and notes the ever-increasing costs of utility infrastructure.[161]

103 The Company abandoned the attrition analysis offered in its direct case, and offers on rebuttal an attrition analysis, based in large measure on Staff's analysis, that reflects a trending of historical capital investment, expense, and revenue data extrapolated forward to 2016 as a means to establish claims about likely attrition in that year. Avista claims that in the circumstances of this case, where evidence demonstrates that rate base and expenses will rise faster than revenues between the historical test period and the rate period, the Commission should look to an attrition adjustment for ratemaking purposes.

104 Although Avista largely adopts Staff's attrition study methodology, Staff's Brief cautions the Commission against immoderate dependence on that analysis as a basis for actually authorizing any attrition adjustment. Thus, although the Company and Staff ultimately adopt a common methodological approach, they differ on two key and relevant factors in the application of the methodology: specifically, the term of the historical data and the escalation factor.

105 We also note that the evidence presented indicates that Avista has, at least with respect to its electric operations, either earned at or above its approved rate of return in 2013 and 2014, and may possibly do so in 2015.[162] For this reason and others, Public Counsel and ICNU oppose any attrition adjustment for electric rates, contending instead that Avista's over-earning during the test year must have a direct bearing on Commission consideration of the necessity of any attrition adjustment.[163]

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[158] McGuire, TR 445:24-446:3.

[159] Andrews, Exh. No. EMA-1T at 14:6-7.

[160] *See* Morris, Exh. No. SLM-1T at 10-11.

[161] *Id.* at 6:18-19; 7.

[162] McGuire, TR. 441:19-24; Norwood, Exh. No. KON-5.

[163] Ramas, Exh. No. DMR-1T at 25; Mullins, Exh. No. BGM-1Tat 8.

106 The parties' positions vary widely. Public Counsel and ICNU oppose the use of an attrition adjustment, contending it is simply unnecessary. As a nod to some aspects of Avista's under-earnings claims, Public Counsel supports the use of EOP rate base for the Company's natural gas operations to account for regulatory lag, but for all other purposes opposes the Company's proposed attrition adjustments. NWIGU simply opposes the use of an attrition adjustment to natural gas revenue requirements and does not support EOP or pro forma adjustments.

107 We agree with Staff's observation that capital spending on distribution plant is a dominant driver in the Company's and Staff's attrition analyses.[164] Staff provides useful analysis showing that there is indeed a mismatch in revenues, expenses, and capital investment that may affect Avista's opportunity to earn its authorized rate of return, although it cautions us in its brief to consider whether or not the Company has met its burden in this case.[165]

108 As we note above, the primary issues we must resolve concerning attrition in this case are 1) the appropriate criteria for determining whether an attrition adjustment is warranted; 2) the appropriate methodology for an attrition study; and 3) whether Avista has met its burden of proof to justify granting an attrition adjustment for both electric and natural gas rates. We consider those questions here.

1. When is an attrition adjustment warranted?

109 In the early attrition cases, the Commission found extraordinary circumstances that supported the use of attrition in periods of high inflation and extraordinary levels of investment in production plant, among other criteria. We agree with the intervenors that those circumstances, which were truly extraordinary, are not present in this case. The evidence in this case demonstrates that Avista is making increased capital investments in non-revenue generating plant (primarily on the distribution system) in an environment of low load growth. However, we do not believe that these circumstances are extraordinary. In fact, we believe that these circumstances represent the "new normal."

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[164] Avista notes that its rate of capital additions increased dramatically in 2007, and has remained at an elevated rate since. Forsyth, Exh. No. GDF-1T at 4:15-5:15.

[165] Although Staff's brief may differ in its emphasis, Mr. McGuire, the key Staff witness on attrition and final revenue requirement, was clear in his testimony and at hearing that if the Commission only used a modified historical test year with known and measurable pro forma adjustments, the Company would likely experience attrition in the rate year and would not have a reasonable opportunity to earn a fair rate of return. McGuire, Exh. No. CRM-1T at 9:17-18; 28:8-13; McGuire, TR 437:14-20; 442:23-443:4.

110 In more recent cases, the Commission has entertained the use of a variety of regulatory methods to address regulatory lag, lost revenue due to conservation, low load growth and weather fluctuations, as well as the need to invest in the existing distribution grid to meet changing customer demands. These include, in addition to attrition adjustments, such methods as expedited rate cases, decoupling, and EOP pro forma adjustments While the Commission has not established a different standard or criteria for attrition adjustments in more recent cases, the Commission has indicated, without more detail, that "an attrition adjustment should not be limited to circumstances where the utility can demonstrate extreme financial distress."[166] We continue to hold that view, and determine that it is not necessary to require a finding of extraordinary circumstances to justify granting an attrition adjustment. An attrition adjustment is yet another tool in our regulatory "toolbox" for utility ratemaking. However, we do require that utilities requesting an attrition adjustment demonstrate that the cause of the mismatch between revenues, rate base and expenses is not within the utility's control. Without such a standard, a utility could plan for a level of expenditures that would exceed revenues and rate base recovery, creating the need for an attrition adjustment.

2. What is the appropriate methodology for an attrition study?

111 We find Staff's approach, as adjusted and corrected by the Company, to provide the most appropriate methodology in this docket for supporting an attrition adjustment. Because an attrition study is an additional tool to use in conjunction with a modified historical test year, the appropriate methodology begins with development of a modified historical test year with pro forma plant additions, even subsequent to a test year. An attrition study is based on the resulting projected earnings and revenue requirements, and the attrition adjustment is added only if the study shows a mismatch of earnings and expenditures.

112 On direct, Avista used an inappropriate method for developing an escalation rate for its attrition study.[167] Allowing an attrition adjustment based on a utility's budgeted capital spending, portrayed in its testimony as a "cross-check," is contrary to this ratemaking methodology, given its uncertain and speculative nature. In addition, the Company chose to abandon the use of the escalation factors it developed in its attrition study and instead use its projected budget amounts to determine an escalation rate.

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[166] *Avista Order 09 &14*, ¶ 73. (original footnotes omitted).

[167] The Company used a compound growth factor for fitting a line to the data.

113 Further, on rebuttal, the Company's attrition study removes one category of expenses, net benefits, from a calculation based on historical data that should include such expenses. The justification for this removal is scant. Such a removal requires a high level of justification, as it runs counter to the principle that an attrition study should use multiple years of historical data to arrive at a stable, non-volatile projection of revenue, expenses and rate base. In all, the Company's methods do not meet the Commission's standard.

114 Mr. McGuire's attrition study uses a sound methodology for developing an escalation rate from historical data.[168] With corrections, the Company largely adopts Staff's methodology on rebuttal, but insists that the 2007-2014 time period is the most appropriate. In this instance, we agree with the Company's time period rather than that of Staff. We recognize the use of informed judgment in determining which time period may best represent future costs and revenue, and note Mr. McGuire's testimony at hearing about the minimal revenue impact of the difference between the Company's and Staff's recommended time periods.[169]

115 The use of escalation factors from attrition studies to set rates is also a matter of informed judgment. Here, we accept Staff's use of a weighted average escalation factor for O&M expense. It is supported with sound reasoning, as it recognizes and reflects recent reductions in O&M expense. However, as described below, we decline to use the recommended 3 percent escalation rate. We do not reject this escalation rate out of hand, but find the Company and Staff do not present sufficient evidence to support their recommendation to modify the result of their studies.[170] The Commission has accepted the modification of escalation rates derived from attrition studies in the past, and may do so again in the future depending on the specific factual circumstances and recognizing that the Company carries the burden to make its case.

3. Has the Company met its burden of proof to justify granting an attrition adjustment?

116 As we find that making increased capital investments in non-revenue generating distribution plant in an environment of low load growth is the new normal for investor-owned utilities in Washington, it is necessary for Avista, and any other utility seeking an attrition adjustment, to demonstrate that its need to invest in non-revenue generating

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[168] Staff uses a least square method for fitting a line to the data.

[169] McGuire, TR 462:10-463:18; 481:9-15.

[170] *Id.* at 484:14 – 485:11.

plant, particularly distribution plant, is so necessary and immediate as to be beyond its control. In other words, faced with little or no load growth, and hence revenue growth, for the foreseeable future, can Avista demonstrate the need for such investments, and the benefit to its customers of its increased level of capital investments, beyond its expected revenues?

117 Several parties urge us to firmly reject what they describe as Avista's attempt to capture future capital spending and incorporate it into an attrition adjustment. They contend that Commission authorization of this approach would enable the Company to follow a plan of capital over-spending that would be consciously pursued in order to increase shareholder earnings. As ICNU points out, such an approach is nothing new to the realm of utility regulation and is widely documented and commonly referred to as the Averch-Johnson Effect.[171]

118 As ICNU witness Mr. Mullins testified:

> [A]bsent regulatory policies to deter over spending, ratepayers will have no protection against unconstrained capital spending on the part of the utility. Traditionally, the Commission's adherence to a modified historical test period has served to partially check this incentive to overspend. If the modified historical test period is abandoned in favor of a trend-based revenue requirement methodology, not only would that check be eliminated, but utilities would be provided with an even greater incentive to overspend.[172]

119 For this very reason, while we no longer find it necessary to justify granting attrition adjustments on the existence of extraordinary circumstances, we do require utilities to demonstrate persuasively that the attrition occurring is outside of their control. We understand Avista's contention that it operates in a challenging environment in which low load and revenue growth is outpaced by capital investment requirements and changes in operating expense levels. However, we also recognize there is risk to the Company's ratepayers by embracing an attrition adjustment that may allow Avista to manage its capital expenditures without regard to rate impact, effective cost control, demonstrated

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[171] Mullins, Exh. No. BGM-1CT at 13:5-11 (citing Harvey Averch & Leland L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 Am. Econ. Rev. 996, 1052 (1962)).

[172] *Id.* at 14:3-9.

benefit, or actual need, and only in reference to its own budgeted targets.[173] Simply stated, we are concerned about authorizing a practice that simply projects future levels of expense and capital expenditures that may, as multiple commenters point out, "become a 'self-fulfilling prophecy' where there is an incentive for rates of capital expenditure to be driven by an effort to match earlier projections."[174]

120 We recognize that Avista's shareholders benefit significantly in increasing its capital expenditures and share the concerns of other parties regarding this investment's impact on ratepayers. Yet these concerns are balanced against others about the Company investing in its distribution system to ensure the safe and reliable service its customers demand as well as providing a realistic opportunity for the Company to earn the settlement rate of return in the rate effective year. Further, we do not find the Company's practices to be so unjustified as the intervenors claim. As we discuss further below, we find that the evidence in this case supports granting an attrition adjustment both for Avista's natural gas and electric service. However, based upon our concerns about whether Avista has provided evidence supporting its expected electric distribution plant expenses and capital investment, we zero out any escalation rate for distribution plant capital investments in arriving at an attrition adjustment for Avista's electric service.

a. Natural Gas

121 First, concerning Avista's natural gas service, the Company has reasonably demonstrated that it is making significant investments in non-revenue generating plant for the purposes of safety and reliability, to comply with explicit regulatory requirements and in accordance with prior Commission orders.[175] For example, Avista has pipe replacement programs to replace natural gas pipe and facilities that have been determined to have a high risk of failure, such as Aldyl-A and steel pipe, which are at the end of their useful lives or have failed. The Commission has procedures in place to review and approve this

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[173] Additionally, Avista benefits from a full electric and natural gas decoupling mechanism, starting in January 2015, which removes the link between the Company's distribution revenues and its volumetric rates.

[174] *Investigation of Possible Ratemaking Mechanisms to Address Utility Earnings Attrition*, Docket U-150040, Public Counsel's Comments, ¶ 40 (Mar. 27, 2015) (quoting the testimony of David C. Gomez in Avista's 2014 GRC, Dockets UE-140188/UG-140149).

[175] Schuh, Exh. No. KKS-5 (attachment NGD-7 and NGD-1.1); Kopczynski, Exh. No. DFK-1T at 20:7-21.

program on a biennial basis.[176] The Commission has recognized these activities as a priority, stating that "it is in the public interest for all gas companies to take a proactive approach to replacing pipe that presents an elevated risk of failure."[177] We accept that Avista has established that the need for its capital investments in natural gas operations are beyond its control.

122 With respect to attrition related to Avista's natural gas operations, we authorize an attrition adjustment in accordance with the methodology advocated by Staff, with exceptions regarding the appropriate escalation rate for distribution plant O&M expenses and the time period. In rebuttal testimony, Avista agrees to adopt Staff's approach of escalating O&M expenses by 2.17 percent, which is the arithmetic average of a) 1.34 percent, the one-year trend in O&M expense from 2013 to 2014 that Staff proposes, and b) the 3 percent proposed in Avista's direct testimony.[178]

123 We decline to use the 3 percent proposed in Avista's direct testimony, even when averaged with historical data.[179] We prefer to use an escalation rate more firmly grounded in historical data. Therefore, for the purposes of calculating an attrition adjustment for Avista's electric and natural gas operations, we escalate O&M expenses by the arithmetic average of a) the one year trend in O&M expense from 2013 to 2014 and b) the multiyear trend in O&M expense from 2007 to 2014.[180] This produces an annual escalation rate of 2.42 percent for natural gas O&M expenses.

124 Further, we recognize and accept that Avista has been under-earning on its gas operations for several years while engaging in rapid replacement and improvement of gas distribution infrastructure. The Company's investments in natural gas distribution plant are necessary to ensure public safety, and comply with Commission orders and policies supporting replacement of pipe that has a high risk of failure, or presents public safety and reliability concerns. We find that Public Counsel's proposal to set the revenue requirement for gas operations based on an EOP approach for a test year ending September 30, 2014, does not provide the Company a realistic opportunity to earn its

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[176] Gomez, Exh. No. DCG-1TC at 32:8-10.

[177] *In the Matter of the Policy of the Washington Utilities and Transportation Commission Related to Replacing Pipeline Facilities with an Elevated Risk of Failure,* Docket No. UG-120715, ¶ 37 (Dec. 31, 2012).

[178] Andrews, Exh. No. EMA-5T at 33:11-15; McGuire, Exh. No. CRM-1T at 40:7-17.

[179] McGuire, Exh. No. CRM-40:8-17.

[180] The escalation rate for the multi-year trend must be developed using Staff's least-squares regression methodology.

settlement rate of return in the rate year. Given the necessity of these investments, and the pressure this will place on the opportunity for the Company to earn the Settlement rate of return given low load and revenue growth, we acknowledge that the Company is likely to experience attrition in its natural gas operations in the rate year. We therefore accept and modify Staff's attrition methodology for the purposes of setting rates for Avista's natural gas operations. As a result, we grant an attrition adjustment of approximately $6.8 million for Avista's natural gas operations, resulting in an overall increase in revenue requirement of $10.8 million.

b. Electric Operations

125 Compared with the testimony and evidence concerning the extent and necessity of Avista's investments in its natural gas operations, the Company's claims about investment in distribution plant on the electric side are mixed. Avista has adopted an annual process where it monitors actual capital expenditures and funds new projects late in the year in order to ensure it spends its budget.[181] The Company relies on testimony and exhibits concerning its pro forma plant addition cross-check study from Ms. Smith and Ms. Schuh,[182] as well as testimony from Mr. LaBolle concerning the Company's Asset Management Distribution Program,[183] and Mr. Norwood concerning the necessity of the Company's capital budgeting and spending.[184]

126 As Mr. McGuire, Mr. Gomez and Mr. Cebulko identify, the Company has not fully explained the relationship between the Company's business cases, asset management program and total net plant investment. This relationship is not readily apparent from the record. The evidence lacks detailed description of how the Company prioritizes its capital investments in electric distribution plant, or performance criteria to track the need or impacts of those investments. Further, ICNU notes:

> In practice, the Company has ensured that actual capital expenditures match and then exceed original forecasts on an annual basis. This is accomplished via end-of-year expenditure ramping. The CPG [Capital Planning Group] "has a list of

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[181] Norwood, Exh. No. KON-1T at 9:3-7; Mullins, Exh. No. Exh. No. BGM-4C at 18 (the Company's Response to ICNU DR 69, Att. A at 37) (Avista's Capital Planning Group "has a list of shovel-ready work that can be activated in November should there be any available funds.").

[182] Smith, Exh. No. JSS-1T; Smith, Exh. No. JSS-4T; Schuh, Exh. No. KKS-1T; Schuh, Exh. No. KKS-6T.

[183] LaBolle, Exh. No. LDL-1T at 21:3-22:8.

[184] Norwood, TR. 118: 9-120:13.

> shovel-ready work that can be activated in November *should there be any available funds*." That is, the Company has designed a program to guarantee full capital spending rather than preserving cost controls. This late-year ramping is apparent in the record, given both actual expenditures in 2014 and forecast expenditures in 2015. Such evidence speaks powerfully to a Company whose spending practices need to be carefully reined in, rather than fueled, carte blanche, through the grant of an "undistributed increase" to revenue in the form of an attrition adjustment.[185]

127 The record contains some, but not complete, evidence as to what degree the Company's electric system as a whole, or in part, is unsafe or unreliable, and whether distribution capital spending is driven by, or at least guided by, a specific plan to address the safety or reliability shortcomings of the Company's electric service. Ms. Schuh testifies for Avista that her Exhibit No. KKS-5 includes a "project description, project alternatives, cost summary, business risk, financial assessment, strategic assessment, [and] justification for the project (e.g., mandatory, resource requirements, etc)."[186] Yet this exhibit provides minimal explanation of the projects' relationship to overall reliability, safety, or service quality benefits. Focusing on electric distribution plant projects in the exhibit, we found the section describing each project's rationale for decision to be blank, and project alternatives section lacking substantive detail.[187] This evidence does not convince us that Avista's projected electric distribution investments are entirely outside of its control, or required for the safe and efficient operation of its system. However, Mr. Norwood testified at hearing that these capital expenses are necessary:

> [the departments are] directed to provide projects that need to be done, whether it's related to reliability or to a systematic replacement of items over time, so it's not a wish list. So because senior management limits the total amount, then each department has to go back – and the capital planning group does this – to figure out which has the highest priority. [188]

128 To support its distribution plant investments, Avista provided its 2013 Asset Management Distribution Program Update, which identifies the Company's plans for monitoring and

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[185] ICNU's Brief, ¶ 12.

[186] Schuh, Exh. No. KKS-1T at 4:16-20.

[187] Most projects did not list any alternatives. Of those projects that listed alternatives, most include only a no action alternative. Of the distribution projects over $20 million, only Wood Pole Management included an alternatives beyond no action.

[188] Norwood, TR 119:9-16.

evaluating its distribution plant investments, and analyzes the performance of certain asset management programs.[189]

129 Where, as in this case, there is some, but not complete, evidence to demonstrate that the circumstances driving attrition are outside of the Company's control, the Commission retains broad discretion to consider other factors, such as the Company's intent to file another rate case within the next year, and the analysis under *Hope*, *Bluefield*, and *Permian Basin*. We believe we can exercise broad discretion to consider such seminal cases using our informed judgment in deciding whether or not an attrition adjustment is warranted given the specific facts and circumstances in a rate case.

130 In the past, the Commission has accepted some rate escalation or authorization of relief beyond the modified historical test year when rates will be in effect for more than one year. For example, approving a multi-year general rate case stay-out period was critical to the Commission's decision to approve an escalation factor for PSE.[190] This approach requires the Company to accept some risk that rates in a future year will be sufficient, but it also provides more certainty to customers. It creates an incentive for the Company to control costs during the years that rates are in effect. Yet the Company has stated that it intends to file annual rate cases for the next five years, rather than committing to a stay-out period.[191]

131 In addition, while the record shows that Avista's electric operations are currently financially healthy and the Company has actually earned near or above authorized levels for its Washington electric operations for the past two years, we are concerned this may not hold in the rate year or beyond. Absent an attrition adjustment, we are concerned that

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[189] The 2013 Asset Management Distribution Program Update provides a detailed assessment of the benefits associated with some of Avista's asset management programs, including reduced outage frequency, and associated operations and maintenance savings. These metrics are valuable, and provide information to assist the Company in making prudent investment decisions. It may be useful for Avista to work with Staff to provide this information in a more refined format. However, the majority of programs and assets listed do not have an asset management program, or specific metrics to track their impact on system safety or reliability. Labolle, Exh. No. LDL-2.

