BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. AVISTA CORPORATION, Respondent.	DOCKETS UE-160228/UG-160229

POST-HEARING BRIEF ON BEHALF OF COMMISSION STAFF

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. ATTRITION 2

A. Overview 2

B. Commission Standard for Attrition 3

C. The Causes of Attrition in This Case Are Sufficiently Clear and Beyond the Utility's Control 4

1. Revenues are flat, but the Company's costs are increasing. 5

2. Rate base expenditures continue to increase and those increases are sufficiently beyond Avista's control. 6

3. Growth in Avista's O&M expenses is also beyond the Company's control. 8

4. Summary of the causes of attrition and Avista's lack of control. 10

D. Staff's Attrition Study Is a Fair and Accurate Representation of Avista's Economic Position During the Rate Year 10

1. Staff's analysis provides an accurate and thorough evidentiary basis to project Avista's used and useful rate base in the rate year. 11

2. Staff's analysis escalates O&M expenses in a fair and reasonable manner. 14

3. Avista's attrition study employs a reasonable overall methodology but contains material errors. 15

4. ICNU's and NWIGU's attrition study is arbitrary, inaccurate, and unreasonable. 18

E. Pro Forma Adjustments to Attrition Models 19

III. COST OF CAPITAL 20

A. Introduction 20

B. Legal Standard 20

C. Capital Structure 21

D. Cost of Debt 23

E. Return On Equity 23

1. Market conditions indicate investor expectations of lower returns. 24

2. Returns approved by state regulatory bodies indicate Avista's return should be lower than the return Avista requests. 24

3. Equity returns in Washington also indicate Avista's equity return should be lower. 25

4. Methodologies that analysts use to estimate the cost of equity indicate that Avista's equity return should be lower 25

F. Conclusion On Cost of Capital 30

IV. PRO FORMA PLANT ADDITIONS 30

V. ADVANCED METERING INFRASTRUCTURE 35

VI. POLICY ISSUES 37

A. A Rate Plan Is Unnecessary But Shifting the Rate Case Cycle Is Sensible 37

B. Preserving the ERM Balance Protects Ratepayers 38

VII. ADDITIONAL POWER SUPPLY ISSUES 39

VIII. COST OF SERVICE, RATE SPREAD, DEMAND RESPONSE, AND DEMAND SIDE MANAGEMENT 40

A. The Commission Should Institute a Generic Cost of Service Proceeding.............41

B. The Commission Should Approve a Uniform Spread of any Increase in Rates Among the Classes...43

C. The Commission Should Reject ICNU's Proposal for a Demand Response Program 46

D. The Commission Should Reject ICNU's Proposal for a Self-Direct Program...47

E. The Commission Should Reject ICNU's Proposed Changes to Schedule 91 49

IX. ADJUSTMENTS AND OTHER ISSUES 50

A. Incentive Expense 51

B. Pipeline Safety Labor Expense (Full-Time Employees) 52

C. Employee Benefits Expense 52

D. Plant Held for Future Use 55

E. Montana Riverbed Lease Expense..57

F. O&M Offsets 59

X. CONCLUSION.. 59

TABLE OF AUTHORITIES

Cases

Bluefield Waterworks & Impr. Co. v. Pub. Serv. Comm'n of W. Va.,
262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923) 20, 21

Fed. Power Comm'n v. Hope Natural Gas Co.,
320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944) 20, 21

Permian Basin Area Rate Cases,
390 U.S. 747, 770, 88 S. Ct. 1344, 20 L. Ed. 2d 312 (1968) 21

Statutes and Regulations

RCW 19.280.030 47
RCW 80.04.250(1) 11
WAC 480-07-510(3)(e)(ii) 51
WAC 480-07-510(3)(e)(iii) 52, 53
WAC 480-07-510(3)(i) 40
WAC 480-107-007(2) 46, 47
WAC 480-107-015 46
WAC 480-107-065 46
WAC 480-140-040 33

Administrative Cases

Accounting Treatment for Land Held For Future Utility Use and For Profits or Losses Realized Through Sales of Those Lands,
Federal Power Commission Docket No. R-379, Order No. 420,
45 F.P.C. 106, 107, 111; 1971 FPC LEXIS 289 (Jan. 7, 1971) 56

Investigation of Possible Ratemaking Mechanisms to Address Utility Earnings Attrition,
Docket U-150040, Public Counsel's Comments (Mar. 27, 2015) 6

Wash. Utils. & Transp. Comm'n v. Avista Corp.,
Docket UE-090134, Order 10 (Dec. 22, 2009) 52, 53

Wash. Utils. & Transp. Comm'n v. Avista Corp.,
Dockets UE-120436 and UG-120437, Order 09 (Dec. 26, 2012) 25

Wash. Utils. & Transp. Comm'n. v. Avista Corp.,
Dockets UE-150204 and UG-150205, Order 05
(Jan. 6, 2016) 3, 5, 6, 10, 12, 20, 31, 32, 33, 34, 35, 36, 46

Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.,
Docket UE-100749, Order 06 (Mar. 25, 2011).....46

Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.,
Dockets UE-140762, UE-140617, UE-131384,
UE-140094, Order 08 (Mar. 25, 2015).....43, 44, 45, 53

Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.,
Docket UE-152253, Order 12 (Sept. 1, 2016).....25, 53, 54

Wash. Utils. & Transp. Comm'n v. Puget Sound Energy,
Dockets UE-130137 and UG-130138, Order 14 (June 29, 2015).....25

Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.,
Dockets UE-040640 and UG-040641, Order 06 (Feb. 18, 2005).....21

Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.,
Dockets UE 111048 and UG 111049, Order 08 (May 7, 2012).....43, 44

Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.,
Cause No. U-80-10, Fifth Supplemental Order (Jan. 2, 1981).....56

Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.,
Dockets UE-920433 and UE-921262, Eleventh Supp. Order;
147 P.U.R.4th 80, 90 (Sept. 21, 1993).....56

I. INTRODUCTION

1 Staff of the Washington Utilities and Transportation Commission (Commission) presents a thoroughly analyzed case that will result in rates that are not only fair to ratepayers but will also provide Avista Corporation ("Avista" or "Company") with sufficient revenue through July of 2018. For electric service, Staff calculates a revenue requirement of $25,570,000, and for natural gas service, a revenue requirement of $2,143,000.[1]

2 The revenue requirements that Commission Staff (Staff) proposes are based on preparation of traditional pro forma results of operations, adjusted for attrition. Staff completed a sophisticated and objective attrition study. From its attrition study, Staff derives an "attrition adjustment" of $26,005,000.[2] While Staff's revenue requirement ultimately relies on the attrition study, Staff's presentation of its pro forma results of operations stands on its own.

3 Staff presents a fully audited modified historical test year, applying standard ratemaking principles in traditional ways. This is important because, if the Commission does not accept an attrition analysis, the Commission can rely on Staff's pro forma results of operations to set rates. In addition, this period of attrition will likely come to an end at some point. Ongoing rigorous audits of rate cases while attrition persists can serve as a restraint and guide for company revenue requirement proposals both during and at the close of this period.

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[1] Huang, Exh. No. JH-1T 7:8, 7:16.

[2] Staff's electric pro forma results of operation and attrition adjustment have changed since Staff filed responsive testimony, given Staff's acceptance of Avista's pro forma property tax adjustment, which is no longer in dispute, and due to Staff's modification of its position on the Montana Riverbed lease expense.

4 An attrition-based revenue requirement should not be seen as an abandonment of standard ratemaking principles. Ratemaking principles can be applied in a number of different ways in different contexts. Ultimately, the attrition allowance as well as the modified historical test year are all ratemaking tools that can coexist within the same framework of ratemaking principles.

5 Discussion follows of the issues that remain in dispute.

II. ATTRITION

A. Overview

6 The Commission has seen the attrition movie before. This case is just a formulaic sequel. A few characters changed and a few minor plot lines emerged in this year's version, but the storyline is very much the same. The utility seeks additional revenue to accommodate circumstances facing the industry broadly, and the Company specifically. Meanwhile customer groups believe those circumstances are imaginary and the extra revenues are unnecessary. Staff offers an independent, unbiased analysis. At the end of the day, the Parties provided a detailed story in the form of an evidentiary record, and the Commission is well-equipped to write the ending. The moral of this story, per Staff, is that the rates in effect at a given time should be sufficient to recover the costs of the same time period.

7 For its part, Staff's attrition case ultimately rests on a basic premise: Avista's costs are growing faster than its revenues, and the attrition adjustment is a fair and reasonable methodology to address that reality. The Parties recognize that the Company's sales are growing at only one percent per year or less. On the cost side of the equation, however, any reasonable analysis shows rate base and O&M expenses increasing at more than one percent

annually. ICNU's witness, Mr. Mullins, even with his gerrymandered mathematics, shows growth rates of about six percent and three percent for expenses and rate base, respectively.[3] Public Counsel's witness argues about inflation rates, but even the lowest of those rates, the use of which Staff sees as unreasonable, show average annual increases over 1.5 percent.[4] The Commission should thus adjust rates to be more forward looking and provide revenues in the rate year that are sufficient to allow the Company a fair opportunity to earn its authorized return. An attrition adjustment is an appropriate tool in the Commission's toolbox for achieving that objective.

B. Commission Standard for Attrition

8 The Commission has a long-used and recently updated framework for evaluating attrition.[5] That framework involves a handful of basic questions to determine whether an attrition adjustment is appropriate and, if so, in what amount:

1. Does the record adequately show the causes of attrition?
2. Are those causes beyond the Company's control?
3. Does the record contain an appropriate methodology for measuring attrition and adding (or subtracting) a reasonable attrition adjustment to utility rates?[6]

9 Staff answers each of the above questions affirmatively and provides an objective, mathematically sound attrition study as support. Staff witness Mr. Hancock first points to verifiable data from reputable, independent third parties that confirm Avista's narrative of the circumstances causing the Company's attrition. Next, Mr. Hancock conducts a rigorous

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[3] *See* Mullins, Exh. No. BGM-3 (electric) and Mullins, Exh. No. BGM-4 (natural gas). Mr. Mullins's cross answering exhibits do appear to materially change his electric rate base growth rates, reducing them to about 1.7 percent. *See* Mullins, Exh. No. BGM-11.
[4] *See* Watkins, Exh. No. GAW-1T 5 (Table 1 – Annual Inflation Rates for PPI and CPI, 2007-016).
[5] *Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, Dockets UE-150204 and UG-150205, Order 05, 19-27 (history of attrition) *and* 41, ¶110 (standards for attrition) (Jan. 6, 2016) ("Avista GRC Order").
[6] *Id.* at 41, ¶ 110.

attrition study that focuses on consistency, clear standards, and statistical relevance. Mr. Hancock explains his rationale at each step of the analysis. Mr. Hancock's testimony also highlights the limited places where he modifies his methodology and explains the reasons for doing so. Staff's story is a thorough analysis that concludes the Commission should grant Avista an attrition allowance for the Company's electric and natural gas operations.

C. The Causes of Attrition in This Case Are Sufficiently Clear and Beyond the Utility's Control

10 The Commission's most recent order on attrition states, "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."[7]

11 Staff witness Mr. Hancock walks through each component of the ratemaking formula and explains the circumstances surrounding Avista's revenues, rate base, and expenses.[8] Mr. Hancock concludes that those circumstances, or "the new normal" in the utility industry, appear to be the root cause of the Company's attrition.[9] Mr. Hancock goes on to review macroeconomic, government, and industry-wide data to confirm the Company's narrative that the circumstances facing Avista are most likely beyond the Company's control.

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[7] *Id.* at 41, ¶ 110.
[8] Hancock, Exh. No. CSH-1T 21:5 - 22:16 (revenues), 23:1 - 25:4 (rate base), 25:9 - 25:15 (expenses). *See also* Hancock, Exh. No. CSH-1T at 18:5 - 19:2 (discussing load growth and utility industry), 35-52 (explaining each component in the attrition study and reasonableness of escalation factors).
[9] Hancock, Exh. No. CSH-1T 21:6-9 (answering the question "What does Staff think is causing Avista's attrition?"), 20:5 ("new normal"), 26:8-10 ("the revenue requirement in this case, absent an attrition adjustment, is likely to be insufficient to provide a fair opportunity to achieve the authorized rate of return").

1. Revenues are flat, but the Company's costs are increasing.

12 Avista is experiencing little to no load growth.[10] As Mr. Hancock explains, that low load growth has two primary causes. The first cause is energy efficiency. Modern homes and businesses use substantially less energy than even a few decades ago.[11] Government policies are also actively discouraging load growth.[12] The second cause, which is likely the more important one for Avista, is low customer growth. Mr. Hancock explained in written and oral testimony that Avista is a decoupled utility with stabilized revenues per customer.[13] Spokane County, though, averaged less than one percent annual population growth from 2007 to 2015.[14] The Company thus has both a sales growth problem and a low customer growth problem. Low sales growth combined with low customer growth means the revenue side of the ratemaking equation is mostly flat. As Mr. Hancock points out, however, the cost side of the ratemaking equation is not flat.[15]

13 Avista also has little to no control over the underlying causes of low load growth. The Company does not build appliances or construct buildings, and there is no evidence that Avista has any impact on the number of people moving to the Spokane area on an annual basis. And as the Commission has noted, the trend towards energy efficiency and low load growth is not likely to reverse itself anytime soon.[16] The only rational conclusion is that, at least on the revenue side, attrition is both real and beyond the Company's control.

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[10] Morris, Exh. No. SLM-1T 15; Andrews, Exh. No. EMA-1T 15-16; Hancock, Exh. No. CSH-1T 21:8; Mullins, Exh. No. BGM-1T 7-9 (acknowledging that Avista is operating in a low load growth environment); Watkins, Exh. No. GAW-1T 7-8 (documenting Avista's customer and load growth rates from 2007-2015).
[11] Hancock, Exh. No. CSH-1T 21:18 - 22:2.
[12] *Id.* at 18:5-20.
[13] *Id.* at 22:11-15; Hancock, TR. 412:18 - 413:11.
[14] Hancock, Exh. No. CSH-1T 22 n. 20.
[15] *Id.* at 21:6-9.
[16] Avista GRC Order at 40, ¶ 109.

2. Rate base expenditures continue to increase and those increases are sufficiently beyond Avista's control.

14 Escalating rate base is probably the most controversial part of attrition. Both Public Counsel's and the industrial groups' attrition witnesses testify to the incentives and potential for abuse inherent in forward looking rate base figures.[17] The Commission, for its part, has also warned against the "self-fulfilling prophecy" of setting rates on the basis of projected rate base totals.[18] Staff witness Mr. Hancock recognizes the controversy around Avista's increased rate base investments and explains his analysis showing that the causes of ongoing growth in rate base appear legitimate and beyond Avista's control.

15 Avista's rate base *is* growing. There is no disagreement on that point. Mr. Hancock testifies that Avista's Net Plant after DFIT has grown by approximately $50 million per year since at least 2007.[19] The only relevant question for the Commission's purposes is *why* plant balances continue to grow and whether those reasons are beyond the Company's control. While the intervenors offer general discussion of consumer inflation rates and discretionary capital spending,[20] Mr. Hancock looks beyond the Company's filing to verifiable, well-documented macroeconomic data from independent and credible sources.

16 As Mr. Hancock explains, the Federal Reserve has pursued a low interest rate policy since the 2007-2008 financial crisis.[21] Lower interest rates mean lower borrowing costs, which mean lower costs for large capital projects. Mr. Hancock's testimony further shows

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[17] Mullins, Exh. No. BGM-1T 8-9; Watkins, Exh. No. GAW-1T 3-4.
[18] Avista GRC Order at 44 (citing *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-140189 (consolidated))).
[19] Hancock, Exh. No. CSH-1T 23:4-5.
[20] Watkins, Exh. No. GAW-1T 5, 9, and 16 (showing Avista's rate base and labor expenses are growing faster than consumer inflation); Mullins, Exh. No. BGM-1T at 7:19-20 ("expenditures that are discretionary need to be deferred").
[21] Hancock, Exh. No. CSH-1T 23:10-19.

that the largest credit agencies upgraded Avista's credit rating in late 2007.[22] The natural consequence of issuing higher quality debt is Avista now has better access to capital markets and even lower costs of borrowing. More projects thus have lower discount rates and positive net present values.[23] Mr. Hancock's reasoning is not just theoretical. Even excluding the more nebulous costs of equity, Avista has seen its debt costs drop by about 100 basis points since 2009.[24] One hundred basis points for a Company capitalized to approximately three billion dollars with a debt ratio exceeding 50 percent equals, by itself, a big annual number.[25] That number is a function of capital markets and federal interest rate policy beyond the Company's control. A credible analysis, such as the one Mr. Hancock provides in testimony, must conclude that lower capital costs materially increase the likelihood that more capital projects show net benefits and will move forward.

17 Next, Mr. Hancock correctly points out that Avista has filed rate cases in almost every year from 2007 to 2015.[26] The Company's results of operations, including its capital investment programs, have thus been closely scrutinized almost annually by the Commission and the various Parties in this proceeding. Those results reflect annual litigation, audits, and Commission decisions determining that Avista's operations from 2007 to 2015 were fair and reasonable. Such close scrutiny over such a significant amount of time gives further support to Staff's conclusion that the causes for increased plant investment are both legitimate and beyond Avista's control.