[190] *In the Matter of the Petition of Puget Sound Energy and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets No. UE-130137 and UG-130138 (consolidated), Order 07, ¶ 171 (June 25, 2013).

[191] Norwood, TR 97:10-25.

the Company may not have an opportunity to achieve earnings on electric operations at or near authorized levels.

132 Were we to reject an attrition adjustment for electric revenue requirement in this case, the result under Staff's modified historical test year pro forma analysis would be a reduction in electric revenue requirement of more than $20 million.[192] Public Counsel and the intervenors recommend even more severe reductions based solely on a modified test year analysis with known and measurable pro forma adjustments. We cannot reasonably conclude such an end result would be appropriate under the standards in *Hope* and *Bluefield*. The Commission's responsibility to set rates that are fair, just, reasonable, and sufficient turns not on the particular rate making methodology it selects, *i.e.*, modified historical test year or attrition, but on its outcome, or "end results."[193] Indeed, the Supreme Court in *Hope* determined that the Federal Power Commission (FPC) "was not bound to the use of any single formula or combination of formulae in determining rates."[194] The Court explained that:

> Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the [Federal Power] Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.[195]

133 In the *Permian Basin* case, another FPC case often cited with *Hope*, the United States Supreme Court embraced the end result test.[196] The Washington Supreme Court in

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[192] Hancock, Exh. No. CSH-2 at 1 (Revised Oct. 13, 2015).

[193] *See Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 88 L. Ed. 333 (1944) (*Hope*) (the methods by which government regulators determine a utility's rate are inconsequential so long as the *end result* is fair).

[194] *Id.* at 602.

[195] *Id.* This language became known as the "end result" test.

[196] *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 791–92, 88 S. Ct. 1344, 1372–73, 20 L. Ed. 2d 312 (1968) (*Permian Basin*). The Court stated: "The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about prospective responses of the capital market; it is instead obliged at each step of the regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the 'end result' of the Commission's order must be measured as much by the success with which they protect those interests as by the effectiveness with which they 'maintain credit ... and ... attract capital'." 390 U.S. at 791. See also, *People's Organization for*

POWER, referring to *Permian Basin* and other authority,[197] observed that "within a fairly broad range, regulatory agencies exercise substantial discretion in selecting the appropriate rate making methodology."[198] The *POWER* Court added that "there is a constitutionally based floor below which a rate ceiling set by a regulatory agency will be reversed by the courts as confiscatory."[199] Quoting another leading U.S. Supreme Court decision, the *POWER* Court states what this means in terms of return:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[200]

134 These are the fundamental principles that have long guided the Commission when it determines rates for a jurisdictional utility such as Avista. A drastic rate reduction, such as proposed by parties that urge us to reject an attrition adjustment, would run afoul of these principles.

135 Thus, after considering the evidence in this case, as well as our public interest obligations and the "end-result" test cited above, we grant an attrition adjustment in electric operations in this case. Considering the weakness in the record concerning projected distribution plant capital investments noted above, we make two modifications to Staff's

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Washington Energy Resources v. Washington Utilities & Transportation Comm'n, 104 Wn.2d 798, 811-12, 711 P.2d 319 (1985) (*POWER*) (quoting *Permian Basin*).

[197] In addition to *Hope* and *Permian Basin*, the Court cites *Jewell v. State Utils. & Transp. Comm'n*, 90 Wash.2d 775, 776, 585 P.2d 1167 (1978).

[198] 104 Wn.2d at 812.

[199] *Id.*

[200] *Id.* at 813 (quoting *Bluefield Water Works & Imp. Co. v. Public Serv. Comm'n*, 262 U.S. 679, 692, 43 S.Ct. 675, 67 L.Ed. 1176 (1923)).

attrition analysis to arrive at the attrition adjustment we authorize today.[201] The modifications concern the analysis of distribution plant capital investments and expenses.

136 First, we decline to include any escalation of capital investments in distribution plant. As described above, the record in this case lacks support for the elevated level of distribution plant investments. The Company has not met its burden to show that its proposed investments are based on circumstances beyond its control. Thus, while we authorize rates based on the attrition methodology proposed by Staff, we modify Staff's method to remove all escalation of distribution plant rate base.

137 Second, consistent with our discussion of O&M escalation rates for natural gas above, we modify the electric O&M escalation rate. Avista's initial testimony provided historical analysis showing that from 2007-2013, electric O&M expenses grew by 5.7 percent annually using the compound growth rate method.[202] Yet in its initially-filed attrition study, Avista used a lower annual growth rate of 3 percent "to reflect the recent cost-cutting measures implemented by the Company, and the expectation that Avista will manage the growth in these expenses to a lower level in future years."[203] In response testimony, Staff proposes to escalate O&M expenses by 2.42 percent, the arithmetic average of a) 1.82 percent, the one year trend in O&M expense from 2013 to 2014 and b) the 3 percent proposed in Avista's direct testimony.[204] In rebuttal testimony, Avista proposes to escalate O&M expenses by 5.16 percent, the arithmetic average of a) the one year trend in O&M expense from 2013 to 2014 and b) the multiyear trend in O&M expenses from 2007 to 2014, with net benefits removed.[205]

138 We do not find the escalation rates of the Company or Staff supporting attrition to be satisfactory. Avista's proposal on rebuttal removes one category of expenses, net benefits, from a calculation based on historical data that should include such expenses. We decline to adopt an approach that arbitrarily removes one category of expenses. Staff uses the 3 percent escalation rate proposed in Avista's direct testimony, and as stated

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[201] These two modifications are in addition to the four corrections the Company makes on rebuttal to Staff's attrition analysis.

[202] Andrews, Exh. No. EMA-1T at 28:6-8.

[203] *Id.* at 28:3-5. Mr. McGuire states that despite several requests, Staff "could not determine whether the proposed 3.0 percent growth rate was reasonable or unreasonable." McGuire, Exh. No. CRM-1T at 40:11-12.

[204] *Id.* at 39:8-40:17.

[205] Andrews, Exh. No. EMA-5T at 29:6-33:10.

above, but fails to support the premise behind it. The record here supports an escalation rate more firmly grounded in historical data.

139 Therefore, for the purposes of calculating an attrition adjustment for Avista's electric operations, we escalate O&M expenses by 3.21 percent, the arithmetic average of a) 1.82 percent, the one year trend in O&M expense from 2013 to 2014 and b) 4.6 percent, the multiyear trend in O&M expense from 2007 to 2014.[206] This is the same methodology we adopt in this Order to escalate Avista's natural gas O&M expenses.

140 Accordingly, we find the overall revenue requirement for Avista's electric service should be reduced by approximately $8.1 million, based upon the results of a modified historical test year with known and measurable pro forma adjustments, including an attrition adjustment of approximately $28.3 million. While the end result is still a reduction in revenue requirement for Avista's electric service, it is significantly less than what would result from adopting Staff's pro forma analysis or the intervenor's revenue requirement recommendations. Further, the Company has stated on the record it expects to file a rate case every year for the next five years. If the Company continues to experience attrition in its electric operations, we expect the Company will have the opportunity in future cases to fully demonstrate that such expected capital expenditures, particularly for its distribution system, provide benefit to ratepayers and are beyond its control.

141 While we grant a modified attrition adjustment for electric operations, we emphasize that we share Staff's frustration about continuing to authorize recovery for these significant capital investments, absent a complete demonstration by the Company of quantifiable benefits to ratepayers. Before seeking further rate increases for its electric service, the Company must provide more analysis showing how it plans and prioritizes investments in its distribution system, and how those decisions impact system reliability and economy. Staff asserts that an examination of Avista's capital spending plans and results is called for, and we agree.[207] We encourage the Company to work with Staff on this issue. The econometric study recommended by Staff could provide useful information about Avista's relative reliability, compared to other utilities. We agree, but since Staff has begun its work on the study,[208] we do not think it is necessary to require it in this order.

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[206] *Id.* at 32:7-16 (Table No. 6).

[207] Gomez, Exh. DCG-1CT at 62:12-13.

[208] Cebulko, Exh. No. BTC at 2:18-20.

C. Generation Plant Operations and Maintenance

142 This adjustment involves O&M expenses at Avista's thermal generation plants. In rebuttal testimony, Avista proposes to defer major maintenance expenses at the Coyote Springs 2, Rathdrum, and Boulder Park plants, and use revised test year expenses for the Colstrip plant.[209]

143 Major maintenance, also called an overhaul, is performed at thermal generation plants on a regular cycle based on the utilization of the plant.[210] Major maintenance involves the closure of the plant for a significant period, usually many weeks or months, and is distinct from basic maintenance. The expenses associated with these overhauls are part of the Company's O&M expenses. In 2016, Avista expects to incur major maintenance expenses at Colstrip, Coyote Springs 2, Rathdrum, Boulder Park, and other generation plants.[211]

144 Avista anticipates that Colstrip and Coyote Springs 2 major maintenance will result in a higher expense level than found in the test year.[212] Therefore Avista argues it will underrecover its O&M expense in 2016 without non-standard accounting treatment.[213] Avista's position regarding treatment of O&M expenses has changed since its initial filing,[214] and Avista proposes on rebuttal to:

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[209] Norwood, Exh. No. KON-1T at 45:15-46:6; Andrews, Exh. No. EMA-5T at 13:6-15:8; Smith, Exh. No. JSS-4T at 23:2-3. Avista no longer supports its two earlier positions regarding major maintenance.

[210] At Colstrip, major maintenance occurs on each unit every three years. Johnson, Exh. No. WGJ-1T at 14:8-9. At Coyote Springs 2, major maintenance normally occurs every four years. Ball, Exh. No. JLB-1T at 13:8.

[211] Johnson, Exh. No. WGJ-1T at 15:3-4; Ball, Exh. No. JLB-1T at 9:6-11.

[212] Johnson, Exh. No. WGJ-1T at 15:3-4. Avista states that "both plants have highly variable maintenance schedules that are dependent on factors outside the Company's control," but does not explain why costs will be higher. *Id.* at 14:15-17.

[213] Johnson, Exh. No. WGJ-1T at 15:5-7.

[214] In its initial filing, Avista proposed to move the recovery of O&M expenses at Colstrip and Coyote Springs 2 from general rates to the Energy Recovery Mechanism (ERM). In the Settlement, Avista dropped its request to recover these expenses through the ERM. Subsequently, Avista proposed to recover the entire cost of forecasted generation plant O&M, including major maintenance, through general rates in one year. Norwood, Exh. No. KON-1T at 43:1-3. In response testimony, ICNU, Public Counsel, and Staff objected to including the entire major maintenance amount in a single year's rates because major maintenance does not occur every

- Defer and later recover actual major maintenance expenses at the Coyote Springs 2, Rathdrum, and Boulder Park plants,[215]
- Use the revised test year expense for Colstrip, as the $1.09 million more in revenues the revision provides is sufficient for major maintenance at Colstrip,[216] and
- Continue to use forecasted 2016 expenses for all other generation plants.[217]

145 *Other Party Positions.* Staff and ICNU recommend basing rates on a normalized[218] level of major maintenance expenses. ICNU argues that rates should include one-third of Avista's forecasted cost of major maintenance at Colstrip because Colstrip has a three-year maintenance cycle, and one-fourth of Avista's forecasted cost of major maintenance at Coyote Springs 2 because Coyote Springs 2 has a four-year major maintenance cycle.[219]

146 Staff proposes to separate Colstrip and Coyote Springs 2 O&M expenses into two categories: major maintenance and basic O&M.[220] Staff analyzes basic O&M by removing the major maintenance expense from total O&M actuals for the past seven years.[221] It then creates a "line of best fit" to estimate expected basic O&M costs for

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year. Mullins, Exh. No. BGM-1T at 36:7-16; Ball, Exh. No. JLB-1T at 13:5-11; Ramas, Exh. No. DMR-1T at 50:2-9. Staff notes that Avista's second proposal would provide the Company revenue to fully recover these costs every year until the next rate proceeding, even though these costs do not occur every year. Ball, Exh. No. JLB-1T at 13:5-11.

[215] Norwood, Exh. No. KON-1T at 45:15-46:6.

[216] In Avista's initial filing, test year expenses for Colstrip O&M included a one-time refund. On rebuttal Avista adds Electric Adjustment 4.06N to remove this one-time refund and increase Colstrip's Washington-allocated test year expenses by $1.09 million. Andrews, Exh. No. EMA-5T at 14:1-15:8.

[217] Smith, Exh. No. JSS-4T at 23:2-3.

[218] Normalized expenses or normalization is the replacement of test year expense levels with a multi-year average of expenses.

[219] Mullins, Exh. No. BGM-1T at 36:21-37:3.

[220] Ball, Exh. No. JLB-1T at 12:2-6. Basic O&M includes all expenses that are not major maintenance.

[221] Staff's analysis involves Colstrip and Coyote Springs 2 only.

2014.[222] Based on that calculation, Staff finds that test-year basic O&M is close enough to expected basic O&M, so an adjustment to basic O&M is not warranted.[223]

147 For major maintenance expenses, Staff proposes to normalize the expenses for Colstrip and Coyote Springs 2 over three and four years, respectively, as that is the length of each plant's major maintenance cycle.[224] Staff notes that the settlements in PSE's last two power cost only rate cases included similar accounting treatments for Colstrip.[225]

148 Additionally, Staff proposes removing the "management reserve," which is intended to cover cost overruns and unexpected damage discovered during major maintenance. Staff argues that including a management reserve is contrary to the use of an average cost through normalization.[226]

149 Public Counsel proposes using the test year level of expenses.[227] After analyzing historical costs and test year costs for Colstrip and Coyote Springs 2, Public Counsel concluded that normalization is not necessary or warranted.[228]

150 *Avista's Response.* Avista objects to these proposals for Coyote Springs 2 because they normalize the costs for customers, but not the Company.[229] Avista notes that it would incur the full costs in 2016 but only recover one-fourth of the revenues each year for four years under Staff's proposal.[230] Avista argues that a more appropriate solution would match the costs and benefits for both customers and the Company.[231]

151 Avista proposes to defer the major maintenance expenses for three plants: Coyote Springs 2 (estimated at $3.5 million), Rathdrum (estimated at $0.7 million), and Boulder Park

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[222] Ball, Exh. No. JLB-1T at 12:14-20. We note that Staff does not specify what analysis Mr. Ball used to create the line of best fit.

[223] Ball, Exh. No. JLB-4C at 2 and 4.

[224] Ball, Exh. No. JLB-1T at 13:15-19.

[225] *Id.* at 15:15-18.

[226] *Id.* at 14:3-12.

[227] Mullins, Exh. No. BGM-1T at 36:19-21; Ball, Exh. No. JLB-1T at 13:5-11.

[228] Ramas, Exh. No. DMR-1CT at 51:21-52:6. Public Counsel's analysis of historical O&M data was particularly informative. Ramas, Exh. No. DMR-2 at 7.

[229] Norwood, Exh. No. KON-1T at 44:18-20.

[230] *Id.* at 45:2-14.

[231] *Id.* at 45:5-14.

(estimated at $0.2 million).[232] Under the Company's proposal on rebuttal, actual expenses in 2016 would be placed in a deferral account with no carrying charge. Beginning in 2017, the actual expenses would be amortized over four years.[233] Avista argues that its proposal smoothes or normalizes cost swings for both the Company and its customers.[234] Avista notes that parties supported a similar deferral as a part of a settlement resolving its 2011 general rate case.[235]

152 *Other Party Replies.* No party supports Avista's proposal on rebuttal. ICNU observes that Avista's proposal is a tracker that requires customers to repay the Company all actual expenses.[236] Public Counsel provides a comparison of test-year actuals ($4.35 million) to the five-year (2010-2014) average of other generation plant O&M ($4.11 million). It concludes that test-year actuals are only $235,000 higher than the five-year average, and therefore Avista's proposed adjustment is not necessary.[237] Staff argues that Avista's approach is not necessary for full cost recovery.[238] It notes that Avista's estimate of major maintenance expenses in 2016 ($6.70 million) is higher than the highest actual expense over the past five years ($4.89 million).[239]

153 *Decision.* This Commission commonly uses test-year actuals for generation plant O&M, though we have occasionally authorized the normalization of major maintenance expenses. In this proceeding, we use test-year expenses for generation plant O&M, except for major maintenance at Colstrip and Coyote Springs 2. For major maintenance at Colstrip and Coyote Springs 2, we adopt Staff's proposal to normalize expenses.

154 A review of historical data provided by Staff and Public Counsel shows that test-year expenses are reflective of actual O&M expenses for Rathdrum, Boulder Park and all other generation plants. Thus, we authorize Avista to use test-year O&M expenses for Rathdrum and Boulder Park, and all other generation plants except Colstrip and Coyote Springs 2. Further, Staff demonstrates that basic O&M expenses at Colstrip and Coyote

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[232] *Id.* at 47:3-5.

[233] *Id.* at 45:3-9.

[234] *Id.* at 45:12-14.

[235] *Id.* at 47:20-48:19.

[236] ICNU's Brief, ¶ 49.

[237] Ramas, Exh. No. DMR-1T at 53:14-20; Ramas, Exh. No. DMR-2 at 8.

[238] Staff's Brief, ¶ 108.

[239] Ball, Exh. No. JLB-1T at 8:3-9:3.

Springs 2 in the test year are sufficiently reflective of historical data for use in setting rates, and we adopt Staff's proposal to do so.

155 With regard to major maintenance expenses, we do not support the inclusion of all expenses in one year's rates as proposed by Avista. Absent a rate case resetting rates immediately after the rate year of this proceeding, Avista would over-recover the major maintenance expenses. While Avista apparently plans to file rate cases every year for the next five years, we do not decide this case based on an expectation of annual rate cases. We find Staff's proposal to normalize major maintenance expenses for Colstrip and Coyote Springs 2 as a reasonable approach to allow Avista to recover these costs. We agree with Staff that including a management reserve is contrary to the use of an average cost through normalization and removes the Company's incentive to limit total overhaul costs.

D. Project Compass

156 On February 2, 2015, Avista replaced its legacy Customer Information and Work Asset Management System following a multiyear project it called Project Compass.[240] As the result of Project Compass, the Company installed and now uses Oracle's *Customer Care & Billing* system and IBM's *Maximo* work and asset management application. In Avista's last general rate case, the Commission authorized Avista to defer actual expenses in 2015 associated with the natural gas revenue requirement of Project Compass.[241] Here, Avista proposes to amortize the expenses from the deferral and include $1.143 million in Washington-allocated expenses associated with Project Compass.[242] No party opposes this accounting treatment of the expenses to reflect the Commission's decision in this case.

157 Staff contests the prudence of Avista's expenditures related to the extended timeline of the project ($17.9 million on a system-level basis) as well as an employee incentive bonus plan for employees involved.[243] The combined impact of Staff's Washington-

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[240] Kensok, Exh. No. JMK-1T at 19:14-15.

[241] *WUTC v. Avista*, Dockets UE-140188 and UG-140189 (consolidated), Full Settlement Stipulation, ¶ 7 (Aug. 18, 2014).

[242] Kensok, Exh. No. JMK-1T at 19:14-15; Smith, Exh. No. JSS-1T at 50:13-18; Smith, Exh. No. JSS-3 at 9, column 4.05.