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[22] *Id.* at 24.
[23] *Id.* at 25:1-4.
[24] Thies, Exh. No. MTT-1T 22.
[25] Thies, Exh. No. MTT-1T 18 (showing the Company's projected overall capitalization at $3.2 billion); Exh. No. MTT-2, p. 2 (showing the Company's actual cost of capital and actual capitalization).
[26] Hancock, Exh. No. CSH-1T 25:19 - 26:6.

18 Ultimately, Mr. Hancock's testimony focuses on the external factors causing increases in Avista's rate base. Staff reviewed the Company's filings on plant investment, and Mr. Hancock specifically highlights Ms. Rosentrater's discussion of distribution plant, but Staff readily acknowledges that the Company knows more about its business investments than Staff, any of the other Parties, or the Commission.[27] Mr. Hancock refers to this as the Company's information asymmetry and emphasizes that the burden of proof rests with Avista.[28] Rather than stopping there or providing general, inactionable discussion about discretionary investment or inflation, though, Mr. Hancock examined relevant macroeconomic circumstances and data to confirm the Company's narrative. The evidence pointed Mr. Hancock (rather than the other way around) to his conclusion that the reasons behind accelerated rate base investment are out of the Company's control.

3. Growth in Avista's O&M expenses is also beyond the Company's control.

19 Escalating O&M expenses for attrition is also controversial. Similar to the situation for rate base, everyone recognizes that Avista's O&M expenses are actually growing faster than revenues. The relevant questions for the Commission are, again, why is this the case and are those reasons beyond the Company's control.

20 Staff witness Mr. Hancock testifies to O&M escalation rates relative to Avista's expense trends *and* industry-specific, third party data.[29] Mr. Hancock shows that the growth in Avista's O&M expenses from 2007 to 2015 closely tracks national trends.[30]
Mr. Hancock's testimony puts Avista's data side-by-side with utility-industry data from the

[27] *E.g.,* Hancock, Exh. No. CSH-1T 19:12 - 20:15, 41:1-8.
[28] *Id.* at 41:12.
[29] *Id.* at 35:1-7.
[30] *Id.* at 44, Illustration 3. The same graph can also be found at Exhibit No. CSH-1T 51, Illustration 4.

Federal Reserve Economic Data ("FRED") database at the Federal Reserve Bank of St. Louis. As Mr. Hancock notes, the Bureau of Labor Statistics and the Federal Reserve Bank of St. Louis are independent and eminently reputable. The resulting picture is thus credible and clear, and Mr. Hancock draws two conclusions. First, Avista's expense trends move in roughly the same direction as the rest of the utility industry data. Second, Avista's growth rates in both electric and natural gas operating expenses outpace the industry-wide data. Mr. Hancock concludes that the Company's pattern of expense growth appears beyond its control but the amount of that growth should be adjusted downward.

21 In contrast to Mr. Hancock's analysis, the non-Staff Parties are effectively asking the Commission to accept their opinions as conclusive evidence. Avista advocates exclusive use of its own O&M cost trends because they most closely match what the Company says will be spent in the rate year.[31] Public Counsel's witness testifies that Avista's labor expenses are increasing faster than inflation and wages in the Spokane region, suggesting the Company's expenses are excessive.[32] Mr. Mullins, testifying on behalf of ICNU and NWIGU, cites only his own discretion for determining appropriate escalation rates.[33] Neither Mr. Mullins's judgment nor Public Counsel's preference to rely on measures that include such disparate items as breakfast cereal or average wages in Spokane County are reasonable gauges of cost pressures facing Avista or the Company's ability to control those costs.[34] Avista's effort to

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[31] *See* Andrews, Exh. No. EMA-1T 35.
[32] Watkins, Exh. No. GAW-1T 18:9-11 (electric operations), 25:2-5 (natural gas operations).
[33] *See* Mullins, Exh. No. BGM-1T 18:8-9 ("Each page also provides a brief narrative to document how I evaluated the escalation rate for each category of cost."); Mullins, Exh. No. BGM-1T 18:21 ("I did not adhere to any bright-line rules for what degree of closeness was evidence of a trend.").
[34] Mullins, Exh. No. BGM-1T 18:21 (explaining that Mr. Mullins used his own judgment to determine evidence of a trend); Hancock, Exh. No. CSH-10T 3:2-6 (explaining that CPI includes non-utility costs such as breakfast cereal, cigarettes, and college tuition); Watkins, Exh. No. GAW-1T 18:7-11 (electric operations) and 29:1-7 (natural gas); *see also* Hancock, TR. 388-394 (Public Counsel's cross-examination of Mr. Hancock about inflation and referencing cross-exhibits Hancock, CSH-13CX through Hancock, CSH-15CX).

downplay industry trends is inconsistent with the Company's reliance on those same industry trends to justify attrition in the first place.[35] Only Staff witness Mr. Hancock provides the detailed analysis and independent data to show that the O&M cost pressures facing Avista are legitimate and, at least to a significant extent, beyond the Company's control.

4. Summary of the causes of attrition and Avista's lack of control.

22 Avista's rate base and expenses are growing faster than the Company's revenues. The Parties disagree on the causes behind those diverging growth rates, but only Staff analyzes revenues, rate base, and expenses in relation to both this case and the broader economic circumstances. Those circumstances and the corresponding data support the conclusion that the causes of attrition are both real and, for the time being, beyond Avista's control. The fact that little has changed in the year since the Commission last accepted Avista's attrition case further supports Staff's conclusions and recommendation. Staff therefore recommends the Commission find an attrition adjustment is warranted in this case.

D. Staff's Attrition Study Is a Fair and Accurate Representation of Avista's Economic Position During the Rate Year

23 After reviewing whether an attrition adjustment is warranted, the Commission's next step is selecting an appropriate methodology for measuring attrition.[36] There are three attrition studies in the evidentiary record. First, Staff's attrition study is a fair and reasonable attempt to measure attrition and calculate an appropriate adjustment using lines of best fit over a consistent period of time. Second, Avista's attrition study largely mimics Staff's overall methodology but unreasonably alters certain mechanisms, which produces a larger

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[35] *Compare* Andrews, Exh. No. EMA-6T 24:12 - 26 (citing Forsyth, Exh. No. GDF-1T 14), and Morris, Exh. No. SLM-1T 2:2-4.
[36] Avista GRC Order at 40, ¶ 108.

revenue requirement. Third, ICNU and NWIGU offer an attrition "study" that is arbitrary and incorrect. Mr. Mullins's attrition study meets no reasonable definition of objectivity or mathematically soundness. Staff's attrition study is thus the most reasonable representation of rate year costs.

1. Staff's analysis provides an accurate and thorough evidentiary basis to project Avista's used and useful rate base in the rate year.

24 As previously noted, escalating rate base is a particularly controversial part of attrition. Public Counsel warns against incentives for utilities to increase capital expenditures.[37] The industrial groups' witness, Mr. Mullins, highlights the same incentives as well as potential conflicts between escalating rate base and the known and measurable standard.[38] Mr. Mullins also opines that attrition meets the statutory requirements in RCW 80.04.250(1) but emphasizes his opinion that Washington state's used and useful standard is a limiting factor on forward-looking rate base figures.[39] Mr. Mullins is half right in that Washington does have a used and useful statutory requirement, but he is wrong in suggesting the statutory text somehow requires that used and useful only be applied in hindsight.

25 Under RCW 80.04.250(1), the Commission has the authority to determine the fair value of used and useful property included in rates. The statute does not remove regulatory tools such as attrition from the Commission's ratemaking toolbox. To the contrary, the statute grants the Commission the power to determine the value of used and useful facilities. That's it. The specific means for determining fair value of used and useful plant is left to the

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[37] *See* Watkins, Exh. No. GAW-1T 4.
[38] Mullins, Exh. No. BGM-1T 6-7.
[39] Mullins, Exh. No. BGM-1T 12:1-2 ("the Attrition allowance model can be deployed in a manner that takes the statutory standard into consideration").

Commission. Several decades of ratemaking history confirm that attrition and many other forms of forward-looking ratemaking tools can meet the used and useful standard.[40] A sound attrition methodology, such as the one Mr. Hancock offers in testimony, provides reasonable expectations of used and useful plant in the rate effective period and complies with the Commission's overarching legal mandate to allow fair, just, reasonable, and sufficient rates.

26 Staff witness Mr. Hancock's testimony explains his analysis and conclusion that his attrition study most reasonably projects Avista's used and useful level of rate base in the rate year. As Mr. Hancock emphasizes, Staff's attrition study relies only on lines of best fit with explanatory variables that show *statistical significance* at a widely-used standard over a *consistent* period of time.[41] These are the key components of Staff's study: consistency and statistical significance. By focusing on these components, Mr. Hancock ensures his attrition study is objective, mathematically accurate, and lawful.

27 Mr. Hancock first explains his consistent use of a 2007-2015 time period. It is easy enough to recognize that the Commission approved a 2007-2014 time period for attrition only last year because that data best represented Avista's cost and revenue trends.[42] In keeping with Staff's emphasis on independent third party data in this case, however, Mr. Hancock also testifies that two major credit rating agencies upgraded Avista's credit rating at the end of 2007 and that rating has since remained unchanged.[43] The 2007-2015

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[40] *See* Avista GRC Order at 19-27 (History of Attrition). Note, however, that Staff does rely on the principle that specific plant additions must be used and useful before they are included in the pro formed rate base from which the attrition adjustment is calculated.
[41] Mr. Hancock's lines of best fit explain 90 percent or more of the variation in rate base. Even more important, the explanatory variables in those lines of best fit show a 95 percent or greater chance of being non-random. Hancock, Exh. No. CSH-1T 14:1-2 and 28:3-8. *See also* Hancock, Exh. Nos. CSH-4 through CSH-9 (attrition studies and growth rates in plant by FERC account).
[42] Hancock, Exh. No. CSH-1T 28:3-14 (citing Docket UE-150204, Order 05 at 42, ¶ 114).
[43] *Id.* at 28:9-14.

time period thus represents a time over which two sophisticated and independent third parties determined that Avista has operated in a consistent and financially sound manner. Even Mr. Mullins generally recognizes 2007-2015 as a reasonable time period for measuring most of the Company's cost trends.[44]

28 Statistical significance is equally important to Staff's attrition study. As Mr. Hancock succinctly explains:

> "Staff's stance is a principled one: it is only appropriate to escalate a subcomponent of the revenue requirement formula where there is a statistically significant relationship between the growth in that subcomponent and the passage of time."[45]

To ensure an additional layer of statistical validity, Mr. Hancock also developed escalation factors for the individual components of net plant. The more granular analysis Mr. Hancock provides allows the Commission to evaluate the growth in rate base components individually rather than as a group. As Mr. Hancock explains, certain types of plant are growing faster than others while other categories have a larger nominal impact on attrition than some.[46] Staff's more granular escalations also remain statistically significant.[47] Although the Company disagrees with Staff's more granular analysis in principle, Avista concedes that the results are essentially equivalent to those from its own, less-granular analysis.[48]

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[44] Mullins, Exh. No. BGM-10T 8:10-12 ("Review of the data in my model, however, seems to support a conclusion that the trajectory for many categories of cost changed in 2007, corresponding to the timing of the credit upgrade.")
[45] Hancock, Exh. No. CSH-1T 29:5-8.
[46] *Id.* at 38-42 (electric operations) and 48-50 (natural gas operations).
[47] *Id.* at 32:11-12. *See also supra* ¶ 26 n.41.
[48] Andrews, Exh. No. EMA-6T 37:17-18.

2. Staff's analysis escalates O&M expenses in a fair and reasonable manner.

29 Staff's O&M escalators balance the actual growth in Avista's expenses with a proxy of reasonable labor and non-labor costs across the utility industry. Mr. Hancock's analysis shows that Avista's expenses move in the same direction and with similar timing as the industry trends documented in the utility-specific versions of the Producer Price Index ("PPI-U") and Employment Cost Index ("ECI-U"). Mr. Hancock notes, however, that Avista's expenses are growing by larger amounts than those of other utilities.[49] To fairly incorporate these underlying facts, Mr. Hancock recommends a downward adjustment to Avista's historical O&M trend that incorporates expense growth rates in the ECI-U and PPI-U. Mr. Hancock accomplishes this goal by recommending the use of a simple, transparent weighted average of 50 percent Avista historical O&M growth rate, 25 percent ECI historical growth rate, and 25 percent PPI historical growth rate.[50] As he explains in testimony, Mr. Hancock's O&M escalation fairly weights Avista's historical performance and the unique circumstances the Company faces with broad measures of reasonable growth rates in the utilities industry.[51] The result is an accurate projection of the fair and reasonable level of O&M expenses into the rate year coupled with an incentive for Avista to control costs.

30 On rebuttal, Avista argues that a weighted average of ECI-U and PPI-U data with Avista-specific data is not reasonable. The Company provides two reasons. The Company's first concern is that the PPI-U and ECI-U include steam, water, and sewage utilities.[52] The

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[49] Hancock, Exh. No. CSH-1T 44-46. *See also* Hancock, CSH-10T 4:4-5 (specifically discussing Avista labor costs growing faster than the ECI-U).
[50] Hancock, Exh. No. CSH-1T 46:11-18.
[51] *Id.* at 47:7-9.
[52] Forsyth, Exh. No. GDF-1T 13:12-19.

Company witness acknowledged at hearing, though, that he has no reason to believe steam, water, and sewage utilities would materially alter either index.[53] It is also important to remember, as Mr. Hancock testifies, the source of the data that Avista is disputing.[54] The Bureau of Labor Statistics is highly reputable, and the BLS combined water, steam, sewage, gas, and electric utilities *because* those entities are similar. The Commission thus has another government agency's view that the various types of utilities are similarly situated.

31 Avista expresses a second concern that Mr. Hancock's recommendation combines Avista-specific and industry-wide data.[55] The Company omits that a significant portion of its own attrition case depends on the idea of industry-wide trends.[56] It is logically inconsistent to rely on industry trends when they support a position but then argue those same trends are inapplicable when they do not. The more reasonable position is Mr. Hancock's: the BLS data is reliable and suggest Avista's O&M expense trends should be adjusted downward. A blended average is an effective and fair means of implementing Mr. Hancock's conclusion.

3. Avista's attrition study employs a reasonable overall methodology but contains material errors.

32 Mr. Hancock's testimony lists eight significant differences between Avista's attrition model and Staff's attrition model.[57] Mr. Hancock goes on to explain his rationale for each of those differences in Staff's model. Some differences are largely administrative and should not be controversial; such as including the more recent 2015 fourth quarter data, incorporating attrition into one rate increase instead of two, and presenting attrition as an

[53] Forsyth, TR. 163:1-18.
[54] Hancock, Exh. No. CSH-1T 45:6-8.
[55] Forsyth, Exh. No. GDF-1T 14:1-16.
[56] *See* Morris, Exh. No. SLM-1T 2:2-4 ("I will summarize the Company's rate request in this filing, and provide some context for why there is a continuing need for retail rate increases, not just for Avista, but for the electric and natural gas utility industry in general.").
[57] Hancock, Exh. No. CSH-1T 29-30.

adjustment to the modified historical test year in the revenue requirement model. The Company disagrees with Staff's recommendation for one increase instead of two, but otherwise Avista largely adopts these "differences" on rebuttal.[58] Two other changes are discussed above as adjusting O&M escalation rates downward to reflect industry data and escalating rate base subcategories rather than net plant as a whole. Another change focuses on after-attrition adjustments, which is not a per se change to the attrition study and something that Mr. Hancock discusses at length later in his testimony. The remaining differences involve escalating natural gas revenues and using a mix of polynomial and linear functions for lines of best fit.

33 For the disagreement around the timing and number of rate increases, Avista continues to advocate for two separate increases rather than a single increase as proposed by Staff. As Mr. Hancock explains, Staff believes a single rate increase effective January 1, 2017, is more fair because it is administratively less burdensome and avoids the potential for three rate increases in less than two years.[59] Avista seems to support the second increase on the basis that the Company will need more revenue in 2018.[60] As even Ms. Andrews acknowledges, however, the timing and number of increases are not material to the overall revenue requirement.[61]

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[58] Andrews, Exh. No. EMA-6T 4:15-24 (explaining that Staff and the Company's updated models are closely aligned). Andrews, Exh. No. EMA-6T 5:5-14 (stating that Avista still believes a two-step increase rather than a single increase as Staff proposed is more reasonable); Andrews, Exh. No. EMA-6T 19-20 (explaining that Avista agrees with most of Staff's updates and listing similarities).
[59] Hancock, Exh. No. CSH-1T 11:18-22.
[60] *See* Andrews, Exh. No. EMA-6T 18:17-19 ("Staff's attrition adjusted proposed revenue increases fall well short of what is needed by Avista to have an opportunity to earn a reasonable return during the January 2017 through June 2018 rate period.")
[61] Andrews, Exh. No. EMA-6T 4:26-44 (excluding timing and number of increases as a main difference when listing the differences between Staff's models and the Company's updated models as O&M Escalations, After-attrition adjustments, linear versus non-linear escalation trending, and AMI.). *See also* Andrews, Exh. No. EMA-6T 21, Table 7 and 22, Table 8, and Andrews, Exh. No. EMA-6T 20:13-17 ("Both sets of electric and natural gas models show an attrition revenue requirement need in 2017 with an incremental revenue

34 The second remaining difference between Staff and the Company is that Staff's attrition study included an escalation for Other Revenues in natural gas service but Avista did not. Staff included an escalator for natural gas Other Revenues because a linear regression was statistically significant.[62] Due to that statistical significance, and the fact that the other option is escalating those revenues at zero percent, Mr. Hancock escalated natural gas service's Other Revenues for the rate effective period. A statistically significant function is more reasonable than Avista's proposal to assume zero percent growth. Staff's recommendation results in a lower attrition allowance.