[243] Gomez, Exh. No. DCG-1TC at 49:10-13; 50:8. Shaded information is confidential.

allocated disallowance recommendation is $12.7 million.[244] Staff's prudence argument involves the process Avista used to hire one of its contractors. In Summer 2011, Avista hired Five Point Partners (Five Point) as an outside firm to assist the Company in developing a "Request for Proposals, in soliciting, comparing and evaluating proposals from an array of options and potential vendors," and in negotiating the "final purchase price for applications and integration services."[245]

158 Five Point helped Avista design a solicitation to select another firm to serve as a "system integrator" and write custom software code that would allow different software applications to communicate with each other. In March 2012, Avista selected EP2M to be its system integrator, and with Five Point's assistance, negotiated a contract.[246] Avista executed its contract with EP2M in June 2012. Six months later, Five Point acquired EP2M.[247] In June 2014, Five Point was acquired in turn by Ernst and Young.[248] In October 2014, Avista signed a time and materials contract with Ernst and Young to continue work on systems integration past the original contract's end date.[249]

159 Staff recommends that the Commission disallow $12.7 million of Project Compass' capital costs relating to the extended timeline.[250] It argues that Avista failed "to recognize, evaluate, identify, document and mitigate the possible risks to Project Compass resulting from the apparent conflict of interest arising from Five Point's

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[244] *Id.* at 49:13-16. Staff identifies various expense levels associated with Project Compass, ranging from $95.1 million as filed to $109.9 million in response to a data request. Staff uses $96.7 million as a starting point to calculate its proposed adjustments to this project's transfer to plant amounts. Gomez, Exh. No. DCG-1TC at 47:1-11.

[245] Gomez, Exh. No. DCG-31C at 26 and 28.

[246] Kensok, Exh. No. JMK-6CT at 16:23; Gomez, Exh. No. DCG-1TC at 52 n. 95; Gomez, Exh. No. DCG-15C at 5.

[247] Gomez, Exh. No. DCG-15C at 4-5.

[248] Gomez, Exh. No. DCG-1TC at 56:12. We refer to EP2M/Five Point/Ernst and Young as "the Contractor" when the entity's name is not relevant.

[249] *Id.* at 57:6-7. The extension included a not-to-exceed amount of $6.2 million.

[250] Gomez, Exh. No. DCG-1TC at 49:12 *citing* Kensok, Exh. No. JMK-2 at 12 (The additional capital budget breaks down as $4.7 million from Avista Labor / Loadings, $3.6 million from AFUDC, $3.2 million from system integrators, $3.2 million from technology contractors, $2.2 million from contingency, and $1.1 million from other). Staff proposes this as a "post-attrition adjustment" so that the impact of the disallowance is not subsumed by the attrition adjustment.

acquisition of EP2M."[251] Staff alleges that Five Point may have compromised the procurement process because it was considering, or in the process of, acquiring EP2M when assisting Avista in its choice of EP2M as system integrator.[252]

160 While Staff acknowledges that it "cannot say with certainty" that there were irregularities in the procurement process, it asserts the Contractor's "performance problems commencing early in the project" are "evidence of questions that should have been asked of Five Point by Avista's project management and Executive Steering Committee."[253] Avista eventually worked with its Contractor to address these problems. As a result, the Contractor "retained additional resources to bolster its overseas code-development team" and improved the "volume, velocity and quality for system defect resolution."[254]

161 Staff also contends that if Avista had taken action in late 2013 or early 2014 to address code development problems, the Company "could have avoided the need for an extension of the project's timeline and added cost."[255] Staff argues that the Contractor's inability to deliver usable code amounts to a contractual breach, and asserts that Avista should have evaluated appropriate responses to a contractual breach, including holding back payments and termination of contract.[256]

162 Staff attacks the extension agreement signed with the Contractor as imprudent. It claims it is unable to follow the management decision-making process that led to its conclusion that "the Extension Agreement was its only viable alternative," or determine the "substance of its negotiations and discussions with [the Contractor] ... that eventually led to the agreement."[257]

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[251] Gomez, Exh. No. DCG-1TC at 51:12-52:5.

[252] *Id.* at 52:5 – 54:13.

[253] *Id.* at 54:5-13.

[254] Kensok, Exh. No. JMK-6CT at 14:1-2; Gomez, Exh. No. DCG-17C at 12.

[255] Gomez, Exh. No. DCG-1TC at 51:12-52:5 and 56:1-6. Staff points to a report prepared for the Executive Steering Committee in January 2014 that says "Five Point has been challenged with resources to deliver integration and configuration code to meet Project deliverable dates." Gomez, Exh. No. DCG-15C, Attachment B at 5.

[256] Gomez, Exh. No. DCG-1TC at 55:2-5.

[257] *Id.* at 57:14-17.

163 Staff recommends disallowance of costs related to the Project Compass bonus plan, which provided compensation to employees assigned to the project for "contributions in achieving the successful implementation."[258] Staff states:

> The Company has not provided an explanation as to how the bonus plan benefits rate payers. After all, the project was late and went over budget by almost 40 percent. While it is commendable that the Company wants to acknowledge the hard work of its employees, Staff feels that the circumstances surrounding the project make it inappropriate to ask rate payers to shoulder the return of and on this expense.[259]

164 *Avista's Response.* Avista argues that the Company made the final evaluation and selection of EP2M "on the merits, without any undue influence of a third party."[260] Staff noted that Avista's earlier testimony stated that "Avista's Project Compass team *and Five Point* evaluated and scored each proposal."[261] The Company states that it protected customers "from any potential conflict of interest by the rigorous and objective processes established for developing vendor proposals, evaluating and scoring proposals, making final vendor selections, and in negotiating the final contracts, purchase agreements, and purchase prices."[262] It states further that it was not aware of the acquisition until it occurred, and the prudence standard does not demand hindsight.[263]

165 The Company expresses comfort with the revised project timeline and cost. It notes that the revisions were within the variability range generally expected for software projects,[264] and in any case many components of the project that were behind schedule did not directly involve the Contractor.[265]

166 Moreover, Avista responds that it considered a range of factors in making the decision whether to continue paying the Contractor and sign a contract extension. These included

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[258] *Id.* at 49:20 – 50:6.

[259] *Id.* at 59:6-10.

[260] Kensok, Exh. No. JMK-6CT at 14:17-15:7; *Id.* at 18:2-3.

[261] Gomez, Exh. No. DCG-19 at 31 (emphasis added).

[262] Kensok, Exh. No. JMK-6CT at 16:3-6.

[263] *Id.* at 16:16 – 18:2. Staff does not allege that Avista was aware of the transaction earlier.

[264] *Id.* at 7:4-10:12

[265] *Id.* at 18:4 – 20:26.

the consequences of stopping payment, such as the potential outcome of litigation and its ability to work successfully with the Contractor to complete the project,[266] the Company's ability to complete the project without the Contractor, and the likelihood of delay and increased costs caused by changing contractors.[267]

167 The Company estimated that finding a new suitable contractor and switching to that contractor would add at least several months to the project timeline, and each month of delay would cost $3.6 million.[268] By contrast, all additional payments to the Contractor beyond its original contract represent less than the estimated cost of two months' delay.[269] Additionally, Avista observes that many of the Contractor's staff were among the original authors of the Oracle *Customer Care & Billing* application they were modifying, raising the concern that a replacement team would not have "sufficient knowledge, experience, skills, and familiarity with the application" to complete the project successfully.[270]

168 Finally, Avista argues that the bonus program was appropriately authorized and ultimately successful. The bonus plan included objective and measurable performance benchmarks, was audited by Avista's internal audit group, and approved by the Board of Directors.[271] It states that "employees dedicated a very difficult two-plus years of their working life to seeing it through to completion, and the bonuses were reasonable and appropriate."[272]

169 In its responsive filing, Staff recommended a specific disallowance of $12.7 million ($17.9 million on a system wide basis), consisting of various capital and labor related items and AFUDC. After receiving new evidence from Mr. Kensok, Staff revised its recommended disallowance downward to a total of $7.1 million, consisting of $5.5 million electric and $1.6 million gas.[273] Due to the size and nature of this disallowance,

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[266] *Id.* at 23:21 – 24:2.

[267] *Id.*

[268] *Id.* at 25:8-18.

[269] *Id.*

[270] *Id.* at 24:10-12.

[271] Kensok, Exh. No. JMK-6CT at 29:1-9. The plan is available as Exhibit No. JMK-12C.

[272] *Id.* at 29:10-13.

[273] Staff's Brief, ¶ 75.

Mr. McGuire for Staff did not include this in his overall attrition adjustment, and instead made a post-attrition adjustment in the overall calculation for the revenue requirement.

170 *Decision.* In determining whether an investment is prudent, the Commission asks:

> what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision. This test applies both to the question of need and the appropriateness of the expenditures. The company must establish that it adequately studied the question of whether to purchase these resources and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made.[274]

171 Staff makes a two-part argument in recommending we disallow a portion of the overall capital costs of Project Compass. First, it argues that Avista imprudently managed and then extended the contract with the information technology contractors, Five Point and EP2M (ultimately Ernst & Young). Second, it argues that because of such imprudent management, Avista should not have granted bonuses to its employees involved in the project.

172 After reviewing all the evidence and hearing the Company's response at hearing, we reject Staff's recommendation. Rather, we find that Avista demonstrated that its revisions to project costs and timelines were within the variability range generally expected for software projects of this magnitude and complexity. When confronted with delays and other challenges, it appropriately considered options on how to proceed, including alternatives such as terminating the contract with Five Point/EP2M and moving to a new contractor. It concluded, and stated for this record, that such alternatives carried too much risk and potential further costs in its judgment. Moreover, we decline to find that the Company engaged in inappropriate actions in the selection of contractors, as Avista testified that it was unaware of the acquisition of EP2M by Five Point at the time of the contractor selection, and Staff has provided no evidence other than speculation to contest that.

173 Finally, we do not agree with Staff's assertion that the bonuses paid to the Avista staff actively involved in managing Project Compass were imprudent, and should therefore by disallowed. Instead, we agree with the Company that such bonuses were properly determined and reviewed internally, were based on objective and measurable

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[274] *WUTC v. Puget Sound Energy, Inc.*, Docket UE-031725, Order 12, ¶ 19 (Apr. 7, 2004).

benchmarks, and were appropriately given to ensure continuity for key employees to ensure efficient final completion for an IT project of this magnitude.

174 Accordingly, we do not find Staff's arguments to be persuasive on this record to disallow a certain portion of the capitalized costs of Project Compass. Rather, we find that Avista carried its burden to show that it acted prudently in managing this project to completion using the existing contractor, including the project extension and increased costs compared to the estimate. Although we do adopt a certain attrition adjustment, as set forth above, we decline to make a post-attrition adjustment for the project either in the initial amount recommendation by Staff on a Washington-allocated basis ($12.7 million) or the revised amount ($7.1 million).

E. Advanced Metering Infrastructure

175 In its initial filing, Avista proposed to begin deploying advanced metering infrastructure (AMI) across its Washington service territory in 2016, citing a $7.5 million net present value benefit over 21 years.[275] The Company requested inclusion of approximately $30 million in capital additions in this case, representing the cost of new meters to be installed in 2016. On rebuttal, the Company removed this capital addition, and instead requests that the Commission rule on "the prudence of the decision to move forward with the deployment of AMI."[276]

176 Deploying advanced metering technologies allows a utility to reduce its operating expenses associated with meter reading and to communicate more frequently with the meter and potentially other devices that use electricity.[277] This technology provides a utility with the means to disconnect and reconnect service remotely, quickly gain awareness of outages, provide conservation voltage reduction services, reduce unbilled usage, and potentially enable demand response, time of use rates, and prepaid services.[278]

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[275] Kopczynski, Exh. No. DFK-1T at 15:9. Avista currently uses a less sophisticated Automated Meter Reading (AMR) technology in its Idaho and Oregon service territory.

[276] Norwood, Exh. No. KON-1T at 40:17-19, and 41:1.

[277] Kopczynski, Exh. No. DFK-5 at 10-12.

[278] *Id.* at 11-17.

177 Avista supports its proposal with a business case analysis,[279] and notes a national trend of utilities deploying advanced metering.[280] The Company's "preliminary estimate" of projected lifetime costs is $223 million over 21 years, including $145 million in capital and $78 million in annual O&M costs.[281] According to Avista, these costs will be offset with projected benefits of $170 million in operational savings and $60 million in direct customer savings.[282] The business case includes an estimated net present benefit of $7.5 million for the 21-year life of the AMI.[283] This net benefit is equal to 3.36 percent of the lifetime costs and, if expressed as an annual amount over a 21-year period, is $357,143 per year.[284] However, in its most recent estimate, Avista lowered the project's net present benefit from $7.5 million to $3.5 million over 21 years.[285]

178 While Avista removes this capital addition on rebuttal, it asks the Commission to make a variety of decisions about AMI. Mr. LaBolle asks for "guidance . . . as to whether or not advanced metering should be implemented,"[286] while Mr. Norwood requests an order "that supports Avista's decision to move forward, in principle, with the deployment of AMI."[287] Avista seeks "an affirmation that the Company should proceed with the implementation of AMI, so long as the costs of implementation are prudently incurred."[288] The Company specifically rejects the notion that it is requesting preapproval of the costs associated with implementation of the project and their recovery in rates,

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[279] *Id.*

[280] Kopczynski, Exh. No. DFK-1T at 8-10. Public Counsel and The Energy Project assert that this trend "occurred as a result of significant grants totaling $4 billion under the American Reinvestment and Recovery Act," and are not indicative of cost-effective investments. Alexander, Exh. No. BRA-1T at 11:17-21.

[281] Kopczynski, Exh. No. DFK-1T at 14:22 – 15:3 (net present value revenue requirement).

[282] *Id.* at 15:3-7 (net present value benefits).

[283] Kopczynski, Exh. No. DFK-1T at 15.

[284] Alexander, Exh. No. BRA-1T at 5:11-12.

[285] La Bolle, TR 374:11-13; La Bolle, Exh. No. LDL-16 at 2.

[286] La Bolle, Exh. No. LDL-1T at 4:5.

[287] Norwood, Exh. No. KON-1T at 40:20-21.

[288] Avista's Response to BR No. 3 at p. 1.

stating that cost recovery "will be the subject of a prudence review in Avista's next general rate filing."[289]

179 Avista also requests specific accounting treatment regarding the undepreciated net book value of retiring existing meters. Avista proposes that the Commission create a regulatory asset for the undepreciated value of existing meters that it plans to remove and approve the amortization of the balance into rates over a ten year period.[290] Avista claims that absent Commission approval of this accounting treatment, the project would be canceled or delayed because the Company would not move forward as it would face an approximately $20 million write-off.[291]

180 *Other Party Positions.* Staff, Public Counsel, The Energy Project, and ICNU oppose Avista's initial proposal in this case. Mr. David Nightingale, on behalf of Staff, objects to the Company's request primarily because, as proposed by the Company, AMI would not be used and useful for service in Washington.[292] The equipment has not been purchased, and Avista is still in the process of developing a plan to acquire smart meters and implement AMI.[293] Mr. Nightingale argues that Avista's proposal consists of a "planning level estimate" including cost and benefit estimates that "are too speculative to be useful for ratemaking purposes," and that fall short of the Commission's known and measurable standard.[294] He recommends the "Commission should exclude these yet-to-be-incurred expenses from this rate case because the AMI is not yet used and useful for service in Washington."[295]

181 Public Counsel and The Energy Project's witness, Ms. Barbara Alexander, concludes that the costs for the AMI project "are neither known and measureable, nor used and useful."[296] Ms. Alexander and Mr. Mullins, for ICNU, also criticize the accuracy of

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[289] *Id.*

[290] Norwood, Exh. No. KON-1T at 41:17-20.

[291] *Id.* at 42:3-4.

[292] Nightingale, Exh. No. DN-1T at 5:3-6:7.

[293] At the time of rebuttal testimony, Avista had issued an RFP for new electric meters and a meter data management system. Norwood, Exh. No. KON-1T at 40:11-14.

[294] Nightingale, Exh. No. DN-1T at 7-10.

[295] *Id.* at 4:4-5.

[296] Alexander, Exh. No. BRA-1T at 10:11-12.

Avista's estimated costs and benefits.[297] They note that Avista's cost estimates are not tailored to Avista's metering system, service territory, communications network, billing system, or outage management systems.[298] As we noted above, on rebuttal, Avista does not counter these arguments and instead removes its proposed $30 million capital addition from its requested 2016 rates.[299]

182 Ms. Alexander also rejects Avista's claimed savings due to remote disconnection and reconnection of electric service. Ms. Alexander objects to Avista's assumption that the Commission will allow it to disconnect service without a utility employee visiting the customer's home. She notes that the employee visit serves an important consumer protection function, especially for low-income customers.[300]

183 Ms. Alexander also raises concerns about the value that Avista attributes to avoided electrical outages. She focuses her critique on the way that Avista calculates the $2.2 million benefit of outage avoidance to customers. This represents an imputed value, *i.e.*, what the U.S. Department of Energy's Interruption Cost Estimator (ICE calculator) says customers would pay to avoid an outage.[301]

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[297] Mullins, Exh. No. BGM-1CT at 5:1-9; Alexander, Exh. No. BRA-1T at 9. Avista provided at least five different cost estimates, two of which come from the Company's initial filing. Those estimates include capital costs ranging from $131 million to $165.5 million, and annual O&M costs ranging from -$5.8 million to $5.8 million. Alexander, Exh. No. BRA-1T at 7:16-18.

[298] Alexander, Exh. No. BRA-1T at 16:2-8.

[299] Norwood, Exh. No. KON-1T at 40:17-19.

[300] Alexander, Exh. No. BRA-1T at 23:12-14. She notes that WAC 480-100-128(6)(k) requires a utility employee dispatched to disconnect service to accept payment from the customer to avoid disconnection, and several states have rejected proposals to eliminate employee visits for disconnection. *Id.* at 26-27. New York, Ohio, and Maryland declined to eliminate employee visits for residential disconnections, and California requires an employee visit if the utility has evidence that the disconnection will cause an adverse medical condition. She notes that between 2009 and 2012, the Company annually accepted between 5,000 and 6,000 payments at the door to stop disconnection of service. *Id.* at 24:1-2. Ms. Alexander concludes that several policies related to AMI, including remote disconnection, data access, and opt-out policies will require significant regulatory proceedings for which Avista has not budgeted in this project. *Id.* at 18:17-19:4-19.

[301] *Id.* at 34-38. Avista calculates a $2.2 million benefit of outage avoidance to its customers by multiplying the number of outage minutes avoided by a dollar amount. The dollar amount is based on an ICE calculator that the U.S. Department of Energy developed to evaluate smart grid projects. Kopczynski, Exh. No. DFK-5 at 13. Ms. Alexander questions the methodology supporting the ICE calculator, and notes that it has not been approved or used by state regulatory commissions in a litigated rate proceedings. Alexander, Exh. No. BRA-1T at 35:10-17. Avista

184 Mr. Mullins argues that allowing carrying charges for the regulatory asset allows Avista double recovery.[302] He argues that it is inappropriate to create a regulatory asset for existing meters before those meters are retired.[303] Mr. Mullins recommends the Commission completely reject the AMI plan proposed in the Company's initial filing.

185 After concluding that Avista's proposal is inappropriate because AMI is not used and useful, Mr. Nightingale recommends a future proceeding to address AMI. He states that if Avista chooses to implement AMI, it should be prepared to demonstrate, after implementation, that the deployment is cost-effective.[304]

186 Mr. Nightingale requests that the Commission initiate a workshop to review its smart grid policies, including its 2007 Policy Statement,[305] the potential to extend or modify the annual smart grid technology report required under WAC 480-100-505, and consider a requirement for utilities to issue a request for proposals for a smart grid potential assessment that serves the same function as the conservation potential assessment described in WAC 480-109-100(2).[306]

187 In their briefs, Staff and Public Counsel argue that Avista is seeking pre-approval of its planned AMI investment.[307] Further, Staff and Public Counsel argue that the Commission need not act in this case for Avista to avoid a write-off;[308] instead Avista could file a separate accounting petition at a later date.[309]

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responds that the methodology is commonly used in the utility industry, citing to an industry standard. La Bolle, Exh. No. LDL-1T at 12:14-13:10.

[302] Mullins, Exh. No. BGM-1CT at 32:11-20.

[303] *Id.* at 33:4-8.

[304] Nightingale, Exh. No. DN-1T at 12-14. He also points to a 2007 Policy Statement that includes a "broad range of factors" the Commission would consider when "examining advanced metering," noting that Avista should be prepared to address those factors. *Interpretive and Policy Statement Regarding Energy Policy Act of 2005 Standards for Net-Metering, Fuel Sources, Fossil Fuel Generation Efficiency and Time-Based Metering,* Docket UE-060649 at 10-11 (August 23, 2007). In addition, Staff notes other factors that Avista should be prepared to consider: cybersecurity, the benefits of energy storage batteries, the benefits of synchrophasers and the benefits of grid voltage regulation and grid stability. Nightingale, Exh. No. DN-1T at 14.

[305] *Id.*

[306] Nightingale, Exh. No. DN-1T at 7-16.

[307] Staff's Brief, ¶ 77; Public Counsel's Brief, ¶ 92.

[308] Staff's Brief, ¶ 90.

[309] Public Counsel's Brief, ¶ 122.

188 *Decision.* We generally support utilities' provision of technologically advanced service to customers when a utility demonstrates that the investment is used and useful and prudent. We acknowledge that Avista has been a leader among the region's utilities in deploying advanced "smart grid" technologies over the past decade in both the Spokane distribution system and the Pullman area that included both distribution and metering technologies.

189 In addition, the Commission has taken an active role in monitoring technology trends. As Staff points out, in 2010 the Commission enacted a rule (WAC 480-100-505) requiring Avista and other utilities to file periodic reports in which the companies assess potential for advanced technologies, including advanced digital and two-way communications, which the customer can use to interact with the utility in new ways. While such reports and periodic Commission briefings are not case-specific reviews of specific capital investments for prudency, we have found them to be useful and informative.

190 The Company portrays AMI as another step in this technological and business evolution of the utility as it adapts to changing circumstances. It has requested some "guidance" or a sense of the Commission's "general direction" toward AMI in this proceeding. However, we note that assessing such a far-reaching technology upgrade in a general sense in a briefing or workshop is a different matter than reviewing a detailed cost-benefit study in a specific rate case proceeding. AMI requires a large upfront capital investment, which Avista claims will be offset by the benefits cited in its business case. We view Avista's requests in this case as requests that the Commission take the first step towards a prudence determination prior to the Company even selecting a vendor to replace the meters, or for that matter, deciding on specific vendors for the meters, communications network, and related infrastructure supporting such a large project.

191 We decline Avista's requested action because this issue is not ripe for Commission determination. The Commission's longstanding practice is to review the prudence of a utility's investment in plant after that plant is placed in service and is used and useful.[310] In contrast, this case discusses a proposal for a future investment that, if we took that first step towards a prudence determination, could be viewed as the Commission indicating pre-approval.

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[310] Indeed, Company witness Kopczynski states "I'm not aware of any time that this Commission has ever authorized anything [by] pre-approval." Kopczynski, TR 299:9-11. While the company claims it is not asking for preapproval, we are concerned that any "guidance" we offer would be viewed as such.

192 The Company testifies that its board of directors has not made a decision regarding this investment,[311] and its management suggests the Company is in a partnership with us on this project.[312] The responsibility for a decision to move forward with an investment rests with the Company.[313] Avista's proposal asks the Commission to make the managerial decisions for it; we decline to do so. The Company must place new plant in service for its ratepayers before the Commission will opine on the prudence of its decision. To do otherwise would deny us the opportunity to apply our prudence standard to "the question of need" for AMI.[314]

193 While we do not make a decision regarding the prudence of this project in this proceeding, we note the considerable uncertainty surrounding the business case analysis Avista prepared. During the pendency of this case, the Company modified both the estimated costs of the AMI deployment, by $20 million in capital costs, and the net benefits, from $7.5 million to $3.5 million. At hearing, Mr. Kopczynski testified that the business case analysis was accurate with "plus-or-minus-50-percent type of uncertainty."[315] The relatively small anticipated benefit of Avista's business case of $3.5 million out of a $227 million project, coupled with "plus-or-minus-50-percent" uncertainty in cost, demonstrates that significant uncertainty exists. While we are aware of the potential upside of AMI deployment, we must also recognize the potential costs to ratepayers if a "minus-50-percent" scenario prevails. The Commission cannot conclude on this record that deployment of AMI, under the business case that Avista presents in this case, is compelling at this time. We look forward to more refined cost-benefit analysis in a future proceeding, including a fuller discussion of "non-quantifiable benefits" suggested by Mr. Kopczynski.[316]

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[311] Kopczynski, TR 318-319; TR 333-334. While Mr. Kopczynski testifies that the Board does not decide on individual projects, we note that it retains ultimate responsibility for overseeing management's decisions regarding individual projects.

[312] Norwood, TR 114:17-21.

[313] *WUTC v. Puget Sound Energy, Inc.*, Docket UG-110723, Order 07, ¶¶ 35-36 (May 18, 2012)**Error! Bookmark not defined.** (A utility "alone shoulders the obligation to . . . determine which [projects] should be constructed and when.").

[314] *WUTC v. Puget Sound Energy, Inc.*, Docket UE-031725, Order No. 12, ¶ 19 (Apr. 7, 2004).

[315] Kopczynski, TR 306:20 – 307-11.

[316] Kopczynski, TR 343:15 – 344:16.

194 Avista claims that absent Commission approval of its proposed regulatory asset in this proceeding the Company would face a $20 million write-off when it purchases new meters.[317] Avista's discussion ignores the Commission's longstanding regulatory practice of reviewing and approving accounting petitions in a timely manner and deciding on the recovery of costs in a future proceeding.[318]

195 Mr. Norwood cites to Generally Accepted Accounting Principles (GAAP) and asserts that absent an accounting order from the Commission, once Avista selects a vendor and signs an agreement, it would be required to write-off its existing net investment in its older meters.[319] We do not read the requirements of ASC 980 (FASB 71)[320] that way, and we have consistently applied those requirements differently. Indeed, contrary to Mr. Norwood's contention, and based on the prior actions of this Commission, it would take an order from this Commission *denying* recovery to trigger the write-off.

196 Further, an order deciding the proper accounting should originate from a timely-filed accounting petition, not as a peripheral issue raised in a general rate case. The Commission can consider the complexities of the treatment of what appears to be a stranded cost issue by examining supporting documents and, if needed, supporting testimony from qualified witnesses.

197 We need not decide on the accounting treatment proposed by Avista in this case. If the Company chooses to acquire new meters, it may file an accounting petition that requests the Commission issue an order determining whether the Company is allowed to defer the undepreciated amounts related to the replaced meters in a regulatory asset account. Our normal practice is to approve such a petition without undue delay, then decide on the recovery of costs in a future proceeding at which the Company must demonstrate that its acquisition was prudent and is used and useful.

198 The Company also asks us to provide guidance on issues such as the amortization period, and the establishment of an appropriate return on such a regulatory asset. ICNU also

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[317] Norwood, Exh. No. KON-1T at 42:3-4.

[318] See, *e.g.*, *In re Petition of Avista Corp. For An Accounting Order to Defer Costs Related to Improving Dissolved Oxygen Levels in Lake Spokane*, Docket UE-131576, Order 01 ¶ 5 (Sept. 26, 2013) (Accounting petition filed on Aug. 27, 2013 and approved on Sept. 26, 2013. A determination of prudence and the eligibility for recovery of any costs to occur in the Company's next general rate case or a future filing.).

[319] Norwood, Exh. No. KON-1T at 41:8-11.

[320] *See Accounting Standards Code - Regulated* Operations *980-340-25-1*.

raises some important issues regarding the timing and length of such an amortization period, as well as the depreciation expense on the existing meters.[321] Again, we decline to provide any specific guidance or decisions in this case.

199 In conclusion, we decline to rule on the prudency of Avista's proposed AMI investment in this case because the issue is not ripe for our determination. This decision should not be interpreted as a rejection of AMI. The Company must decide what metering program provides ratepayers the most benefit at the least cost. If the Company decides to procure a new metering system, it may file a well-supported accounting petition on a timely basis to avoid a write-off. If the Company presents actual costs for AMI capital expenditures, either partial or full deployment, in a future rate case, the Commission will consider the prudence of Avista's investment at that time.

F. Labor Expenses

1. Non-Executive Wages

200 Avista makes several adjustments to test-year expenses for non-executive wages. Those adjustments include:

- annualizing the impact of a 3 percent wage increase for union and non-union employees implemented for 2014;
- annualizing the impact of a 3 percent wage increase for union employees implemented for 2015;
- annualizing the impact of a 3 percent wage increase for non-union employees implemented for 2015, and
- including a 3 percent wage increase for union and non-union employees projected for 2016.[322]

201 Public Counsel observes that Avista removed labor expenses associated with Project Compass from a capitalized expense and instead placed those expenses in this adjustment.[323] ICNU asserts that the Commission rejected Pacific Power & Light's 2014 general rate proposal that similarly escalated labor expenses 27 months beyond the end of

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[321] Mullins, Exh. No. BGM-1CT at 32:11-33:8.

[322] Ramas, Exh. No. DMR-1CT at 35:18-36:10.

[323] *Id.* at 36:10-37:8.

the test period.[324] Staff notes that in Puget Sound Energy's 2009 general rate proceeding, the Commission allowed the inclusion of union contract increases four months following the test year, but rejected the inclusion of union contract increases 10 months following the test year as violating the matching principle.[325]

202 Public Counsel accepts the wage increases for 2014 and 2015, but rejects Avista's inclusion of the increases for 2016 because the increases are "not yet known and measurable and are too far beyond the end of the test year ended September 30, 2014."[326]

203 ICNU criticizes Avista's modeling of labor expenses because it applied the increases to all payroll expenses, rather than using a more precise full-time-equivalent (FTE) model that breaks out labor by capital and expense.[327] Without the precision provided by an FTE model, ICNU argues that the adjustment, particularly the Company's decision to move the Project Compass labor expenses from a capitalized expense to this adjustment, is not known and measurable and should be rejected entirely. Alternatively, ICNU proposes that the adjustment be limited to the wage increases for 2014.[328]

204 Public Counsel also objects to moving Project Compass labor costs from a capitalized expense to this adjustment. Public Counsel observes that Avista's testimony did not disclose this substantial shift, and it did not demonstrate that increased labor costs associated with Project Compass will persist.[329] Avista responds that a large number of existing employees worked on Project Compass, but now that Project Compass is complete they will no longer bill their salaries as a capital expense.[330]

205 Staff supports the 2014 wage increase and the 2015 union wage increase, but opposes both the 2015 non-union increase and the 2016 wage increase. Staff argues that the 2015

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[324] Mullins, Exh. No. BGM-1CT at 42:18-20 (*citing WUTC v. Pacific Power*, Docket UE-140762 *et al.*, Order 08, ¶¶ 31-41 (Mar. 25, 2015)).

[325] Ball, Exh. No. JLB-1T at 20:5-14; *WUTC v. Puget Sound Energy*, Dockets UE-090704 and UG-090705, Order 11, ¶¶ 88 (Apr. 2, 2010) (rejecting union contract increases in October 2009 in a case where the test year ended December, 31 2008).

[326] Ramas, Exh. No. DMR-1CT at 37:11-38:3.

[327] Mullins, Exh. No. BGM-1CT at 43:3-20.

[328] *Id.* at 43:21-44:5.

[329] Ramas, Exh. No. DMR-1CT at 39:6-19.

[330] Smith, Exh. No. JSS-4T at 34:20-27.

union wage increase is pursuant to contract, but other 2015 and 2016 wage increases are not known and measurable.[331]

206 *Decision.* In the past, we have allowed only limited adjustments to labor expenses beyond the test period when those adjustments are known and measurable. We agree with Staff that the 2014 wage increases and 2015 union wage increases should be included in rates, but we reject the 2015 non-union increase and 2016 increases because those increases are not yet known and measurable.

207 We agree with ICNU that it is preferable for Avista to use a model that provides a more precise estimate of labor expenses. Yet we do not see this lack of precision as a reason to reject all of Avista's labor adjustments, or to reject the Project Compass labor adjustment, as ICNU proposes.

2. Executive compensation

208 Executive compensation includes Avista's executive Long Term Incentive Plan (LTIP), executive salaries, and Board of Directors' fees.

a. Executive Long Term Incentive Plan

209 Avista's LTIP "is a pay-at risk plan whereby executive officers and other key employees are eligible to receive common stock and dividend equivalents if stated targets are achieved and employment is maintained."[332] Seventy-five percent of this incentive is contingent on shareholder return, while 25 percent is contingent on continued employment with Avista. Previously, none of the LTIP was included in rates.[333]

210 Avista proposes for the first time to include the retention incentive in rates because the "long-term nature of large-scale generation, transmission and distribution projects spanning multiple years are completed more efficiently with experienced, consistent leadership," and employees with long tenure who "are well versed in the Company's culture and will continue to cultivate the values we have built our Company on."[334]

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[331] Ball, Exh. No. JLB-1T at 20:17-21:2.

[332] Smith, Exh. No. JSS-1T at 21:4-7.

[333] Ramas, Exh. No. DMR-1CT at 33:9-19.

[334] Smith, Exh. No. JSS-1T at 21:9-21.

Avista does not propose to include in rates the portion of the incentive contingent on shareholder return.[335]

211 Staff, Public Counsel, and ICNU oppose including any LTIP expenses in rates because the value of the incentive is based on the value of the Company's stock.[336] They argue that the LTIP benefits shareholders because it focuses the employees on Avista's stock value. Further, they argue that Avista has not provided adequate justification to shift this expense from shareholders to ratepayers.[337]

212 ICNU contests Avista's claim that the failure to include this adjustment previously in rates was an oversight, and it argues the Company is simply attempting to "justify charging ratepayers for restricted stock."[338] Avista responds that its prior practice does not prevent inclusion of the LTIP in this case. The Company reviewed all expenses to ensure an appropriate utility/non-utility allocation and in the process of that review decided to change the allocation.[339]

213 *Decision.* We agree the LTIP is based on the value of the Company's stock and focuses executives' attention on the value of the stock. For this reason, it only serves as a retention tool in order to ensure continued access to stock and dividend equivalents. These characteristics reflect more interest in providing benefit to shareholders than to serve customer or ratepayer interests. Thus, we agree with the other parties that it is inappropriate for the Company to recover any LTIP expenses, including the retention incentive, from ratepayers.

b. Executive Salaries

214 Avista proposes an adjustment to reflect an annualized 2014 level of executive officer salaries.[340] Unlike non-executive wages, Avista does not propose to reflect salary increases for 2015 or 2016 in rates. In this adjustment, Avista proposes only to modify the portion of executives' time allocated to Washington utility and non-utility

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[335] *Id.* at 22:3-5.

[336] Ramas, Exh. No. DMR-1CT at 34:18-26; Ball, Exh. No. JLB-1T at 31:17-32:9; Mullins, Exh. No. BGM-1CT at 38:20-39:8. They also oppose Avista's plan to include the retention bonus rates, because the retention bonus is paid in stock.

[337] *Id.*

[338] Mullins, Exh. No. BGM-1CT at 38:20-39:8.

[339] Smith, Exh. No. JSS-4T at 29:16-22.

[340] Smith, Exh. No. JSS-1T at 26:10-27:8; Ball, Exh. No. JLB-1T at 20:26-21:9.

functions.[341] Avista projects that executives spend an average of 89 percent of their time on Washington utility functions.[342] Avista supports this change based on a review of the executives' job responsibilities, and the shift of their time from working on the sale of a non-utility subsidiary and the acquisition of a small utility in Alaska back to Washington utility efforts.[343]

215 Staff modifies this adjustment to reflect an 83 percent Washington utility allocation based on timesheet data for the test period.[344] Staff argues that Avista "did not provide a clear and convincing description of any anticipated changes in current executive responsibilities."[345] Avista responds that the sale of its largest subsidiary and the acquisition of an Alaskan utility resulted in an abnormally high amount of executive time devoted to non-utility projects in 2014.[346] This level of oversight, according to the Company, will not be required in the upcoming rate year.[347]

216 ICNU modifies this adjustment by using a $325,000 per executive cap on compensation. It supports this cap by noting that no key executives at public power utilities in the Northwest have salaries exceeding $325,000.[348]

217 Avista responds that it is not appropriate to compare its executives' responsibilities to a public power executive's responsibilities for multiple reasons. Public power organizations are normally not dual-fuel utilities, operate in only one jurisdiction, and do not own and operate extensive generation and transmission facilities.[349] In addition, publicly traded companies have more constituencies than public power organizations including the investment community, shareholders, and multiple regulatory agencies.[350] Avista's board annually reviews total compensation, working with a consultant that provides a report of salaries at select peer utilities. That peer group does not include many

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[341] Smith, Exh. No. JSS-1T at 26:10-27:8. Electric Adjustment 3.03, Gas Adjustment Gas 3.01.

[342] Ball, Exh. No. JLB-1T at 21:1-18.

[343] Smith, Exh. No. JSS-1T at 26:10-27:8.

[344] Ball, Exh. No. JLB-1T at 21:11-18.

[345] *Id.* at 21:15-16.

[346] Smith, Exh. No. JSS-4T at 35:13-21.

[347] *Id.*

[348] Mullins, Exh. No. BGM-1CT at 37:20-38:2.

[349] Smith, Exh. No. JSS-4T at 36:4-7.

[350] *Id.* at 36:13-19.

public power entities due to the disparity in their annual revenues, operational focus, and organizational structure.[351]

218 *Decision.* We reject Avista's proposal to adjust the amount of time its executives allocate to Washington utility work because these projections are not known and measurable. Instead, we adopt Staff's allocation based on measured timesheet data from the test period. We reject ICNU's argument that we should cap each executive's salary at $325,000 based on a simple list of executive salaries at consumer-owned utilities in the region. We do not find ICNU's analysis sufficiently robust to counter Avista's reliance on a carefully selected peer group to set executive compensation.

c. Director's fees

219 In Adjustment number 2.12, Avista removed 50 percent of director meeting expenses and 3 percent of director fee expenses.[352] ICNU notes that in Avista's 2009 general rate proceeding, the Commission required the Company to split director fees and meeting costs evenly between customers and shareholders.[353] ICNU's adjustment results in a reduction to Avista's revenue requirement of approximately $0.5 million on a Washington-allocated basis. Avista does not respond to ICNU's proposal on rebuttal.

220 *Decision.* Avista only removed 3 percent of the director fee expenses, while our practice is to allow the Company recovery of 50 percent of director fees from ratepayers. Avista has not presented substantial evidence as to why this practice should be modified. Absent such a showing, we continue to authorize only 50 percent of director fees and meeting costs in both electric and natural gas rates.

G. Low-Income Rate Assistance Program

221 RCW 80.28.068 authorizes the Commission to approve discounted rates for low-income customers and recover the cost of those discounts through surcharges to all customers. Avista's Low-Income Rate Assistance Program (LIRAP) provides bill assistance to eligible customers with a household income less than or equal to 125 percent of the Federal Poverty Level (FPL), and recovers the cost through Schedule 92 (electric) and Schedule 192 (gas). The funding is administered by Community Action Agencies in

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[351] *Id.* at 37:2-14.

[352] Smith, Exh. No. JSS-1T at 45:5-7.

[353] Mullins, Exh. No. BGM-1CT at 39:10-18, *citing WUTC v. Avista*, Dockets UE-090134 and UG-090135 (consolidated), Order 10, ¶ 142 (Dec. 22, 2009).

Avista's service area, which accept applications; determine customers' eligibility for assistance through LIRAP Heat, LIRAP Senior Energy Outreach, and LIRAP Share; and distribute LIRAP grants.

222 In the Commission's order approving the settlement in Avista's 2014 general rate case, the Commission approved a one-time funding increase for LIRAP and required Avista, Staff, Public Counsel, The Energy Project, NWIGU and ICNU to work together to develop mutually agreed-upon additions and modifications to LIRAP by June 1, 2015.[354] The parties were still engaged in those discussions at the time Avista initiated this proceeding.[355]

223 On June 25, 2015, the Commission approved the parties' Joint Petition to (1) establish a pilot rate discount program for fixed-income seniors and disabled persons in addition to the current LIRAP program, (2) establish a LIRAP Advisory Group, and (3) authorize funding for those activities.[356] The Commission also adopted the following goals for Avista's LIRAP program:

- Keep customers connected to energy service,
- Provide assistance to more customers than are currently served,
- Lower the energy burden of LIRAP participants, and
- Collect data necessary to assess program effectiveness and inform ongoing policy discussions.