35 The third difference between Staff and the Company is Avista's preference, in natural gas service, for only polynomial best fit functions versus Staff's use of both linear and polynomial regressions.[63] Although the Company contests Mr. Hancock's mixed use as inconsistent,[64] Staff's practice is actually inherently consistent. Staff's use of both linear and polynomial best fit functions is the result of Mr. Hancock's emphasis on statistical significance. Mr. Hancock chose the line in each instance that best approximated Avista's actual historical data.[65] Simply put, Mr. Hancock employed linear regressions where those functions best explained the underlying data and polynomial regressions where those functions best explained the underlying data. Mr. Hancock's methods ensure the data is speaking for itself. Conversely, the Company's ex-post argument for kink points and exclusive use of polynomial functions are inconsistent with the data and time periods. The Company's proposals are simply an attempt to force the slope of the trend lines steeper than

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requirement need for electric for the period January through June 2018.").

[62] *Id.* at 33:8-20.

[63] *Id.* at 39-43.

[64] *Id.* at 38:20 - 43:3 (responding to "What issues do you see with his analysis and what inconsistencies were noted?").

[65] Hancock, Exh. No. CSH-1T 34.

the 2007 to 2015 data otherwise support. Staff's attrition study thus provides for the more objective and accurate estimate of Avista's operations in the rate period.

4. ICNU's and NWIGU's attrition study is arbitrary, inaccurate, and unreasonable.

36 Mr. Mullins's attrition study is not an attempt to measure Avista's economic position in the rate year. Mr. Mullins's attrition study is, as Mr. Hancock states, "seemingly engineered to produce similar results to that of his more traditional revenue requirement study."[66] Mr. Mullins's own testimony even admits as much.[67]

37 As Mr. Hancock points out, the big problem with Mr. Mullins's attrition study is inconsistency.[68] Mr. Mullins's study does not adhere to any "bright-line rules" and he conducted his own "case by case review" in selecting data sets for his testimony.[69] These are just formalistic ways to justify data manipulation.

38 Mr. Hancock explains that Mr. Mullins's chosen trends and r-squared values are largely mathematical mirages that stem from picking-and-choosing specific datasets.[70] Mr. Hancock's contentions are not up for debate. Mr. Mullins's study uses inconsistent trends, time periods, and definitions of statistical significance for nearly every cost category.[71] An attrition study that relies on backtesting and variable sample sets to generate

[66] Hancock, Exh. No. CSH-10T 5:15-16.
[67] Mullins, Exh. No. BGM-1CT 15:12-15 ("I performed a case by case review of the historical cost data for each category of cost to determine the appropriate data to rely upon to calculate the escalation rates, including evaluation of an appropriate time period to use when evaluating the trend for the cost category in question.").
[68] *See* Hancock, Exh. No. CSH-10T 6:6-14.
[69] Mullins, Exh. No. BGM-1CT 18:21("I did not adhere to any bright-line rules") and 15:12-15 ("I performed case by case of the cost historical cost data").
[70] Hancock, Exh. No. CSH-10T 6:17 - 7:11.
[71] *See* Mullins, Exh. No. BGM-1T 15-16; Mullins, Exh. No. BGM-3 (electric attrition models); Mullins, Exh. No. BGM-4 (natural gas attrition models).

high r-squared correlations is neither objective nor reliable. Therefore, Staff recommends that the Commission give Mr. Mullins's attrition study little to no weight in this case.

39 Staff also disagrees with Mr. Mullins's thought process on post-attrition adjustments. While Mr. Mullins accepts a sort of quid pro quo process to reduce escalation periods in exchange for considering such adjustments,[72] Staff's study emphasizes statistical significance and actual escalation time periods in this case. Mr. Hancock argues for an escalation period to match the actual period between the test year and the rate year.[73] Mr. Mullins suggests negotiating the number of months on a calendar. Mr. Hancock's approach is, again, the more principled and reasonable one.

E. Pro Forma Adjustments to Attrition Models

40 Mr. Hancock cautions the Commission about the use of pro forma adjustments to the attrition model. He then lays out a four step process for evaluating such adjustments.[74] Mr. Hancock's recommended process focuses on determining whether the attrition adjustment accurately captures on-the-ground trends at the Company. Where the Company's actual, documented transfers exceed estimates from the attrition model, Mr. Hancock concludes that a pro forma adjustment is fair and reasonable.[75] After following his principle-based process, Mr. Hancock recommends pro forma adjustments to the attrition models for hydroelectric production projects along the Spokane River.[76] The pro forma adjustment to the attrition model that Mr. Hancock proposes only includes the amount by which the actual transfer to plant exceeds the estimate from his attrition model.

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[72] Mullins, Exh. No. BGM-1T 24:9-13.
[73] Hancock, Exh. No. CSH-10T 9:11 - 10:5.
[74] Hancock, Exh. No. CSH-1T 58-59.
[75] *Id.* at 59:4-9.
[76] *Id.* at 59:13 - 60:16 (testifying in favor of a pro forma adjustment to the attrition model for the Spokane River Projects, which are the Nine Mile hydroelectric dam rehabilitation, the Post Falls south channel gates replacement project, and the Little Falls powerhouse redevelopment project).

III. COST OF CAPITAL

A. Introduction

41 Staff's proposed rate of return of 7.30 percent appropriately reflects market conditions and Avista's financial strength. Currently, Avista enjoys an authorized rate of return of 7.29 percent, which resulted from a settlement that the Commission approved in Avista's last general rate case.[77] Avista's authorized return is based on a cost of equity of 9.5 percent, which Avista now seeks to increase to 9.9 percent. Avista's requested increase is out of step with investor expectations, given low and declining interest rates and the general downward trend of utility returns on equity.

B. Legal Standard

42 A utility's cost of capital is the level of return it requires to service its debt and compensate its equity investors. The commission calculates a utility's cost of capital, or rate of return, in keeping with the principles established in the *Hope*[78] and *Bluefield*[79] line of cases. Determining a utility's annual rate of return is an "exercise of a fair and enlightened judgment"[80] involving "a balancing of the investor and the consumer interests."[81] The return should be sufficient to assure confidence in the financial soundness of the utility and thus allow the utility to maintain its credit and to attract capital.[82] At the same time, the rate of return a commission sets does not guarantee the utility a profit,[83] and a utility is expected to operate efficiently and economically.[84] So long as a commission has fully taken into

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[77] Avista GRC Order.
[78] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944).
[79] *Bluefield Waterworks & Impr. Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923).
[80] *Bluefield* at 692.
[81] *Hope* at 603.
[82] *Hope* at 603; *Bluefield* at 693.
[83] *See Hope* at 603.
[84] *See Bluefield* at 693.

consideration the various interests of the parties when it calculates the rate of return, a rate that falls with a "zone of reasonableness" will be sufficient.[85] Once a sufficient rate is set, however, it may become unreasonable as market conditions change.[86]

43 To calculate a utility's cost of capital, a commission must determine the cost of debt, determine the cost of equity, and determine the utility's capital structure. A utility's rate of return (also known as the weighted cost of capital) is the sum of its cost of debt and its cost of equity, weighted according to the respective shares of debt and equity in the utility's capital structure. The cost of debt typically is computed based on the actual debt and cost rates of debt the utility has issued. In contrast, the cost of equity is an estimate of the likely return an investor would require to invest in an enterprise with comparable risks.[87] The capital structure used to calculate the rate of return may be a company's actual capital structure, a pro forma capital structure, or a hypothetical capital structure.[88] The important principal is that the capital structure that the commission uses for setting rates must balance the "economy" of lower cost debt with the "safety" of higher cost common equity.[89]

C. Capital Structure

44 Avista has proposed a hypothetical capital structure that incorporates 48.5 percent equity,[90] and Staff agrees that this equity level contributes to a capital structure that balances safety and economy. According to Avista, 48.5 percent will be the Company's actual equity

[85] *See Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 88 S. Ct. 1344, 20 L. Ed. 2d 312 (1968).
[86] *Bluefield* at 693.
[87] *See Hope* at 602; *Bluefield* at 692.
[88] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-040640 and UG-040641, Order 06, 13, ¶ 27 (Feb. 18, 2005).
[89] *Id.* at 13, ¶ 27.
[90] Thies, Exh. No. MTT-1T 17:17-20.

level for 2017.[91] Currently, Avista's level of equity is set at this same level, 48.5 percent, pursuant to a settlement adopted by the Commission in Avista's last general rate case.