224 Staff recommends that the Commission approve a five-year plan to increase LIRAP funding by $475,000 per year or twice the percentage increase in the residential revenue requirement, whichever is greater.[357] Staff's proposal is designed to serve 25,565 customers, which is approximately half of the current eligible population, within 10 years. Staff estimates that this plan will enable Avista to provide LIRAP assistance to an

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[354] *WUTC v. Avista*, Dockets UE-140188 and UG-140189 (*consolidated*), Order 05, ¶ 5 (Nov. 25, 2014).

[355] Williams, Exh. No. JMW-1T at 5:4-6.

[356] *WUTC v. Avista*, Dockets UE-140188 and UG-140189 (*consolidated*), Order 07 (June 25, 2015).

[357] Williams, Exh. No. JMW-1T at 2:13-17.

additional 1,085 eligible customers per year, and a total of 20,126 customers by the end of the 2019-2020 program year.[358]

225 Public Counsel and The Energy Project jointly propose a five-year plan to increase LIRAP funding by 10 percent per year, or twice the percentage increase in the residential revenue requirement, whichever is greater.[359] They estimate that this plan will enable LIRAP to serve an increasing number of customers each year, for a total of 22,440 customers in the 2019-2020 program year.[360] Their proposed 10 percent increase in funding is based on the amount by which the Community Action Agencies could reasonably and manageably expand their programs.[361] They assert that their proposal achieves the desired outcome in a shorter, but still reasonable timeframe.

226 On rebuttal, Avista proposes an alternative multi-year plan, which increases LIRAP funding by 7 percent per year, or twice the percentage increase in residential electric and natural gas base rates, whichever is greater.[362] The Company proposes that new rates go into effect on January 1, 2016, and subsequent annual increases to LIRAP funding be filed on August 15th to become effective beginning October 1, 2016. Any additional funding increases necessary to achieve the funding plan would become effective with the corresponding base rate increase authorized in subsequent general rate cases.

227 The Company argues that its plan represents a reasonable annual funding increase and specifies how the proposed increases are recovered from electric and natural gas service schedules, rather than the total program level.[363]

228 Staff testified at hearing that in the interest of fairness eventually all customers who are eligible for assistance and who request it should be able to receive it.[364] Staff estimates

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[358] Williams, Exh. No. JMW-2 at 1.

[359] Collins, Exh. No. SMC-1T at 3:18-22.

[360] Collins, Exh. No. SMC-5 at 1.

[361] Collins, Exh. No. SMC-1T at 13:1-3.

[362] Ehrbar, Exh. No. PDE-8T at 8:1-6; 9:17-19. The Company proposes to base LIRAP funding levels on the final approved base tariff rates as well as the then-current Schedule 150 (Purchase Gas Adjustment) rates. The Company chose 7 percent based on Staff's proposed increase of $475,000 compared to the updated total current LIRAP funding level of $7,048,065 (approx. 7 percent).

[363] *Id.* at 10:1-3.

[364] Reynolds, TR at 538:13-16.

that the Company's proposal would serve approximately half of eligible customers in Avista's service territory within six years.[365] On brief, The Energy Project projected that Avista's proposal would serve half of the eligible customers within seven years, assuming rates do not increase during this time.[366] At hearing, both The Energy Project and Public Counsel continued to support a faster ramp-up of LIRAP funding (10 percent per year or half the residential rate increase) and urged the Commission to retain flexibility over how LIRAP funds are spent.[367]

229 *Decision.* It is clear from the collaborative work of the parties in filing the Joint Petition, and in this case, that current funding levels are not sufficient to serve the eligible population in Avista's service territory.[368] While not all customers who are eligible for assistance will necessarily request it, current funding levels are not adequate to serve many customers who request assistance.[369] However, we also recognize the need to keep any overall increase in LIRAP funding at a reasonable level.[370]

230 Since we do not know the full extent of the unmet need at this time, we believe that it is appropriate to increase the number of eligible customers served gradually over time. We support Staff's goal of eventually providing enough LIRAP funding to serve approximately half of the eligible population, with the assumption that the Low-Income Advisory Group will monitor the program's progress toward this goal, and make recommendations to revise the program, if needed.

231 We also agree that a multi-year funding plan is desirable to provide parties and stakeholders relief from annually litigating LIRAP funding levels.[371] We support the parties' consensus that a five-year timeline will provide this certainty and that a gradual ramp-up in LIRAP funding is appropriate to aid the Community Action Agencies'

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[365] *Id.* at 540:2-5.

[366] The Energy Project's Brief at 6.

[367] Collins, TR at 606:18-23.

[368] According to a study conducted by Eastern Washington University, 51,130 households within Avista's service territory (22.5 percent) earn income at or below 125 percent of the Federal Poverty Level. Collins, Exh. No. SMC-1T at 8:5-8; Collins, Exh. No. SMC-4.

[369] Williams, Exh. No. JMW-1T, at 7:4-7.

[370] *Id.* at 9:22-23.

[371] *Id.* at 10:18-21.

administration of this program.[372] We also agree with the parties that it is important to retain flexibility in the administration of LIRAP funds.[373]

232 We adopt a plan consistent with the five-year plan and true-up schedule Avista filed on rebuttal.[374] Avista's plan to increase funding by 7 percent or twice the percentage increase in Schedule 1 and Schedule 101 base rates, whichever is greater, is reasonable. This funding plan authorizes multi-year rate increases for Schedules 92 and 192, but does not change any LIRAP programs or the way that LIRAP funds are administered.

233 The Company asks that the funding plan commence on January 1, 2016. However, because the Commission is issuing this Order after that date, we authorize the plan to commence on the effective date of this order. Avista should file tariffs to increase electric LIRAP funding by 7 percent and natural gas LIRAP funding by twice the base rate increase for Schedule 101 customers. By August 15th, Avista should file revisions to Schedule 92 and 192 to increase LIRAP funding by 7 percent for the program year beginning October 1st, and annual funding increases through the program year beginning October 1, 2019. Avista should propose additional LIRAP funding increases necessary to achieve the funding plan in subsequent general rate cases.

234 In its compliance filing, Avista should also revise its tariffs to identify each assistance service available to its customers and their eligibility requirements.[375] We expect that the Low-Income Advisory Group will continue to evaluate LIRAP programs and make recommendations to improve them as needed.

H. Miscellaneous Expenses

235 *Property Tax.* In its initial case, Avista included a pro forma adjustment to property tax to reflect the 2016 rate period. The Company's adjustment is based on the projected value of taxable property as of December 31, 2015, and an assumed 2 percent escalation in

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[372] Collins, Exh. No. SMC-1T at 12:14-16.

[373] Collins, TR at 606:18-19.

[374] Avista proposes a five-year funding plan to increase Schedules 92 and 192 by 7 percent or two times the final approved base rate increases for Schedule 1 and Schedule 101 customers, whichever is greater. Ehrbar, Exh. No. PDE-8T at 8:1-13.

[375] This will likely include LIRAP, LIRAP Heat, LIRAP Senior Energy Outreach, and LIRAP Share.

effective property tax rates.[376] Public Counsel and ICNU contest this adjustment, arguing that the inclusion of projected increases in property values extending to December 31, 2015, is well beyond the test year.[377] Further, they argue the annual 2 percent escalation in property tax rates is not known and measurable.[378]

236 Public Counsel recommends a revised adjustment based on the Company's per-book calendar year 2014 plant value amounts, with no escalation.[379] It argues this approach allows for a reasonable increase in property tax expenses associated with the increase in plant values that occurred from December 31, 2013, to December 31, 2014, using the most recent actual property tax levy rates in effect in the rate year.[380] ICNU adopts in its cross-answering testimony Public Counsel's position to remove the escalation in property tax rates.[381]

237 On rebuttal, Avista disputes ICNU and Public Counsel's revisions to this adjustment, stating that it is appropriate to include property tax expenses based on property values as of December 31, 2015.[382] The Company also argues that its escalation is appropriate because the average levy rate has increased over time.[383]

238 *Decision.* As stated in the Pacific Power & Light Order,[384] the Commission prefers to use known and measurable values when calculating pro forma adjustments. Therefore, we reject the 2 percent escalation factor Avista proposed in its direct case. Instead, we adopt Public Counsel's recommended pro forma property tax adjustment for electric and natural gas by using plant values through December 31, 2014, and anticipated property tax levies for 2015. We acknowledge that this approach results in a mismatch of plant and

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[376] Smith, Exh. No. JSS-1T at 31:1-5.

[377] Ramas, Exh. No. DMR-1CT at 43:15-17; Mullins, Exh. No. BGM-1CT at 30:1-4.

[378] Ramas, Exh. No. DMR-1CT at 43:17-20; Mullins, Exh. No. BGM-5T at 13:9-12.

[379] Ramas, Exh. No. DMR-1CT at 44:1-6. The test year in the Company's direct filing ended September 30, 2014, and was adjusted with projected amounts for the fourth quarter to calendar 2014. However, in data responses prior to rebuttal and in rebuttal the Company replaced, and Public Counsel accepted, the use of 2014 actuals as the de facto test year.

[380] *Id.* at 44:6-11.

[381] Mullins, Exh. No. BGM-5T at 13:6-14.

[382] Smith, Exh No. JSS-4T at 39:8-11.

[383] *Id.* at 39:14-16.

[384] *PPL Order 08*, ¶¶ 44, 165.

property tax expense in the rate year. However, we agree with Public Counsel that this is a more reasonable approach than that proposed by Avista because it is known and measurable.[385]

239 *Insurance.* In its initial filing, Avista proposed a pro forma adjustment to 2014 insurance expense to reflect the expected level of general liability, directors and officers (D&O) liability, and property insurance expense in 2016.[386] Avista also removed 10 percent of the total projected D&O insurance expense from the projected levels, based on the 90/10 allocation adopted by the Commission in the Company's 2009 general rate case.[387] Avista states that an increase to test year expense levels is necessary to account for higher insurance costs caused by an increased claim history and suspension of the continuity credit provided in previous years by insurance providers.[388] Staff and Public Counsel contest this adjustment and propose using the test year level of expense.

240 Staff's analysis shows that Avista's annual insurance expense increased an average of 4.6 percent per year from 2008 to 2013, but changes in insurance expense varied significantly, with both decreases and increases occurring during that period.[389] According to Staff, Avista's approach increases the test year level of insurance expense by more than 13 percent.[390] Because insurance expense is difficult to project, Staff recommends rejecting Avista's pro forma adjustment and keeping insurance expense at the test year level.[391]

241 Public Counsel also contests Avista's use of estimated costs beyond the test year, stating that these costs are not known and measurable.[392] Public Counsel recommends using the actual test year expense reduced by 10 percent of the D&O insurance expense, as ordered in Avista's 2009 general rate case.[393]

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[385] Public Counsel's Brief, ¶ 72; ICNU's Brief, ¶ 47.

[386] Smith, Exh. No. JSS-1T at 30:1-4.

[387] *Id.* at 30:5-8; *WUTC v. Avista*, Dockets UE-090134 and UG-090135 (*consolidated*), Order 10, ¶ 137 (Dec. 22, 2009).

[388] Smith, Exh. No. JSS-1T at 30:11-14.

[389] Ball, Exh. No. JLB-1T at 24:11-13.

[390] *Id.* at 24:8-9.

[391] *Id.* at 24:7-16.

[392] Ramas, Exh. No. DMR-1CT at 41:13-16.

[393] *Id.* at 41:18-23 and 42:1-7.

242 On rebuttal, Avista continues to support its projected increases to insurance expense, but revises the test year level expense amount calculated in its initial filing to "appropriately prorate" the effect of the suspension of general liability continuity credit for the test period.[394] Similarly, the Company also revised its calculation of the projected 2016 level of general liability, D&O, and property insurance expense to reflect actual data for 2015.[395]

243 Avista disputes Staff and Public Counsel's recommendations, stating that the Company's projected increase in insurance expense from 2014 to 2015 is "in line with" the historic annual average increase calculated by Staff. Further, Avista argues that its expected increase in insurance expense from 2015 to 2016 is appropriate because it is more conservative than the historic annual average.[396]

244 *Decision.* As stated in the Pacific Power & Light Order,[397] applying known and measurable pro forma adjustments to test year expenses is the preferred method for rate setting. Avista's proposed adjustment to insurance expense incorporates projected increases that are not known and measurable and not supported in the record.[398] Thus, we reject the adjustment. We also adopt Public Counsel's recommendation to reduce test year D&O insurance expense by 10 percent, consistent with the Commission's Final Order in Avista's 2009 general rate case.[399]

245 *Accumulated Deferred Federal Income Tax.* According to testimony, Avista plans to file a "Change of Accounting" with the Internal Revenue Service (IRS) to implement certain IRS Tangible Property Regulations associated with revised rules on property capitalization versus repair deduction requirements.[400] The study to determine the

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[394] Smith, Exh. No. JSS-4T at 19:6-9.

[395] *Id.* at 19:10-11. General Liability and D&O insurance are based on 2015 actuals. The "actual" expense amount for 2015 property insurance includes the actual property policy premium for 2015 through December 1, 2015, plus a one-month prorated total based on the projected premium of the 12-month policy period beginning December 1, 2015.

[396] *Id.* at 20:23-24; 21:1-17.

[397] *PPL* Order 08, ¶¶ 44, 165.

[398] Public Counsel's Brief, ¶ 66.

[399] *WUTC v. Avista*, Dockets UE-090134 and UG-090135 (consolidated), Order 10, ¶ 137 (Dec. 22, 2009).

[400] Smith, Exh. No. JSS-1T at 7, n. 2.

impacts of this accounting change is commonly referred to as the "Repairs Study."[401] Avista included the estimated tax impact on rate base of the results of its Repairs Study in its direct case based on the test year ending September 2014. On rebuttal, Avista updated the Accumulated Deferred Federal Income Tax (ADFIT) associated with the new repairs deduction rules based on additional detail it received from the accounting firm assisting with the tax change. Avista also recorded in December 2014 additional ADFIT associated with Congressional legislation which provided for the extension, retroactively, of the 50 percent bonus tax depreciation through the end of 2014.[402]

246 The results of the final Repairs Study were not available for inclusion in the Company's filed rebuttal cross-check studies because the Repairs Study was not completed until September 2015. In response to Bench Request Nos. 10 and 12, Avista provided the impacts of the repairs deduction, bonus depreciation, and other tax depreciation updates included in the Company's 2014 Corporate Federal tax return, filed September 15, 2015.

247 Public Counsel asserts that ratepayers should receive the significant rate base offset benefits resulting from the repairs deduction. It also contends that ratepayers should benefit from a rate base reduction related to the additional bonus depreciation allowance for federal income taxes for the 2014 tax year.[403]

248 *Decision.* The repairs deduction and bonus depreciation benefit the Company through substantial reductions in current income tax expenses. We agree with Public Counsel that the ratepayers should benefit fully from the significant amounts of ADFIT offset to rate base arising from these two tax events since the ratepayers bear the burden of paying the taxes along with a return on and return of rate base. The final Repairs Study results, together with bonus depreciation and other tax depreciation updates, were not available to the Company and other parties at the time of the filing of their cases. The new information in the final Repairs Study provides more accurate and relevant data and should be used to determine rate base reduction impacts. The Company does not oppose Public Counsel's pursuit of the most current information during the pendency of the case. We therefore make the necessary adjustments to both electric and natural gas modified historical pro forma results of operations on an EOP basis by increasing the December 2014 electric ADFIT offset by $3.896 million and revising the December 2014 natural

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[401] *Id.*

[402] Schuh, Exh. No. KKS-6T at 17:4-18:21.

[403] Public Counsel's Brief, ¶¶ 73-87.

gas ADFIT with a decrease of $3.5 million.[404] These revisions are reasonable and consistent with Commission's decision in Docket UE-100749 to reflect the full impact of the repairs deduction.[405]

249 *Corporate Aircraft.* In its initial case, Avista's revenue requirement in the test period included approximately $1.75 million for use of its corporate jet. ICNU argues that it is more expensive for Avista's employees to travel on the corporate jet than it would otherwise pay to travel on a commercial airline and that it is appropriate to reduce the revenue requirement to reflect what the Company would have otherwise paid. Assuming the Company's average one-way commercial airline ticket would have cost $159, ICNU calculates that the Company paid $1.4 million more for use of the corporate aircraft than it would have paid for travel aboard a commercial airline.[406]

250 On cross-answering, ICNU revised its calculation to reflect the flight logs over the annual period ending September 2014, consistent with the test year.[407] On rebuttal, Avista contests ICNU's adjustment, arguing that it fails to account for the avoided costs the Company would have incurred had it travelled on a commercial airline. Avista witness Ms. Smith states that the Company conducts a cost analysis, which compares the use of the corporate jet to commercial flights prior to reserving the jet.[408] Ms. Smith further argues that ICNU's assumed cost per flight is unrealistic; the gross-up factor for destinations outside of Seattle, Boise, and Portland is arbitrary; and that ICNU fails to consider that the Company frequently travels to destinations without commercial airports.[409]

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[404] Avista Response to Bench Request No. 15, Attachment A.

[405] *WUTC v. PacifiCorp d/b/a Pacific Power & Light Company,* Docket UE-100749, Order 06, ¶ 261 (Mar. 25, 2011).

[406] Mullins, Exh. BGM-1CT at 41:18-24, 42:4-10. ICNU based its calculation on the average cost of a one-way ticket from Spokane to the Company's most common destinations: Seattle (Olympia), Boise, and Portland (Salem). ICNU then applied a 100 percent adder to reflect the fact that the Company sometimes purchases flights outside of the region.

[407] Mullins, Exh. BGM-5T at 13:18-19.

[408] The Company considers airfare plus any meals, hotels, ground transportation, work time lost to airline schedules, check-ins, ticketing, security, boarding and drive time.

[409] Smith, Exh. JSS-4T at 31:18, 32:1-2.

251 On brief, ICNU states that it "strongly believes that Avista's proposal to fund these excessive costs through rates is unconscionable and that the Commission should require shareholders to fund such extravagance above the cost of commercial flights."[410]

252 *Decision.* We are not persuaded by ICNU's methodology and assumptions used to calculate its proposed adjustment. We agree with Avista that ICNU's assumptions are unrealistic, and ICNU's proposed adjustment does not consider the full cost of commercial airline travel and the avoided costs associated with use of the corporate aircraft.

253 On rebuttal, Avista explained that each flight undergoes a cost analysis prior to booking which considers all costs associated with commercial airline travel, such as meals, hotels, travel delays, ticketing, security, boarding, and ground transportation. We are satisfied that Avista has met its burden, and the Company's travel costs are reasonable when all costs are considered.

254 *Transmission revenues and expenses.* In its initial filing, Avista proposed Electric Adjustment 3.01 to increase transmission expenses to reflect the amounts it budgeted for calendar year 2016.[411] Staff opposes Avista's proposal because budgeted amounts are not known and measurable. Instead, Staff proposes that this adjustment reflect known and measurable historical expenses, resulting in an increase of $130,000 net operating income from Avista's initial filing.[412] On rebuttal, Avista in turn rejects Staff's proposal, arguing that it is appropriate to use budgeted expenses, and modifies the adjustment to reflect its most recent budget.[413]

255 *Decision.* We decline to use Avista's budget to set rates because budgeted expenses are not known and measurable. We adopt Staff's proposal to base Electric Adjustment 3.01 on historical expenses.

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[410] ICNU's Brief, ¶ 52.

[411] Cox, Exh. No. BAC-1T at 3:1-24.

[412] Ball, Exh. No. JLB-1T at 16:12-18:36-37.