45 Staff recommends no change from the current equity level of 48.5 percent. Avista has Single A bond ratings on its secured long-term debt,[92] and Avista's credit ratings compare favorably with most electric and combination utilities.[93] Avista's capital structure for Washington has remained fairly stationary over the last four years.[94] Just last August Avista was able to attract capital at a coupon rate of 3.54 percent for $175 million of new debt,[95] which is five basis points below the July average for Single A-rated utility bonds and less even than the September average,[96] showing that Avista is able to attract reasonably priced capital with its existing capital structure. Finally, Avista's equity level is in step with other regulated utilities.[97] In this context, Staff recommends a capital structure comprised of 48.50 percent common equity, 38.38 percent long-term debt, and 3.12 percent short-term debt. Avista does not include short-term debt separately from its total debt, but there is no difference in the ultimate cost of capital calculations resulting from this difference in presentation.[98] In short, Staff's proposed capital structure adequately supports the Company, is in step with the industry, and balances economy with safety.

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[91] Thies, Exh. No. MTT-1T 19:5-6.
[92] Parcell, Exh. No. DCP-1T 16:13-14.
[93] Parcell, Exh. No. DCP-1T 16:11 - 17:2.
[94] Parcell, Exh. No. DCP-1T 18:4-10.
[95] Response to Bench Request No. 5.
[96] *See* Parcell, TR. 349:9-13.
[97] Parcell, Exh. No. DCP-1T 18:12 - 19:1.
[98] Parcell, Exh. No. DCP-1T 20:5-7.

D. Cost of Debt

46 Staff has incorporated Avista's as-filed cost of debt of 5.51 percent into Staff's recommended rate of return. Avista updated its cost of debt on rebuttal[99] but elected not to seek higher revenue increases than proposed in its original filing.[100] Staff also elects not to incorporate into its revenue requirement the cost of debt that Avista presents on rebuttal.

47 According to Ms. Andrews, Avista's revenue requirement and attrition study witness, Avista's cost of debt increased from 5.51 percent to 5.594 percent in August. In August 2016, Avista committed to issue $175 million in debt at an "all-in-rate" of 5.63 percent, "[i]ncluding the cost of hedges." The cost of hedges is approximately $53.9 million, which amounts to over 31 percent of the amount of debt sold, and is the significant factor driving the all-in rate up to 5.63 percent from a coupon rate of $3.54 percent.[101] The debt will be funded and issued in December 2016.[102]

48 Consistent with Avista's decision not to seek recovery of its updated costs in this proceeding, and consistent with Staff's cut-off of July 31, 2016, for evaluating capital additions, Staff does not incorporate Avista's August 2016 debt commitment into its revenue requirement. Staff will review Avista's cost of debt in the Company's next general rate proceeding.

E. Return On Equity

49 Interest rates, approved utility rates of return, and the results of the various methodologies that experts employ to estimate required utility returns all indicate that investors currently expect a lower equity return than Avista has requested. In contrast,

[99] Andrews, Exh. No. EMA-6T 14:3-4.
[100] Norwood, Exh. No. KON-1T 29:7-8.
[101] Response to Bench Request No. 5, Attachment A, p. 2, column g and line 19 (showing a "swap" loss of $53,867,043).
[102] Andrews, Exh. No. EMA-6T 14:6.

Staff's recommended return on equity for Avista of 9.2 percent appropriately reflects the downward trend of capital costs and sits comfortably around the national averages for electric and gas utility returns on equity.

1. Market conditions indicate investor expectations of lower returns.

50 Interest rates remain low,[103] and return on equity analyses using traditional methodologies such as Discounted Cash Flow (DCF) have yielded lower returns.[104] Not only have government interest rates continued to decline[105] but utility bond interest rates are near the lowest levels in the past 35 years.[106] Interest rates on debt have declined since Avista's last general rate case and since this case was filed.[107] In July of this year, the average yield on long-term A-rated utility bonds was 3.59%, and in September it was 3.66 percent;[108] and Avista was able to price bonds in August at a coupon rate of 3.54%.[109] During the year prior to that, the highest rate was only 4.40 percent, in November 2015.[110] These low and declining bond rates indicate that investors expect lower returns.

2. Returns approved by state regulatory bodies indicate Avista's return should be lower than the return Avista requests.

51 At the same time, returns on equity authorized by state regulatory bodies have also declined and continue to do so.[111] Both the electric and gas returns exhibit a definite downward trend since 2012. As of the second quarter of 2016, the average authorized return on equity for electric utilities was 9.52 percent, and for gas utilities it was 9.45 percent.[112]

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[103] Parcell, Exh. No. DCP-1T 12:17-20.
[104] Parcell, Exh. No. DCP-1T 14:12-13.
[105] Parcell, TR. 349:14-17; Parcell, Exh. No. DCP-1T 14:10-12.
[106] Parcell, Exh. No. DCP-1T 14:2-6.
[107] Parcell, TR. 349:14-17.
[108] Parcell, TR. 349:9-13.
[109] Response to Bench Request No. 5.
[110] Exh. No. DCP-4, p. 4.
[111] Parcell, Exh. No. DCP-1T 14:13-15.
[112] Parcell, Exh. No. DCP-1T 14, table.

3. Equity returns in Washington also indicate Avista's equity return should be lower.

52 In Washington the approved rates of return of the other two comparable investor owned energy utilities are both lower than the 9.9 percent equity return Avista is requesting in this case. Puget Sound Energy's currently authorized return is 9.8 percent, which was set as of 2013.[113] In September of this year, this Commission approved a return on equity for Pacific Power & Light Company of 9.5 percent.[114] Avista now seeks a return on equity that is not only higher than these but also higher than the equity return that the Commission approved for Avista this year and even higher than the equity return that the commission approved for Avista back in 2012. In 2012, which was the most recent time before this year's Avista GRC Order that a return on equity was specified for Avista, the Commission approved a return on equity of 9.8 percent.[115] Currently, Avista has an equity return of 9.5 percent, not only in Washington but also in Idaho and Oregon.[116] In the market environment of continuing record-low interest rates, declining bond yields, and ever lower approved utility returns, Avista's proposed return on equity of 9.9 percent is not within the zone of reasonableness.

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

53 Using the DCF methodology, the Capital Asset Pricing Model (CAPM), and the Comparable Earnings method (CE), Staff's expert, Mr. Parcell, concludes that the range for

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[113] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-130137 and UG-130138, Order 14 (June 29, 2015) (PSE Remand Order).

[114] *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Docket UE-152253, Order 12 (Sept. 1, 2016).

[115] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-120436 and UG-120437, Order 09 (Dec. 26, 2012).

[116] Exh. No. AMM-19CX, p. 9, note E.

Avista's return on equity extends from 8.85 to 9.5 percent. And the fair return on equity lies at the mid-point of this range, at 9.20 percent.

a. Staff's cost of equity of 9.2 percent is the high end of the DCF results.

54 The DCF methodology calculates the value of a security as the discounted present value of all future cash flows.[117] The future cash flows include both dividends and growth.[118] Mr. Parcell used a group of proxy companies, as well as Avista, to compute a range of DCF results. Unlike the other cost of capital witnesses in this case, Mr. Parcell conducts his analysis using not only his own proxy group but also Avista witness Mr. McKenzie's proxy group.[119] His conclusions are based upon the results of both proxy groups.[120] Although his computed DCF range falls between 7.0 percent and 9.2 percent, Mr. Parcell judges that the current DCF range is 8.5 percent to 9.2 percent (with a midpoint of 8.85 percent).[121] This range includes only the highest DCF rates.[122]

55 Mr. Parcell used a select set of growth indicators that appropriately reflect investor's expectations of dividend growth. Avista claims that Mr. Parcell relies too heavily on historical growth rates,[123] but this is not the case. Investors, as Mr. Parcell testified, are likely to consider a wide array of growth indicators, which is why he considers five different indicators of growth in his analysis.[124] Two of these are recent historical averages, and three are projections. This combination provides a sound basis for estimating investors' growth

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[117] Parcell, Exh. No. DCP-1T 23:12-14.
[118] PSE Remand Order at 17, ¶ 33.
[119] *See* Parcell, Exh. No. DCP-1T 22:21-22.
[120] Parcell, Exh. No. DCP-1T 23:3-5.
[121] Parcell, Exh. No. DCP-1T 27:2-7.
[122] Parcell, Exh. No. DCP-1T 27:3-7.
[123] McKenzie, Exh. No. AMM-6T 17:14-15.
[124] Parcell, Exh. No. DCP-1T:

expectations. In any event, Mr. Parcell's DCF conclusions, which are based only on the highest results, do not rely on historical growth rates as Mr. McKenzie erroneously claims.