[413] Smith, Exh. No. JSS-4T at 13:17-14:4.

FINDINGS OF FACT

256 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

257 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including natural gas and electrical companies.

258 (2) Avista Corporation d/b/a Avista Utilities (Avista or Company) is a "public service company," an "electrical company," and "gas company" as those terms are defined in RCW 80.04.010 and used in Title 80 RCW. Avista provides electric and natural gas utility service to customers in Washington.

259 (3) On February 9, 2015, Avista filed certain revisions to its currently effective electric service tariffs which, if approved by the Commission, would increase the Company's electric revenue requirement by $33.2 million. This matter was designated as Docket UE-150204.

260 (4) Also on February 9, 2015, Avista filed certain revisions to its currently effective natural gas service tariffs which, if approved by the Commission, would increase the Company's natural gas revenue requirement by $12 million. This matter was designated as Docket UG-150205.

261 (5) On February 20, 2015, the Commission suspended the operation of both proposed tariff revisions pending an investigation and hearing and consolidated the filings for hearing and determination pursuant to WAC 480-07-320.

262 (6) On May 1, 2015, Avista, Staff, Public Counsel, NWIGU, and ICNU filed a partial, multiparty settlement stipulation (Settlement) which is attached to, and

incorporated herein as Appendix C. The unopposed Settlement proposes a slightly lower rate of return and return on equity for the Company, adjusted and updated power supply costs, a rate spread that is distributed across the rate schedules on a uniform percentage basis, and a rate design for any electric and natural gas rate increase.

263 (7) The Settlement does not propose a rate design in the event of an electric or natural gas rate decrease.

264 (8) On October 5-6, 2015, the Commission convened an evidentiary hearing to address the remaining contested issues.

265 (9) We find Staff's methodology for evaluating electric pro forma plant additions well-principled and audited and accept the pro forma plant additions based on the methodology.

266 (10) Avista requests an attrition adjustment for both its electric and natural gas operations, claiming earnings erosion due to low customer growth and high capital expenditures.

267 (11) The evidentiary record supports a finding that Avista will experience attrition in its electric and natural gas operations over the rate effective year.

268 (12) Avista's natural gas distribution plant investments are necessary to improve safety, and comply with Commission orders and policies supporting replacement of pipe that has a high risk of failure, or presents public safety and reliability concerns.

269 (13) Absent an attrition adjustment, the Company may not have an opportunity to achieve earnings on electric operations at or near authorized levels.

270 (14) Test year expenses are sufficiently reflective of historical data for use in setting rates for thermal generation plant operations and maintenance (O&M) expenses, except for major maintenance at Colstrip and Coyote Springs 2.

271 (15) Staff's proposal to normalize major maintenance expenses at Colstrip and Coyote Springs is a reasonable approach, while Avista's proposal for continued inclusion of a management reserve is contrary to the use of an average cost.

272 (16) With regard to Staff's recommended disallowance for the $12.7 million attributable to an extension of the Project Compass timeline and Project Compass bonus plan, Avista demonstrated that it considered switching to a different contractor and decided against it since this would result in an extended timeline that would have been more costly. Further, the Project Compass bonus plan was used to motivate employees to complete an essential project, and the bonuses were approved through appropriate channels.

273 (17) The Company's request for a prudency review of its proposed advanced metering infrastructure proposal is premature.

274 (18) Avista's adjustment increasing 2014 wages and 2015 union wages relies on known and measurable changes. The proposed wage increases for 2015 non-union employees and all 2016 wage increases are not known and measurable.

275 (19) Likewise, the Company's proposal to adjust the amount of time its executives allocate to utility work in Washington is not known and measurable.

276 (20) ICNU's executive compensation analysis is not sufficiently robust to counter Avista's reliance on a carefully selected peer group to set executive compensation.

277 (21) The Commission's historical practice has been to allow the Company to recover 50 percent of its director fees from ratepayers, and Avista has not presented substantial evidence in favor of its proposal to include in rates 97 percent of director fees.

278 (22) The Commission finds reasonable the five-year plan to increase funding for the Low-Income Rate Assistance Program by seven percent or twice the percentage increase in the residential electric and natural gas base rates as reasonable.

279 (23) Public Counsel's proposed adjustments for pro forma property tax and insurance expense produce values that are known and measurable.

280 (24) Public Counsel's proposal that ratepayers fully benefit from significant amounts of Accelerated Deferred Federal Income Tax offset is reasonable given the burden ratepayers bear of paying the return on and return of rate base.

281 (25) ICNU's assumptions and methodologies used in reaching its proposed corporate jet adjustment are unrealistic and do not consider the full cost of commercial airline travel and the avoided costs associated with use of the corporate aircraft.

282 (26) We find that Avista's budgeted 2016 transmission expenses are not known and measurable.

283 (27) The Commission's resolution of the disputed issues in this proceeding, coupled with its approval of the unopposed Settlement, results in our findings that Avista's electric revenue excess is approximately $ 8.1 million and its natural gas revenue deficiency is $10.8 million, as set forth in detail in Appendices A1, A2, B1, and B2 following this Order.

284 (28) The rates, terms, and conditions of service that result from this Order are fair, just, reasonable, and sufficient.

285 (29) The rates, terms, and conditions of service that result from this Order are neither unduly preferential nor discriminatory.

CONCLUSIONS OF LAW

286 Having discussed above all matters material to this decision, and having stated the following summary conclusions of law, incorporating by reference pertinent portions of the preceding detailed conclusions:

287 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

288 (2) The rates proposed by tariff revisions filed by Avista on February 9, 2015, and suspended by prior Commission order, were not shown to be fair, just or reasonable and should be rejected.

289 (3) Avista carried its burden to prove that its existing rates for natural gas service provided in Washington State are insufficient to yield reasonable compensation for the service rendered. Avista failed to meet its burden to prove that its existing rates for electric service in Washington State are insufficient to yield reasonable compensation for the service rendered.

290 (4) Avista's existing rates for natural gas service provided in Washington are insufficient to yield reasonable compensation for the service rendered. The Company's existing rates for electric service provided in Washington are

excessive for the Company to meet its financial needs to cover its expenses and attract capital on reasonable terms and is unreasonable to ratepayers.

291 (5) Avista requires relief with respect to the rates it charges for natural gas services provided in Washington. Ratepayers require relief with respect to the rates charged for electric services provided in Washington.

292 (6) The Commission must determine the fair, just, reasonable, and sufficient rates to be observed and in force under Avista's tariffs that govern its rates, terms, and conditions of service for providing natural gas and electricity to customers in Washington State.

293 (7) With the exception of the electric rate design provision, which is moot, the unopposed Settlement filed by Avista, Staff, Public Counsel, ICNU, and NWIGU on May 1, 2015, is lawful, supported by an appropriate record, and consistent with the public interest in light of all the information available to the Commission.

294 (8) A uniform percentage allocation of the electric revenue requirement decrease across the rate schedule blocks is equitable and reasonable.

295 (9) We conclude Staff's methodology for electric pro forma plant additions is well principled and reasonable, and we also approve Staff's adjustment updating the test year to reflect the results of the 2014 Commission Basis Report. The Commission accepts Staff's pro forma plant additions, with the exception of Project Compass which we fully allow in rates without disallowance.

296 (10) We accept and modify Staff's attrition methodology for the purposes of setting rates for Avista's natural gas operations as reasonable.

297 (11) While we approve an attrition adjustment for the Company's electric operations, we modify Staff's attrition methodology in two respects: first, we remove any escalation of projected capital investments for distribution plant, which have not been demonstrated on the record as necessary or beyond the Company's control; and second, we modify the electric operations and maintenance (O&M) escalation rate and escalate O&M expenses by 3.21 percent, the arithmetic average of a) 1.82 percent, the one year trend in O&M expense from 2013 to 2014 and b) 4.6 percent, the multiyear trend in O&M expense from 2007 to 2014.

298 (12) We affirm the use of test year actuals for calculation of Thermal Generation Plant Operations and Maintenance expenses at Rathdrum and Boulder Park, and all other generation plants except Colstrip and Coyote Springs 2. Further, the Commission approves Staff and ICNU's proposal to normalize major

maintenance expenses at Colstrip and Coyote Springs 2 as a reasonable approach. We reject Avista's proposal for a management reserve as contrary to the use of an average cost through normalization.

299 (13) Staff's recommended disallowance for the Project Compass extension and bonus plan are denied. We approve Avista's proposed Project Compass adjustment.

300 (14) The Commission declines to preapprove the Company's advanced metering infrastructure plan. If the Company chooses to acquire new meters, it may file an accounting petition that requests the Commission issue an order determining whether the Company is allowed to defer the undepreciated amounts related to the replaced meters in a regulatory asset account. Our normal practice is to approve such a petition without undue delay, then decide on the recovery of costs in a future proceeding at which the Company must demonstrate that its acquisition was prudent and is used and useful.

301 (15) Avista's adjustments to 2014 non-executive wages and 2015 union wages are approved as known and measurable, and we deny adjustments for 2015 non-union wages and projected 2016 wages as not known and measurable.

302 (16) We deny inclusion of the executive long term incentive plan as inappropriate.

303 (17) The Commission rejects the Company's proposal to reallocate 89 percent of executive time as Washington jurisdictional. Similarly, we decline to adopt ICNU's request to cap all executive compensation at $325,000.

304 (18) We approve as reasonable a plan consistent with Avista's five-year plan to increase funding for the Low-Income Rate Assistance Program by seven percent or twice the percentage increase in the residential electric and natural gas base rates. In its compliance filing, Avista should revise its tariffs to identify each assistance service available to its customers and their eligibility requirements.

305 (19) The Commission rejects the Company's 2 percent property tax escalation factor and reaffirm our preference for known and measurable values when pro forma adjustments. As a result, we use plant values through December 31, 2014, and anticipated property tax levies for 2015.

306 (20) We reject Avista's proposed adjustment to insurance expense which incorporates increases that are not known and measurable.

307 (21) The necessary adjustments should be made to both electric and natural gas modified historical results of operations by increasing the December 2014 electric accumulated deferred federal income tax (ADFIT) offset by $3.896 million and revising the December 2014 natural gas ADFIT with a decrease of $3.5 million as both revisions are reasonable and consistent with the Commission's prior decision in Docket UE-100749.

308 (22) We reject as unsubstantiated ICNU's proposed adjustment to the Company's corporate jet expenses.

309 (23) The Commission adopts Staff's proposal to base Electric Adjustment 3.01 on historical expenses.

310 (24) The rates, terms, and conditions of service that result from adoption of the Settlement as well as the Commission rulings on the above adjustments result in rates that are fair, just, reasonable, and sufficient.

311 (25) Avista should be required to make such compliance and subsequent filings as are necessary to effectuate the terms of this Order.

312 (26) The Commission Secretary should be authorized to accept by letter, with copies to all parties to this proceeding, filings that comply with the requirements of this Order.

313 (27) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order.

ORDER

THE COMMISSION ORDERS:

314 (1) The proposed tariff revisions Avista Corporation, dba Avista Utilities, filed on February 9, 2015, and suspended by prior Commission order, are rejected.

315 (2) The Settlement filed by the parties on May 1, 2015, which is attached to this Order as Appendix C, is approved and adopted as being in the public interest.

316 (3) Avista is required to make a compliance filing including such new and revised tariff sheets as are necessary to implement the requirements of this Order.

317 (4) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, such filings as Avista makes to comply with the terms of this Order.

318 (5) The Commission retains jurisdiction over the subject matters and parties to this proceeding to effectuate the terms of this Order.

Dated at Olympia, Washington, and effective January 6, 2016.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

PHILIP B. JONES, Commissioner

ANN E. RENDAHL, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.

APPENDIX A

COMMISSION DETERMINATION OF CONTESTED ADJUSTMENTS

TABLE A1
Electric - Contested Adjustments

Adj. No.	Contested Adjustment Description	Net Operating Income	Rate Base	Revenue Requirement
		(000's of Dollars)		
2.12	Director fees & Misc. Restating Expenses	26	-	(42)
ICNU-1	Corporate Jet	-	-	-
2.18	Restate L-T Incentive Pay	155	-	(250)
3.01	Pro Forma Transmission Revenue/Expense	59	-	(95)
3.02	Pro Forma Labor Non-Exec	(1,872)	-	3,018
3.03	Pro Forma Labor Exec	(79)	-	127
3.05	Pro Forma Insurance Expense	35	-	(56)
3.06	Pro Forma Property Tax	(733)	-	1,182
3.07	Pro Forma Information Tech/Service Expense	(218)	-	352
3.10	Pro Forma Major Maint.-Hydro Thermal, Other	-	-	-
3.11	Planned Capital Add Dec 2014 EOP	(1,756)	(4,371)	2,318
3.12U	Planned Cap. Add Dec 2014 EOP-Update(Incl. in 3.11)	-	-	-
3.13	WA CS2 & Colstrip O&M/ICNU 3.10	180	-	(2
PC-E3.13	Reflect Updated Repairs Tax Deduction	(37)	(3,896)	(398)
4.01	Planned Capital Add 2015 EOP	(2,601)	56,363	10,819
4.02	Planned Capital Add 2016 AMA	-	-	-
4.04	O&M Offsets	309	-	(498)
4.05	Reconcile Pro Forma To Attrition	-	-	-
4.06N	Colstrip Refund Non-recurring	-	-	-
	Total Electric Contested Adjustments	(6,532)	48,096	16,187
	Add:			
	Total Electric Uncontested Adjustments from Table B1	125,058	1,267,795	(52,629)
	Attrition Allowance			28,332
	Total Contested & Uncontested Adjustments	118,533	1,315,891	(8,110)

TABLE A2
Natural Gas - Contested Adjustments

Adj. No.	Contested Adjustment Description	Net Operating Income	Rate Base	Revenue Requirement
		(000's of Dollars)		
2.12	Director Fees, Misc. Restating Adjustment	51	-	(82)
2.15	Restating Long-Term Incentive Plan	46	-	(74)
3.00	Pro Forma Labor Non-Exec	(561)	-	905
3.01	Pro Forma Labor Exec	(14)	-	23
3.03	Pro Forma Insurance	10	-	(16)
3.04	Pro Forma Property Tax	(131)	-	211
3.05	Pro Forma Information Tech/Serv Expense	(9)	-	15
3.07	Planned Capital Add Dec 2014 EOP	(112)	3,388	579
3.07U	Planned Capital Add-Dec. 2014 EOP-Update	-	-	-
3.08	Reflect Updated Repairs Tax Deduction (Incl. in 3.07U)	33	3,500	358
4.01	Planned Capital Add 2015 EOP	(757)	15,953	3,095
4.02	Planned Capital Add 2016 AMA	-	-	-
4.03	Project Compass Deferral, Regulatory Amortization	(743)	-	1,198
4.04	O & M Offsets	18	-	(29)
4.06	Reconcile Pro Forma to Attrition	-	-	-
	Total Natural Gas Contested Adjustments	(2,170)	22,841	6,183
	Add:			
	Total Natural Gas Uncontested Adjustments from Table B2	18,925	240,814	(2,208)
	Attrition Allowance			6,849
	Total Natural Gas Adjusted Results	16,754	263,655	10,824

APPENDIX B

UNCONTESTED ADJUSTMENTS

TABLE B1
Electric - Uncontested Adjustments

Adj. No.	Uncontested Adjustment Description	Net Operating Income	Rate Base	Revenue Requirement
			(000's of Dollars)	
1.00	Results of Operations	102,983	1,260,500	(17,886)
1.01	Deferred FIT Rate Base	(56)	(6,009)	(616)
1.02	Deferred Debits and Credits	614	(7,399)	(1,860)
1.03	Working Capital	194	20,703	2,121
2.01	Eliminate B & O Taxes	(57)	-	92
2.02	Restate Property Tax	(244)	-	393
2.03	Uncollectable Expense	(726)	-	1,171
2.04	Regulatory Expense	48	-	(77)
2.05	Injuries and Damages	(157)	-	253
2.06	FIT/DFIT/ ITC/PTC Expense	(213)	-	344
2.07	Office Space Charges to Subsidiaries	10	-	(17)
2.08	Restate Excise Taxes	127	-	(204)
2.09	Net Gains / Losses	59	-	(94)
2.10	Weather Normalization	(4,375)	-	7,056
2.11	Eliminate Adder Schedules	-	-	-
2.13	Eliminate WA Power Cost Defer	1,703	-	(2,747)
2.14	Nez Perce Settlement Adjustment	(9)	-	15
2.15	Restate Debt Interest	(869)	-	1,402
2.16	Restate Incentive Expenses	729	-	(1,175)
2.17	Regulatory Amortization Restating Adj.	1,604	-	(2,587)
3.00	Pro Forma Power Supply	15,815	-	(25,508)
3.04	Pro Forma Employee Benefits	(2,077)	-	3,351
3.08	Pro Forma Lake Spokane Deferral	(189)	-	305
3.09	Pro Forma Revenue Normalization	10,144	-	(16,361)
	Total Electric - Uncontested Adjustments	125,058	1,267,795	(52,629)

TABLE B2
Natural Gas - Uncontested Adjustments

Adj. No.	Uncontested Adjustment Description	Net Operating Income	Rate Base	Revenue Requirement
		(000's of Dollars)		
1.00	Per Results Report	15,002	233,475	3,255
1.01	Deferred FIT Rate Base	(28)	(3,032)	(311)
1.02	Deferred Debits and Credits	(1)	-	1
1.03	Working Capital	97	10,371	1,062
2.01	Eliminate B & O Taxes	(7)	-	12
2.02	Restate Property Tax	(52)	-	84
2.03	Uncollectible Expense	98	-	(157)
2.04	Regulatory Expense	(21)	-	34
2.05	Injuries and Damages	(182)	-	293
2.06	FIT / DFIT Expense	-	-	-
2.07	Office Space Charges to Subs	1	-	(2)
2.08	Restate Excise Taxes	-	-	-
2.09	Net Gains/Losses	3	-	(5
2.10	Weather Normalization / Gas Cost Adj.	(497)	-	801
2.11	Eliminate Adder Schedules	-	-	-
2.13	Restating Incentive Adjustment	216	-	(349)
2.14	Restate Debt Interest	(161)	-	260
3.02	Pro Forma Employee Benefits	(626)	-	1,009
3.06	Pro Forma Revenue Normalization	5,541	-	(8,935)
4.05	Pro Forma Atmospheric Testing	(460)	-	741
	Total Natural Gas - Uncontested Adjustments	18,925	240,814	(2,207)

APPENDIX C

SETTLEMENT STIPULATION
DOCKETS UE-150204 and UG-150205 (consolidated)

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. AVISTA CORPORATION d/b/a AVISTA UTILITIES Respondent.	)	DOCKETS UE-150204 and UG-150205 (*Consolidated*) MULTIPARTY SETTLEMENT STIPULATION

I. PARTIES

1. This Multiparty Settlement Stipulation is entered into by Avista Corporation ("Avista" or the "Company"), the Staff of the Washington Utilities and Transportation Commission ("Staff"), the Public Counsel Unit of the Washington Office of Attorney General ("Public Counsel"), Northwest Industrial Gas Users ("NWIGU"), and the Industrial Customers of Northwest Utilities ("ICNU"), jointly referred to herein as the "Parties." Accordingly, this represents a "Multiparty Settlement" under WAC 480-07-730. The Parties agree that this Multiparty Settlement Stipulation (hereinafter "Multiparty Settlement" or "Stipulation") is in the public interest and should be accepted by the Commission as a partial resolution of the known issues in these dockets.[1] The Parties understand this Multiparty Settlement Stipulation is

[1] The Energy Project does not join in the proposed settlement. Nevertheless, the Parties agree to work together in good faith to explore opportunities to review LIRAP funding in the context of this case, including consideration of a multi-year funding plan.

subject to approval of the Washington Utilities and Transportation Commission (the "Commission").