56 In addition, Mr. Parcell's DCF analysis incorporated the most recent market data available; whereas Avista declined to update its testimony.[125] Mr. Parcell used data for the proxy groups as of the end of July 2016.[126] In contrast, Avista's return on equity witness Mr. McKenzie used market data ending in January of 2016.[127] Because Mr. Parcell applied updated financial information to Mr. McKenzie's proxy group as well as his own,[128] he was able to update Mr. McKenzie's DCF analysis.[129] Mr. Parcell's updated DCF results provide a more up to date estimate of investor expectations.

57 When Avista's DCF results are updated and corrected, its results are very similar to those of both Staff and ICNU. Avista reaches its average DCF range of 8.8 to 10.4[130] by discarding low end outliers from its DCF results,[131] which inflates its estimated return on equity.[132] ICNU's expert, Mr. Gorman, also noted this.[133] Correcting for this inflation and also incorporating updated market data as discussed above, results in average DCF equity returns of between 8.7 percent and 9.2 percent for Mr. McKenzie's proxy group. This is quite close to Mr. Parcell's DCF results of 8.5 percent to 9.2 percent. It is also similar to the results of Mr. Gorman. Mr. Gorman concluded that his DCF analysis supports a return on equity of 8.7 percent.[134] Mr. Gorman also corrected Mr. McKenzie's DCF results and found

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[125] *See* Exh. No. AMM-19CX.
[126] Parcell, Exh. No. DCP-1T 24:18-19.
[127] *See* Exh. No. AMM-5.
[128] Parcell, Exh. No. DCP-1T 42:16 - 43:1.
[129] Parcell, Exh. No. DCP-15.
[130] McKenzie, Exh. No. AMM-1T 34, Table 5.
[131] *See* McKenzie, Exh. No. AMM-1T 33:14-15; Exh. No. AMM-6, p. 3.
[132] *See* Parcell, Exh. No. DCP-1T 41:17-19; Parcell, TR. 355:20 - 356:20.
[133] Gorman, Exh. No. MPG-1T 51:4 - 52:15.
[134] Gorman, Exh. No. MPG-1T 32:1-3.

that they are bounded at the high end at 9.2 percent.[135] The DCF methodology is the only methodology relied on by all three parties that testified on cost of capital in this proceeding. It is noteworthy that, once Avista's results are corrected and updated, none of the parties' DCF results have a maximum equity return above 9.2 percent.

b. Staff's Comparable Earnings results are based on investor perceptions while Avista's Expected Earnings results are simply unmoored calculations of an average and midpoint.

58 Avista and Staff use a similar method, which Staff terms "Comparable Earnings" (CE) and Avista calls "Expected Earnings," to evaluate the prospective return available from alternative investments of similar risk.[136] The results, however, are quite different. Avista's Expected Earnings results of 10.4 to 10.8 percent skew the Company's cost of equity out of the zone of reasonableness.[137] Staff's results, in contrast, reside in a range from 9.0 percent to 10.0 percent, with a midpoint of 9.5,[138] which is Avista's current approved return on equity.

59 Mr. Parcell uses the CE method to measure the returns investors expect to earn on the original cost book value of enterprises with similar risk to the utility, in this case, Avista.[139] This means that Mr. Parcell examined both historical and projected equity returns for utilities in both Mr. McKenzie's as well as his own proxy group. In addition, Mr. Parcell also examined the return for Standard and Poor's composite 500 companies, which he used as a check but did not use to determine his CE result. Examining earnings over a diverse period in time ensures a more accurate trend in that it smooths abnormal conditions and

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[135] Gorman, Exh. No. MPG-1T 52:10-13; *see* Gorman, TR. 354:11 - 355:16.
[136] *See* Parcell, Exh. No. DCP-1T 30:20-21.
[137] *See* Exh. No. AMM-4.
[138] Parcell, Exh. No. DCP-1T 34:11-12.
[139] Parcell, Exh. No. DCP-1T 31:13-16.

allows identification of trends.[140] Then Mr. Parcell referenced the returns with the proxy companies' market-to-book ratios (M/B ratios) to evaluate the returns that produced favorable M/B ratios.[141]

60 Mr. Parcell found that average historic equity returns of the proxy group companies ranged from 8.7 percent to 10.6 percent, and that projected equity returns ranged from 9.0 percent to 10.1 percent. With reference to the Standard and Poor's composite 500 return and to the M/B ratios of the proxy group companies, Mr. Parcell reasonably concluded that the CE cost of equity falls within the range of 9.0 to 10.0, with a midpoint of 9.5.[142] Contrary to Mr. McKenzie's claims, [143] Mr. Parcell did not "adjust" his results at all.[144] Mr. Parcell's CE range corresponds with the prospective returns that he found for the proxy companies. This level of return on equity for companies with risk comparable to Avista represents value for investors and generally reflects investor expectations.

61 As Mr. Parcell explains in his testimony, Mr. McKenzie's Expected Earnings results are overstated and do not adequately reflect investor expectations.[145] Mr. McKenzie finds a range of expected equity returns from 7.6 percent to 13.9 percent.[146] He then concludes that the average equity return projected for the proxy group starts at 10.4 percent, which is 90 basis points above Avista's current 9.5 percent return on equity, and soars further upward to the midpoint value of 10.8 percent.[147] Because Mr. McKenzie looks only at prospective returns and does not evaluate M/B ratios, his results do not reflect the magnitude of value

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[140] Parcell, Exh. No. DCP-1T 32:7-16.
[141] Parcell, Exh. No. DCP-1T 31:15-21.
[142] Parcell, Exh. No. DCP-1T 34:10-12.
[143] McKenzie, TR. 362:22-24.
[144] Parcell, TR. 364:10-16.
[145] Parcell, Exh. No. DCP-1T 53:14 - 54:10.
[146] Exh. No. AMM-11.
[147] *See* Exh. No. AMM-4.

that investors are likely to ascribe to the returns.[148] Thus his Expected Earnings results essentially are picked out of the air, without consideration of which equity returns, some of which may not be the very highest returns, will be acceptable to investors.

F. Conclusion On Cost of Capital

62 The components of Staff's proposed rate of return of 7.30 percent are reasonable and in step with market conditions. Of these components, capital structure is not in dispute. Although Staff includes short-term debt in its proposed capital structure, and Avista does not, this difference does not actually affect the capital structure, and Staff agrees that Avista's proposed equity level adequately balances consumer and investor interests. Staff accepts Avista's as-filed cost of debt but declines to incorporate the Company's August debt commitment into the cost of capital until it can be reviewed in Avista's next general rate case. Avista's proposed return on equity of 9.9 percent is simply unreasonable in 2016. Avista's current authorized equity return is 9.5 percent. In this environment of persistent low interest rates, utility bond rates that have continued to decline, and a downward trend in regulated utility returns, Staff's proposed cost of equity of 9.2 percent is eminently reasonable and entirely consistent with investor expectations at this time.

IV. PRO FORMA PLANT ADDITIONS

63 At issue is the treatment of 2016 post-test period capital additions. Staff's proposal reasonably accepts 2016 "major" plant additions that Avista transferred to plant and that are used and useful as of July 31, 2016. Staff's proposal in this case is largely identical to Staff's proposal in the last Avista general rate case, which the Commission accepted in its Avista

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[148] *See* Parcell, Exh. No. DCP-1T 53:16-17, 54:10-12.

GRC Order.[149] In the pending case, Staff's thresholds for "major" capital additions are $7,947,430 for Washington-allocated electric additions, and $1,547,880 for Washington-allocated gas additions.[150]

64 As in the last Avista general rate case, Staff reviewed only "major" 2016 capital additions in the pending case, and Staff accepted the Company's pro forma adjustments only to the extent these plant additions were used and useful by July 31, 2016. Avista does not agree with Staff's July 31, 2016, cut-off for the 2016 capital additions, and believes that the "major" threshold also understates rate base.[151] Avista's position, however, disregards standard ratemaking principles.