II. INTRODUCTION

2. On February 9, 2015, Avista filed with the Commission certain tariff revisions designed to increase general rates for electric service (Docket UE-150204) and natural gas service (Docket UG-150205) in the State of Washington. Avista requested an increase in electric base rates of $33.2 million, or 6.6 percent, and an increase in natural gas base rates of $12.1 million, or 6.9 percent. On February 20, 2015, the Commission entered Order 01 suspending the tariff revisions and setting Dockets UE-150204 and UG-150205 for hearing and determination pursuant to WAC 480-07-320. Representatives of all Parties appeared telephonically at a Settlement Conference held on April 24, 2015, which was held for the purpose of narrowing or resolving the contested issues in this proceeding. Subsequent discussions led to this Multiparty Settlement Stipulation.

3. The signing Parties have reached a Multiparty Settlement of several issues in this proceeding. If approved, this Multiparty Settlement would resolve all issues pertaining to cost of capital, power supply, rate spread and rate design. The Parties, therefore, adopt the following Multiparty Settlement Stipulation in the interest of reaching a fair disposition of certain issues in this proceeding and wish to present their agreement for the Commission's consideration and approval.

III. AGREEMENT

4. Cost of Capital. The Parties agree to the following cost of capital components:

	Percent of Total Capital	Cost	Component
Total Debt	51.5%	5.20%	2.68%
Common Equity	48.5%	9.50%	4.61%
Total Debt	100.0%		7.29%

5. Power Supply.

a) Power Supply Update – The Parties agree that Avista shall file with the Commission an updated Power Supply adjustment two months before new electric retail rates from this electric Docket go into effect.[2]

b) Specified Adjustments to Power Supply Costs – The Parties agree with the new base Power Supply costs filed by the Company, with the following specified adjustments:

(i.) Correction for AURORA$_{XMP}$ Coding Error: The AURORA$_{XMP}$ power supply model contains the functionality to calculate the mark-to-market value of the financial transactions entered into in the pro forma year by calculating the "gain" or "loss" of each transaction by comparing the fixed price of the transactions compared to the modeled energy price in AURORA$_{XMP}$. An enhancement of the AURORA$_{XMP}$ model by EPIS in late 2014 contained an incorrect calculation of the mark-to-market function, which the Company discovered in April 2015.[3] The logic in the model essentially reversed the signs so that a gain became a loss and a loss was reflected as a gain. The effect of this correction is a reduction in power supply expense of approximately $6.9 million (Washington basis).

(ii.) Chelan PUD Contract Expense: During the development of the power supply costs for the rate case, the Company had been working with Chelan PUD regarding a planned auction for Chelan to sell a 5% share of Rocky Reach/Rock

[2] As in past proceedings, the purpose of this power supply update would be to: 1) update the three-month average of natural gas and electricity market prices; 2) include new short-term contracts for gas and electric; and 3) update or correct power and transmission service contracts for the 2016 rate year.

[3] This enhancement to the Aurora Model was completed after the power supply update filed with the Commission in November 2014 related to Avista's prior General Rate Case Docket UE-140188 and therefore had no impact on the results submitted in that case.

Island output for the 2016 through 2020 period. The Company included an estimate of the expected purchase price in the pro forma; however, on March 17, 2015, the Company was able to purchase the output at a lower price than what was included in the rate case. The actual purchase price for 2016 is $5.5 million less (on a system basis) than the estimate. The effect of this update is a reduction in power supply expense of $3.6 million (Washington basis).

(iii.) Hydro Station Service: The modeled station service included for the Noxon, Little Falls, and Long Lake hydro facilities will be removed from the Company's power supply adjustment. The effect of this adjustment is an estimated reduction in power supply expense of $28,000 (Washington basis).

(iv.) Colstrip and CS2 Thermal O&M: O&M costs related to Coyote Springs II and Colstrip will be removed from the base Power Supply costs. The effect of this adjustment is an estimated reduction in power supply expense of $3.6 million (Washington basis). The revenue requirement related to these costs will be addressed during the remainder of the case.

c) Other Adjustments to Power Supply Costs – The Parties agree to an additional adjustment to the new base Power Supply costs filed by the Company, following discussions by the Parties. The Parties agree that it would be fair and reasonable to further reduce power supply expense by $1.5 million. At the time that power supply costs are updated pursuant to Section 5. a) above, the resulting power supply costs will be reduced by $1.5 million on a Washington basis.

d) ERM Annual Rate Adjustments – The Parties agree that the ERM rate adjustment trigger will remain at $30 million, as approved in Docket UE-120436.

e) Retail Revenue Adjustment – Avista proposed that the name of the Retail Revenue Credit be changed to the Load Change Adjustment Rate. The Parties agree that the proper name should be Retail Revenue Adjustment. Furthermore, the Parties agree that the methodology for calculating the Retail Revenue Adjustment will not change and will remain the same as approved in Docket UE-140188.

6. Electric Rate Spread/Rate Design.

a) Electric Cost of Service/Rate Spread – The Parties agree to apply an equal percentage of revenue increase for purposes of spreading the revised electric revenue requirement. The Parties, however, do not agree on a specific Cost of Service methodology.

b) Electric Rate Design –

(i.) The Schedule 1 Basic Charge will remain at $8.50 per month, with the revenue spread to the volumetric rates on a uniform percentage basis.

(ii.) For the rate design of Schedule 25, the revenue change applicable to the schedule will be spread on a uniform percentage basis to the three energy block rates; however, the increase to the third energy block will be adjusted, if necessary, so that the largest customer served on Schedule 25 receives the same percentage increase as the overall revenue increase in this case. The demand charge for the first 3,000 kVa will remain $21,000 per month, and the variable demand charge will remain at $6.00 per kVa over 3,000 kVa per month.

(iii.) The Rate Design for all other Schedules will be as follows:

- Schedules 11/12 will have an increase in the Basic Charge from $18.00 to $20.00 per month, and a uniform percentage rate change to blocks. In

addition, the demand charge will increase from $6.00 to $6.50 per kilowatt for all demand in excess of 20 kW per month.

- Schedules 21/22 will have no change to the current $500 per month fixed demand charge. The revenue increase for the schedule will be spread on a uniform percentage increase to all blocks, and the demand charge will increase from $6.00 to $6.50 per kilowatt for all demand in excess of 50 kW per month.
- Schedules 31/32 will have an increase in the Basic Charge from $18.00 to $20.00 per month, and there will be a uniform percentage increase to all blocks for the remaining revenue increase applicable to the schedule.
- Street Lighting Schedules 41-48 would see a uniform percentage increase, and the street light calculation methodology described in Exhibit No.__(PDE-1T), pp. 14-16 will be adopted.

7. Natural Gas Rate Spread/Rate Design.

a) Natural Gas Cost of Service/Rate Spread – The Parties agree to apply an equal percentage of margin increase for purposes of spreading the increase in the retail natural gas non-gas revenue requirement. The Parties, however, do not agree on a specific Cost of Service methodology.

b) Natural Gas Rate Design –

(i.) The Schedule 101 Basic Charge will remain at $9.00 per month, with the revenue spread to the volumetric rates on a uniform percentage basis.

(ii.) For Schedule 146, the monthly basic charge will increase from $500 to $525 per month, and the remaining revenue increase will be spread on a uniform percentage basis to all blocks.

(iii.) The Rate Design for other Schedules will be as follows:

- Schedule 111 will have an increase in the monthly Minimum Charge based on Schedule 101 rates (breakeven at 200 therms), and a uniform percentage increase to all blocks.
- Schedule 121 will have an increase in the monthly Minimum Charge based on Schedule 101 rates (breakeven at 500 therms), and a uniform percentage increase to all blocks.
- Schedule 131 will have a uniform percentage increase to all blocks.

IV. EFFECT OF THE MULTIPARTY SETTLEMENT STIPULATION

8. Binding on Parties. The Parties agree to support the terms of the Multiparty Settlement Stipulation throughout this proceeding, including any appeal, and recommend that the Commission issue an order adopting the Multiparty Settlement Stipulation contained herein. The Parties understand that this Multiparty Settlement Stipulation is subject to Commission approval. The Parties agree that this Multiparty Settlement Stipulation represents a compromise in the positions of the Parties. As such, conduct, statements and documents disclosed in the negotiation of this Multiparty Settlement Stipulation shall not be admissible evidence in this or any other proceeding.

9. Integrated Terms of Multiparty Settlement. The Parties have negotiated this Multiparty Settlement Stipulation as an integrated document. Accordingly, the Parties recommend that the Commission adopt this Multiparty Settlement Stipulation in its entirety. Each Party has participated in the drafting of this Multiparty Settlement Stipulation, so it should not be construed in favor of, or against, any particular Party.

10. Procedure. The Parties shall cooperate in submitting this Multiparty Settlement

Stipulation promptly to the Commission for acceptance. Each Party shall make available a witness or representative in support of this Multiparty Settlement Stipulation. The Parties agree to cooperate, in good faith, in the development of such other information as may be necessary to support and explain the basis of this Multiparty Settlement Stipulation and to supplement the record accordingly.

11. Reservation of Rights. Each Party may offer into evidence its prefiled testimony and exhibits as they relate to the issues in this proceeding, together with such evidence in support of the Stipulation as may be offered at the time of the hearing on the Multiparty Settlement. If the Commission rejects all or any material portion of this Multiparty Settlement Stipulation, or adds additional material conditions, each Party reserves the right, upon written notice to the Commission and all parties to this proceeding within seven (7) days of the date of the Commission's Order, to withdraw from the Multiparty Settlement Stipulation. If any Party exercises its right of withdrawal, this Multiparty Settlement Stipulation shall be void and of no effect, and the Parties will support a joint motion for a procedural schedule to address the issues that would otherwise have been settled herein.

12. Advance Review of News Releases. All Parties agree:

a. to provide all other Parties the right to review in advance of publication any and all announcements or news releases that any other Party intends to make about the Multiparty Settlement Stipulation. This right of advance review includes a reasonable opportunity for a Party to request changes to the text of such announcements. However, no Party is required to make any change requested by another Party; and,

b. to include in any news release or announcement a statement that Staff's recommendation to approve the Multiparty Settlement is not binding on the

Commission itself. This subsection does not apply to any news release or announcement that otherwise makes no reference to Staff.

13. No Precedent. The Parties enter into this Multiparty Settlement Stipulation to avoid further expense, uncertainty, and delay. By executing this Multiparty Settlement Stipulation, no Party shall be deemed to have accepted or consented to the facts, principles, methods or theories employed in arriving at the Multiparty Settlement Stipulation, and, except to the extent expressly set forth in the Multiparty Settlement Stipulation, no Party shall be deemed to have agreed that such a Multiparty Settlement Stipulation is appropriate for resolving any issues in any other proceeding.

14. Public Interest. The Parties agree that this Multiparty Settlement Stipulation is in the public interest.

15. Execution. This Multiparty Settlement Stipulation may be executed by the Parties in several counterparts and as executed shall constitute one Multiparty Settlement Stipulation.

Entered into this 1st day of May 2015.

Company:

By: _____
David J. Meyer
VP, Chief Counsel for Regulatory and
Governmental Affairs

Staff:

By: _____
Patrick J. Oshie
Assistant Attorney General
Brett P. Shearer
Assistant Attorney General
Jennifer Cameron-Rulkowski
Assistant Attorney General

Public Counsel:

By: _____
Lisa Gafken
Assistant Attorney General

NWIGU:

By: _____
Chad M. Stokes
Tommy Brooks
Cable Huston Benedict
Haagensen & Lloyd LLP

ICNU:

By: _____
Melinda Davison
Jesse Cowell
Davison Van Cleve, P.C.

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By: _____
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ATTACHMENT B

WUTC DOCKETS UE-150204 and UG-150205 (*Consolidated*)
Order 06: Order Denying Joint Motion for Clarification, Denying Petition for Reconsideration, and Denying Motion to Reopen the Record

SERVICE DATE
FEB 19 2016

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	DOCKETS UE-150204 and UG-150205 (consolidated)
Complainant,	)	ORDER 06
v.	)	ORDER DENYING JOINT MOTION FOR CLARIFICATION, DENYING PETITION FOR RECONSIDERATION, AND DENYING MOTION TO REOPEN THE RECORD
AVISTA CORPORATION d/b/a AVISTA UTILITIES,	)	
Respondent.	)	

MEMORANDUM

1 **PROCEEDING:** On February 9, 2015, Avista Corporation d/b/a Avista Utilities (Avista or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its currently effective Tariff WN U-28, Electric Service. The Company requested authority to increase charges and rates for electric service by approximately $33.2 million or 6.7 percent in billed rates. The Company simultaneously filed revisions to its currently effective Tariff WN U-29, Natural Gas Service. Avista sought to increase rates for natural gas service by approximately $12 million or 6.9 percent in billed rates. The Commission suspended the tariff sheets and set the dockets for hearing.

2 On May 1, 2015, Avista, the Commission's regulatory staff (Staff),[1] the Public Counsel Unit of the Office of Attorney General (Public Counsel), the Industrial Customers of Northwest Utilities (ICNU), and the Northwest Industrial Gas Users (NWIGU) filed a Settlement Agreement to resolve certain issues pertaining to the Company's cost of capital, power supply, rate spread, and rate design.[2] The effect of the settlement reduced Avista's requested electric revenue requirement from $33.2 million to $17 million and its

[1] In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See*, RCW 34.05.455.

[2] Settlement ¶ 3.

requested natural gas revenue requirement from $12 million to $11.3 million.[3] The settlement provided for a 9.5 percent ROE and an overall ROR of 7.29 percent.[4] The Company agreed to file an updated power supply adjustment two months prior to new electric rates from this proceeding going into effect.[5] The Company filed the update to its power supply adjustment on October 29, 2015. This reduced the power cost adjustment by $12.3 million.[6]

3 The Commission entered Order 05, its Final Order in these consolidated electric and natural gas general rate case proceedings, on January 6, 2016. As required under the Administrative Procedure Act,[7] Order 05 fully resolved all issues exclusively on the basis of the record developed over the 10-month statutory period allowed for review in these complex cases.[8] In Order 05, on the basis of evidence offered in support of the settlement, the Commission approved the parties' proposals, as discussed above, and adopted their Settlement Agreement as its own resolution of the issues identified.

4 While the parties' settlement reduced the number of contested issues and, hence, simplified the case to some degree, significant issues were not resolved by the agreement. These were the subjects of extensive, detailed evidentiary presentations by the parties. The fully contested issues included disputes over pro forma plant additions, generation plant operations and maintenance expense, labor expenses, advanced meter infrastructure, Project Compass,[9] low-income rate assistance, and various miscellaneous expenses including property tax, insurance, accumulated deferred Federal Income Tax, corporate aircraft expense, and transmission revenues and expenses.

5 The most significant contested issues in terms of dollars were Avista's proposed attrition adjustments to the Company's rates for electric and natural gas. More than one-third of

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[3] Joint Motion for an Order Approving Settlement ¶ 2.

[4] *Id.* ¶ 4.

[5] *Id.* ¶ 5. The statutory effective date of Avista's general rate request in these combined dockets, absent a Commission final order, is January 11, 2016.

[6] *Id.*

[7] RCW 34.05.461(4).

[8] RCW 80.04.130(1).

[9] On February 2, 2015, Avista replaced its legacy Customer Information and Work Asset Management System following a multiyear project it called Project Compass.[9] As the result of Project Compass, the Company installed and now uses Oracle's *Customer Care & Billing* system and IBM's *Maximo* work and asset management application. In this case, Avista sought recovery of costs associated with the project.

the Commission's 93 page Final Order narrative is devoted to this subject. As discussed in Order 05:

> Attrition occurs when the test-period relationship between rate base, expenses and revenues does not hold under conditions in the rate effective period, such that a utility's expenses or rate base grows more quickly than revenues, and a utility would likely have no reasonable opportunity to earn its allowed rate of return. An attrition adjustment is a discrete adjustment to the modified historical test year that the Commission may use when it determines attrition is present.
>
> When developing an attrition adjustment, parties first provide a revenue requirement analysis based on a modified historical test year. Parties then perform an attrition study to determine the utility's revenue requirement in the rate year. The attrition adjustment is the difference between the revenue requirement provided by the modified historical test year and the revenue requirement provided by the attrition study.[10]

6 Both Avista and Staff performed attrition studies. These studies involved the development and use of complex models populated by myriad data. The modeling methodologies used by Avista and Staff in the first instance were significantly different and there were also significant differences separating the parties in terms of what data should populate the models. On rebuttal, Avista abandoned the attrition study it filed in its direct testimony and instead adopted Staff's proposed attrition study and methodologies, albeit with several changes.

7 Public Counsel and ICNU opposed making any attrition adjustment in this case. For that reason, they did not present their own models, being of the opinion that no study would support such adjustments.

8 The Commission found "Staff's approach, as adjusted and corrected by the Company, [provided] the most appropriate methodology in this docket for supporting an attrition adjustment."[11] The Commission discusses in considerable detail in Order 05 the ramifications of this finding for the application of an attrition adjustment in this case.

9 After careful and thoroughgoing consideration of the record evidence, the Commission concluded that it would allow attrition adjustments affecting both electric and natural gas rates. Order 05 explains, however, that the Commission's decisions in awarding attrition

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[10] Order 05 ¶ 47 and accompanying n. 60.

[11] Order 05 ¶ 111.

adjustments would be informed not only by its application of a modified version of Staff's model, but also by its informed judgment as a regulatory body charged with making decisions that produce end results, regardless of the methods used, that yield rates that are fair, just, reasonable, and sufficient.[12]

10 Order 05, among other things, takes into account a positive $28 million attrition adjustment to the modified test year amounts for the Company's electric service. The Commission's decisions on other issues, however, established negative adjustments that more than offset the positive attrition adjustment. In the final analysis, the Commission authorized Avista to file revised tariffs with electric rates that will recover $8.1 million less in revenue, for a 1.63 percent rate decrease, relative to the Company's rates in effect at the time these dockets were initiated.

11 Following the Commission's entry and service of Order 05 on January 6, 2016, the Commission, at the request of the Company, convened an informal telephonic order conference with Avista, Commission Staff, Public Counsel, the ICNU, and NWIGU to "[e]nsure that any compliance filing can be accurately prepared and presented."[13] During the order conference, the Commission's Accounting Advisor, Mr. Danny Kermode, explained systematically the data from the record on which the Commission relied, how these data inputs were utilized, , and how, together, the results formed the basis for Avista's electric revenue requirement decrease of $8.1 million.

12 On January 7, 2016, Avista filed electric and natural gas tariff sheets revising Tariff WN U-28 to reflect the $8.1 million reduction in electric base revenue and Tariff WN U-29 to reflect the $10.8 million increase in natural gas base revenue as specified in Order 05. The Commission reviewed the tariff sheets and determined that they did, in fact, comply with the terms of the Order. The Commission Secretary, as authorized by Order 05, therefore approved the revised tariff sheets by letter, with copies to all parties. Under the terms of the Secretary's letter, the revised tariff sheets became effective as filed, with an effective date of January 11, 2016. This was the last day of the suspension period allowed under RCW 80.04.130(1).

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[12] *See* Order 05 ¶¶ 129, 132 – 135.

[13] Email from Marguerite E. Friedlander, Administrative Law Judge, Commission, to parties in Dockets UE-150204 and UG-150205 (consolidated), January 6, 2016 (citing WAC 480-07-840(1)(b)). The Energy Project was unable to participate in the conference but raised no objection to it.

13 **ICNU/Public Counsel's Joint Motion for Clarification.** On January 19, 2016, ICNU and Public Counsel (Joint Parties) filed a Joint Motion for Clarification of Order 05. Joint Parties state that they do not seek to change the outcome of any issues resolved by the Commission in Order 05. Instead, they argue that the Commission's rulings in Order 05, taken together, should have resulted in a $16.6 million attrition allowance and an electric revenue requirement reduction of $19.8 million.[14] Joint Parties provided work papers with their filing that allowed the Commission to identify precisely the source of the computational difference between Order 05 and Joint Parties' Motion. The approximate $12 million difference between their proposed attrition adjustment and what the Commission determined for electric service is explained largely by different treatments of power costs in the attrition model.

14 The settlement provides that "[t]he Parties agree that Avista shall file with the Commission an updated Power Supply adjustment two months before new electric retail rates from this electric Docket go into effect."[15] A footnote to this Settlement provision states that "[a]s in past proceedings, the purpose of this power supply update would be to: 1) update the three-month average of natural gas and electricity market prices; 2) include new short-term contracts for gas and electric; and 3) update or correct power and transmission service contracts for the 2016 rate year."

15 Avista filed its updated power supply adjustment on October 29, 2015. The Commission incorporated the revised data provided, namely the $12.3 million reduction in pro forma net power costs, by inserting it directly into the appropriate tab in Staff's attrition model. Joint Parties, however, "believe that the $12.3 million reduction detailed in the Company's update[d] filing should have been applied as a discrete adjustment *outside* of the attrition model."[16]

16 We do not agree that it is appropriate to treat Avista's power cost update outside of the attrition model. Instead, we believe that overall net power costs, including any update or revision to such costs, should continue to be examined in the context of both the attrition methodology agreed to by Staff and Avista in the case, and in the record evidence upon which the Commission relied to make its final decision in Order 05. A change in any specific data or assumption used in the attrition model will invariably affect other data in the model and needs to be assessed logically on a holistic basis, not on a selective basis

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[14] Joint Motion for Clarification ¶ 6. Joint Parties also request a typographical correction to Footnote 72 in Order 05 removing reference to Public Counsel. We agree that this typographical error needs editing and will address the issue in a subsequent errata order.

[15] Settlement ¶ 5(a) (May 1, 2015).

[16] *Id.* (emphasis added).

inside or outside of the model, especially after the close of the record. We continue to believe that the end result of an $8.1 million decrease in revenue requirement is proper after incorporating Avista's power cost update directly into the attrition model. We believe it is improper to assess the updated net power costs, as the Joint Parties argue, outside of the agreed-upon attrition methodology, resulting in a further $12.3 million reduction in revenue requirement. It follows that the Joint Parties' Motion for Clarification of Order 05 should be denied.

17 **Staff Petition for Reconsideration.**[17] Also on January 19, 2016, Staff filed its "Motion to Reconsider," seeking "a review of [the Commission's] calculation of Avista's overall revenue requirement to ensure that the adjustments set forth in Table 1 have been properly incorporated."[18] As noted, it appears from the substance of Staff's filing that it actually seeks clarification by motion under WAC 480-07-835 and 840, rather than reconsideration by petition under WAC 480-07-850. WAC 480-07-835 provides that:

> The purpose of a motion for clarification is to ask for clarification of the meaning of an order so that compliance may be enhanced, so that any compliance filing may be accurately prepared and presented, to suggest technical changes that may be required to correct the application of principle to data, or to correct patent error without the need for parties to request reconsideration and without delaying post-order compliance.

18 Staff's post-order filing states at ¶ 2 that: "It is merely addressing what it believes to be the appropriate calculation of Avista's revenue requirement for electric operations, including various adjustments set forth in Order 05." Staff reiterates in ¶ 4 that: "Staff's motion only seeks Commission review of its calculation of Avista's overall revenue requirement to ensure that the adjustments set forth in Table 1 have been properly incorporated." Finally, Staff states at ¶ 11 that it believes "the Commission's application of the principles enunciated in *Hope* and *Bluefield*" "would benefit from clarification as to the Commission's intent," if the Commission agrees with Staff that it has miscalculated Avista's revenue requirement for electric service. In sum, all of this suggests what Staff is asking for is clarification, not reconsideration, the purpose of which is quite different, as described in WAC 480-07-850.

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[17] Staff styles its filing as a "Motion to Reconsider." The Commission's procedural rules, however, call for "Reconsideration of a final order by petition," not by motion. This, in itself, is a technicality of no particular consequence. However, as discussed in the body of this order, it appears that what Staff seeks is clarification by motion, not reconsideration by petition. We nevertheless will refer in this order to Staff's filing as a "Petition for Reconsideration."

[18] Staff's Petition for Reconsideration ¶ 4.

19 Staff states that it followed the computation of each adjustment and decision that the Commission made in Order 05 and arrived at an electric revenue requirement decrease of $27.4 million.[19] Using Avista's proposed attrition model, Staff contends that the Commission may have erred when it updated the Company's power supply costs within the model.[20] Staff explains that:

> [T]he cells in the pro forma power supply worksheet ("PF Power Supply 09.2014 load") would have linked to dependent cells in a hidden worksheet related to incremental load expense ("incremental load expense"). If not controlled for, these dependent cells would have updated column [J] of the attrition tab ("Attrition 09.2014 to 2016"). The resulting update would have, in effect, offset changes in column [I] of the attrition tab that would have been carried forward from the pro forma power supply worksheet.[21]

Staff, like Joint Parties, "recommends that the Commission input the October 29, 2015, power supply update ($12.3 million) outside of, rather than within, the attrition model."[22] This is in spite of Staff's recognition that "there are multiple interdependent formulas in the attrition model,"[23] which, as previously discussed, is precisely why it is inappropriate to consider Avista's power cost update outside the attrition model.

20 Staff did not provide its work papers with its Petition to Reconsider. The Commission accordingly issued Bench Request Nos. 19 and 20. Upon examination of Staff's computations, filed in response to the Bench Requests on January 26, 2016, it became clear that the Staff's revised revenue requirement decrease, now $27.7 million, was due, in part, to various errors and erroneous assumptions in Staff's calculations. Staff also made changes to the attrition model relative to what is in the evidentiary record that the Commission relied on in Order 05.

21 Joint Parties also filed responses to Bench Request Nos. 19 and 20, replying to Staff's responses to the Bench Requests and referencing several instances where Joint Parties disagree with Staff's interpretation of Order 05. Most notably, Joint Parties used Staff's attrition model to calculate the attrition allowance authorized in Order 05, while Staff

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[19] *Id.* ¶ 7 (Table 2).

[20] *Id.* ¶ 9.

[21] *Id.*

[22] *Id.* ¶10.

[23] *Id.*

derived its calculations from Avista's model. Joint Parties included Avista's post-attrition adjustment for Project Compass as Order 05 rejected Staff's removal of certain Project Compass expenditures, while Staff removed the Project Compass adjustment in its entirety. Joint Parties applied the power supply cost update as an adjustment outside of the attrition model, while Staff, according to Joint Parties, "was not opposed to applying this adjustment outside of the model, [but] Staff has also proposed a methodology that would estimate 2016 power costs in the attrition model.".

22 On January 28, 2016, Avista filed a Motion for Waiver of Rules Allowing for an Answer to ICNU and Public Counsel's Joint Motion for Clarification and Staff's Motion to Reconsider (Avista's Motion for Waiver). Avista' filing included its responses to the Joint Motion for Clarification and Staff's Petition for Reconsideration. We grant the request for a waiver and consider Avista's responses.

23 Avista states that it does not challenge the end result of the Commission's order decreasing the Company's electric revenue requirement by $8.1 million, and argues that the decrease is within the "bounds of reasonableness" when compared to the Company's recommendation of a decrease in electric revenues of $5.7 million and other parties' recommendations for much larger decreases.[24] Avista notes that, during the January 6, 2016, telephonic order conference, Staff asked "a question related to the significant difference between the attrition adjustment proposed by [it] and that approved by the Commission."[25] The Company states that Mr. Kermode explained the derivation and further answered in the affirmative when asked by ICNU whether the updated power supply costs had been incorporated into the Commission's calculations.[26] The Commission's reduction of $8.1 million to the Company's revenue requirement, according to Avista, will still allow it an actual opportunity to earn the stipulated 9.5 percent return on equity (ROE), in accordance with the parties' settlement.[27] The Company argues that the $19.8 million revenue requirement decrease proposed by Joint Parties and the $27.7 million decrease recommended by Staff "would not come close to providing a reasonable opportunity for Avista to earn the agreed-upon 9.5 [percent] authorized ROE for 2016."[28] Thus, Avista focuses appropriately on the end result

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[24] *Id.* ¶ 16 (Table 1).

[25] *Id.* ¶ 9.

[26] *Id.*

[27] *Id.* ¶ 16.

[28] *Id.* ¶ 18. Avista calculates the ROE opportunities for either ICNU/Public Counsel's or Staff's Motions at 8.21 percent and 7.50 percent, respectively.

reflected in Order 05 and cites specifically to the Commission's reliance on the 'end result" principle in the *Hope Natural Gas Co.* case that provides "it is the result reached not the method employed which is controlling."[29]

24 To address the computational questions raised in both Joint Parties' and Staff's Motions, the Commission convened in its main hearing room on February 3, 2016, a second order conference with Administrative Law Judge Marguerite Friedlander presiding and led by the Commission's Accounting Advisor. Having reviewed the work papers supporting the Motion for Clarification and the Petition for Reconsideration, Mr. Kermode presented a careful, step-by-step explanation of the Commission's use of data, and its calculations and the resulting impacts when the various adjustments are included in Staff's attrition model reflected in Order 05. Mr. Kermode demonstrated conclusively that the results reflected in Order 05 are correct, based on the evidentiary record in these proceedings and that the Commission's application of Staff's attrition methodology is proper.

25 We determine, on the basis of the preceding discussion, that Staff's Petition for Reconsideration, whether considered as a request for reconsideration or clarification, should be denied.

26 **Motion to Reopen the Record.** On February 4, 2016, Staff filed a Motion to Reopen the Record for the Limited Purpose of Receiving into Evidence Instruction on Use and Application of Staff's Attrition Model (Staff's Motion to Reopen). Staff requests that the Commission waive its rule that provides for reopening the record in a proceeding, only "after the close of the record and *before* entry of the final order."[30] By waiving this rule, Staff argues that the Commission could address the "perceived limitations on the Commission's ability to effectively use Staff's attrition model and input the results of

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[29] *Id.* ¶ 21 (citing *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 88 L. Ed. 333 (1944)).

[30] WAC 480-07-830 (emphasis added). The Commission's procedural rules provide:

> The commission may grant an exemption from or modify the application of its rules in individual cases if consistent with the public interest, the purposes underlying regulation, and applicable statutes. The commission may modify the application of procedural rules in this chapter during a particular adjudication consistent with other adjudicative decisions, without following the process identified in subsection (2) of this section.

WAC 480-07-110(1). While Staff's motion and Avista's answer refer to a "waiver" of the rules, the rule refers to a exemption, which the Commission may grant during an adjudication.

Avista's [power cost update] filed October 29, 2015."[31] It recommends that the evidentiary record be reopened to allow introduction of "helpful information . . . on the application and use of its attrition model, including the impacts of Commission determinations in Order 05."[32] According to Staff:

> By reopening the record, the Commission will be able to address its specific issues, and remove any limitations on its ability to calculate Avista's revenue requirement based on Staff's *updated* attrition model. Moreover, reopening the record would not prejudice any party. This is so even if the Commission's review results in a properly revised revenue requirement. No party can claim to be harmed by Commission action *correcting* a calculation.[33]

In its Motion to Reopen, Staff proposes its third electric revenue requirement reduction amount – this time in the amount of $19.6 million.[34]

27 On February 9, 2016, Avista and Joint Parties filed responses to Staff's Motion to Reopen. Avista opposes Staff's Motion to Reopen, emphasizing the importance and fundamental nature of the end result test that the Commission and the U.S. Supreme Court use as a key guiding principle in determining rates for jurisdictional utilities such as Avista.[35] Even with Staff's third revised electric revenue requirement of $19.6 million, calculated using Staff's "corrected" attrition model, Avista argues it would have an opportunity to earn an ROE of no more than 8.22 percent, which is nearly 130 basis points lower than the 9.5 percent agreed to in the parties' settlement and approved by the Commission.[36]

28 Avista says in addition that the entire record may need to be reopened if the Commission decides to allow additional, however limited, attrition evidence.[37] In the Company's

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[31] Staff's Motion to Reopen at 2-3.

[32] *Id.* at 3.

[33] *Id. (emphasis added)*

[34] *Id.* Commission Staff's Petition for Reconsideration supports a $27.4 million adjustment. Staff's response to Bench Request 19 shows an adjustment of $27.7 million. Staff's Motion to Reopen the Record, based on a third set of calculations shows an adjustment of $19.6 million.

[35] Avista's Response ¶¶ 19-20.

[36] *Id.* ¶ 24.

[37] *Id.* ¶ 28.

view, the Commission's decision resulting in an $8.1 million reduction is based on a full examination of the record evidence relevant to each issue and adjustment that affects Avista's revenue requirement, and leads to fair, just, reasonable, and sufficient end results.[38] This is a reduction that still allows Avista a reasonable opportunity to earn its authorized return. To the extent the adjustments proposed by Staff and Joint Parties result in rates that make it highly unlikely that Avista could earn the rate of return the Commission approved in Order 05, Avista is correct that such adjustments do not produce acceptable end results in accordance with the *Hope* and *Bluefield* standards. Rates that have such an effect cannot be said to be fair, just, reasonable, and sufficient.

29 In their response, Joint Parties support Staff's Motion to Reopen. They argue that a waiver of the rule requiring the timeliness of motions to reopen the record should be granted, arguing that the Commission's Order 05, is not truly a final order because the Commission still has to resolve two outstanding post-Final Order motions.[39] In addition, Joint Parties assert that Staff's attrition model is not functioning as intended when Avista's updated power cost data are added.[40] Specifically, Joint Parties allege that Avista did not provide the pro forma 2016 load information in its October 29, 2015, update.[41] While they acknowledge that Staff's attrition model functions as designed "using the information provided to it," Joint Parties claim that this "missing information" produces a number that is incorrect.[42] They recommend that the Commission either recalculate Avista's power supply cost update outside of Staff's attrition model or reopen the record for the limited purpose of the inclusion of Staff's additional updates to its model.[43]

30 **COMMISSION DETERMINATIONS:** WAC 480-07-850(1) describes a petition for reconsideration as a filing that allows a party "to request that the commission change the outcome with respect to one or more *issues* determined by the commission's final order."[44] In regard to its Petition for Reconsideration, Staff explained that it is not questioning the Commission's decisions on the contested issues in the case. Instead, it only seeks Commission review of its "calculation of Avista's overall revenue requirement to ensure that the adjustments set forth in Table 1 have been properly

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[38] *Id.* ¶¶ 28-29.

[39] Joint Parties' Response ¶¶ 3-5.

[40] *Id.* ¶ 6.

[41] *Id.*

[42] *Id.* ¶ 9.

[43] *Id.* ¶ 15.

[44] Emphasis added.

incorporated."[45] While Staff characterized its first, post-Final Order motion as a "Motion to Reconsider," it is more akin to a Motion for Clarification, as previously discussed.

31 That said, during two order conferences the Commission's Accounting Advisor clarified why and how Staff's and Joint Parties' computations produce incorrect results in the context of the record in this proceeding. During these conferences, all parties, including Staff, Public Counsel, and ICNU, were invited to ask unlimited clarifying questions regarding the calculations and incorporations of the Commission's various decisions into Staff's attrition model. Given all of this, we certainly have made clear the Commission's results determined in Order 05 and have demonstrated their correctness as simply and as comprehensively as we can. To the extent not fully resolved to the satisfaction of the parties by Order 05 itself and by these post-Final Order clarification conferences, we conclude that no further clarification is required and determine that Staff's Petition for Reconsideration and Joint Parties' Motion for Clarification should be denied.

32 As Staff and Joint Parties acknowledge, the appropriate time, indeed the time mandated by our own rules, to file a motion to reopen the record is after the close of the record and prior to the entry of a final order in the proceeding.[46] Order 05, the Final Order, was entered on January 6, 2016. Staff's Motion to Reopen was filed on February 4, 2016, nearly a month after the Final Order was served. Staff recommends an exemption from this timeliness requirement, stating that the Commission may grant an exemption of its own rules, yet provides no showing of good cause for taking such an unusual step after the entry of a Final Order.

33 WAC 480-07-830, also provides that the Commission may reopen a record to take additional evidence "that is essential to a decision and that was unavailable and not reasonably discoverable with due diligence at the time of the hearing or for any other good and sufficient cause." Avista filed its power cost update on October 29, 2015, after the hearing but well before the Commission entered its Final Order on January 6, 2016.[47]

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[45] Staff's Petition for Reconsideration ¶ 4.

[46] WAC 480-07-830.

[47] We reject out of hand the Joint Parties' argument that Order 05 is not a final order. That this argument is incorrect is demonstrated, among other things, by language in the Commission's rules governing motions for clarification and petitions for reconsideration. WAC 480-07-835 provides:

> Filing a petition for clarification tolls the time for judicial review but does not toll the time for compliance with the final order of which clarification is sought.

WAC 480-07-840 provides:

Staff, and the other parties had ample time - over two months - to assess the comprehensive impact of the net power cost update within the context of the attrition model. They had ample time to raise with the Commission any issues they had with results that were not what they wanted or expected. In fact, not only did Staff and Joint Parties fail to recognize timely that Staff's own model appeared not to produce the result that these parties expected, they also failed to bring to the Commission's attention their belated allegation that Avista only supplied one-half of the power cost update. Staff and Joint Parties omit any explanation why either of these "discoveries" were not reasonably known, if they acting with due diligence, well before January 6, 2016.

34 While Joint Parties support Staff's Motion, they still acknowledge that "the attrition model functioned"[48] and that "the model will calculate an attrition revenue requirement using the information provided to it."[49] If Avista's power cost update, as Joint Parties allege, was incomplete in any way, the time to bring that to the Commission's attention was at, or shortly after, its filing on October 29th. Simply because Joint Parties and Staff expected a different result from Staff's attrition model than what the model actually produced when updated with revised power costs in late October does not provide good cause for reopening the record at this time.

35 As Avista aptly notes, much more goes into the revenue requirement number than simply the power supply adjustment or even the attrition model results. If we were to open up the record for either of those issues, we might be required to reopen the record in its entirety to protect all parties' rights to due process. The myriad adjustments in the interrelated cells of the models that inform our decisions in this matter that create final revenue requirements numbers cannot be considered separately or on an ad hoc basis.

> An order conference will not stay the effect of an order, the time for compliance, the time for securing post-order review, or the time for petitioning for judicial review, unless the conference results in a supplemental commission order, which then becomes a final order subject to review. An order conference does not constitute a formal interpretation of an order. The final order that is the subject of an order conference will remain the sole expression of the commission's decision unless supplemented through an additional order.

WAC 480-07-850 provides:

> Filing a petition for reconsideration does not automatically stay the effect of an order or serve as a request for a stay. A party may request that the commission stay the effectiveness of an order pending reconsideration by filing a petition for stay pursuant to WAC 480-07-860.

[48] Joint Parties' Response ¶ 9.

[49] *Id.*

36 Finally, Avista has made clear, contrary to Staff's assertion, that it would be prejudiced, perhaps seriously prejudiced, by our reopening the record at this late date, a date well after the statutory deadline for the Commission to reach finality in these dockets. There comes a point in any case when parties directly impacted by the outcome are entitled to repose. We reach that point today insofar as our rules governing adjudicative proceedings take us. We determine that Staff's Motion to Reopen should be denied along with Staff's Petition for Reconsideration and Joint Parties' Motion for Clarification.

37 The Commission's Final Order, Order 05, approved an $8.1 million decrease in Avista's electric revenue requirement as a fair, just, reasonable, and sufficient end result, based on substantial record evidence. None of the Petitions, Motions, or Replies discussed in this order have offered convincing factual or legal arguments to alter that decision.

ORDER

THE COMMISSION ORDERS THAT:

38 (1) The Motion for Clarification filed by the Industrial Customers of Northwest Utilities and the Public Counsel Section of the Washington Office of Attorney General and the "Motion to Reconsider" filed by the Commission's regulatory staff (Staff) are denied.

39 (2) Staff's Motion to Reopen the Record for the Limited Purpose of Receiving into Evidence Instruction on Use and Application of Staff's Attrition Model is denied.

Dated at Olympia, Washington, and effective February 19, 2016.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

PHILIP B. JONES, Commissioner

ANN E. RENDAHL, Commissioner