65 As in the last case, Staff considered four criteria when it evaluated Avista's proposed pro forma adjustment for plant additions:

1. If the pro forma adjustment is to add new plant, is it "major?"
2. Are the costs associated with the adjustment known and measurable?
3. Has it been shown that the new plant will be used and useful?
4. Have the costs related to the adjustment been prudently incurred.[152]

As a practical matter, in order to make these determinations, Staff must cut off its audit in order to timely respond to Avista's case. Staff's responsive testimony was due August 17, 2016. Accordingly, those capital additions transferred to plant in July were the last capital additions that Staff could review. The Commission recognized this practicality in its Avista GRC Order and supported the Staff cut-off.[153] In the pending proceeding, Staff would not have had an opportunity to make a record on any 2016 additions that Avista may have

[149] Avista GRC Order at 17-18, ¶¶ 40-46 ("we find Staff's method for pro forma plant additions for both electric and gas operations to be well principled and appropriately audited." ¶ 46).
[150] Huang, Exh. No. JH-1T 16:15-21.
[151] Schuh, Exh. No. KKS-8T 7:19-20.
[152] Huang, Exh. No. JH-1T 12:1-7.
[153] Avista GRC Order at 18, ¶ 44.

transferred to plant after July 31, 2016, and it is therefore appropriate to exclude such post-July 2016 additions from the pro forma adjustment.

66 Avista objects to Staff's exclusions of the Company's 2016 capital additions, arguing that this plant will be serving customers in the rate effective period.[154] As the Commission stated, however, in its last Avista GRC Order, "[t]he 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."[155] In the last Avista case, the Commission exercised this discretion when it accepted the major post-test year additions proposed by staff, explaining that they were "based upon known and measurable plant additions that occurred during, or reasonably soon after, the test year"[156] and that, "[u]nlike the Company's cross-check study, the plant additions proposed by [non-Company] parties are not an estimate, projection, budget forecast, or some similar exercise of judgment."[157] Consistent with the Commission's reasoning in the last Avista general rate case decision, any capital additions that were not in service as of July 31, 2016, should be excluded from pro forma post-test year capital additions adjustments. Such capital additions are forecasts of possible investment and cannot, given the timeline of this case, be considered to be used and useful or to be known and measurable expenses.

67 Staff and Avista calculate different thresholds for "major" capital additions, but Staff's approach is more appropriate. Avista and Staff both base their respective calculations

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[154] Schuh, Exh. No. KKS-8T 3:16 - 4:1.
[155] Avista GRC Order at 16, ¶ 35.
[156] Avista GRC Order at 16, ¶ 36.
[157] Avista GRC Order at 16, ¶ 37.

of major capital additions on one-half of one percent of Avista's Washington-allocated plant in service.[158] This language appears in WAC 480-140-040, and the Commission accepted this framework for calculating the threshold for "major" capital additions, which Staff proposed in the last Avista rate case.[159] Since the last Avista rate case, Staff has refined its calculation to better match WAC 480-140-040. The relevant language of the rule is as follows:

> Major construction projects will be determined for water, gas, and electrical companies, as all projects where the Washington-allocated share of the total project is greater than five-tenths of one percent of the company's latest year-end Washington-allocated net utility plant in service. . . .

68 Staff's calculation of the threshold incorporated Avista's 2015 Washington-allocated net utility plant from the Company's electric and natural gas Commission Basis Reports (CBRs).[160] Not only does Staff's threshold reflect the most recent CBRs, it also follows the exact language of the rule. The rule refers to "net" utility plant in service, which is the original cost of utility property minus any accumulated depreciation.[161]

69 Staff applies the exact net utility plant language to its calculation of the threshold, whereas Avista does not.[162] Avista argues that "ADFIT" (accumulated depreciation and federal income tax) should be included in the "net plant" balance used to calculate the threshold because the Company includes ADFIT for other capital additions in this filing.[163] This argument is somewhat of a misdirection, however, because Staff is not suggesting that ADFIT should never be added to the 2016 capital additions. Staff applies the exact language of the rule only to calculate the threshold for major capital additions. Because "net plant," by

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[158] Huang, Exh. No. JH-1T 15:4-21; Schuh, Exh. No. KKS-1T 3:18-20.
[159] Avista GRC Order at 17, ¶ 40.
[160] Huang, Exh. No. JH-1T 16:9-13.
[161] Huang, Exh. No. JH-1T 15, n.5.
[162] *See* Schuh, Exh. No. KKS-8T 3:5-6.
[163] Schuh, Exh. No. KKS-8T 3:1-5.

definition does not include ADFIT, Avista's calculation is inconsistent with the rule language. Staff's proposed calculation of "net utility plant" is both consistent with the rule and not inconsistent with the treatment of other plant additions; Staff's calculation of Avista's rate base including the 2016 capital additions also includes the ADFIT associated with that plant.[164]

70 Staff's pro forma adjustments for 2016 transfers to plant include $77.9 million for electric and $8.9 million for natural gas.[165] These are significant amounts and incorporate sizable projects, including the Nine Mile Redevelopment project.[166] Avista complains, "For 2017, the plant adjustments that are included based upon the threshold limitation [that is, including only "major" projects] exclude "roughly one-half of the overall plant that will be serving customers in the rate effective period (regardless of which application of the threshold is considered)."[167] This assertion is not well supported. First, it is unclear exactly which plant Avista is referring to. Presumably Avista is including all of its non-major 2016 plant additions in its calculation of the "one-half," regardless of whether they went into service by July 31, 2016. It may also be including what would be denominated "major" plant additions forecasted to go into service after July 31, 2016. And it may also be including its forecasted 2017 (cross check) plant additions in the calculation of "one-half of the overall plant." Thus, some of the "one-half" likely is based on inherently unreliable projections and on plant that was not known and measurable or used and useful. In addition, including any in-service 2016 capital additions in rate base is a sort of compromise between setting a

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[164] Huang, Exh. Nos. JH-5 and JH-6, pages 1-3 (Electric-3.10, Gas-3.09).
[165] Huang, Exh. No. JH-1T 18:8-10, Tables 3 & 4.
[166] *See id.* at 18, Tables 3 & 4.
[167] Schuh, Exh. No. KKS-8T 3:19 - 4:1. But compare last year's case at Avista GRC Order at 17-8, ¶ 42: "Staff proposes to include $56.7 million of electric plant additions and $16 million of natural gas plant additions, comprising approximately 41 and 47.5 percent, respectively, of Avista's projected major 2015 plant additions."

sufficient rate base and allowing for meaningful review of the Company's case. Finally, it is important to remember that these adjustments are merely pro forming test year plant additions. Rates, in Staff's case, depend on an attrition adjustment, which is based in part on escalated rate base. The task of these pro forma 2016 capital addition adjustments is to contribute to an accurate presentation of the modified historic test year, from which the Commission can derive an appropriate attrition adjustment.

V. ADVANCED METERING INFRASTRUCTURE

71 Avista continues to request preapproval of its Advanced Metering Infrastructure (AMI) project. Let us be clear: There are still no AMI meters in service. And yet, Avista wants ratepayers to begin paying for a system that does not yet serve anyone. All of the parties would be better situated to consider the costs and benefit of the system once some meters actually have been placed into service. At that time, the Commission could best evaluate whether AMI is a prudent investment and whether Avista should receive a return of and on the project.

72 In Avista's last general rate case, the Company sought approval from the Commission for its AMI project. At that time, Avista had not even entered into any contracts for actual implementation of the project.[168] The Commission declined to undertake a prudence review, explaining as follows:

> 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 <u>after</u> that plant is placed in service and is used and useful. 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.[169]

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[168] *See* Avista GRC Order at 68, 190.
[169] Avista GRC Order at 68, ¶ 191 (emphasis in original).

> . . . The Company must place new plant in service for its ratepayers before the Commission will opine on the prudence of its decision.[170]

The Commission further explained:

> 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.[171]

73 When Staff witness Mr. Nightingale filed responsive testimony, Avista had entered into some contracts related to the project but had not yet contracted for installation of the meters.[172] On rebuttal, Avista witness Ms. Rosentrater testified that the planned start date for meter installation had moved from July to September 2017.[173] Avista has now entered into major contracts for the project, but it still has not yet contracted for meter deployment.[174] Until some meters actually are installed, there can be no assurance that they will be installed and in service as of a particular date.[175] The Commission's order in the last Avista general rate case was clear that AMI must be deployed and in service for ratepayers before the Commission would consider the prudence of the investment. Not only are no meters currently in service, but Avista does not plan to install any meters until September, a full nine months into the rate effective period.

74 As Mr. Nightingale testified at hearing, Staff does not suggest that Avista wait until completion of the project to seek a prudence review and recovery of costs. Rather, Avista could seek partial recovery in a future rate case for investment that the Company can show

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[170] Avista GRC Order at 69, ¶ 192.
[171] Avista GRC Order at 71, ¶ 199 (emphasis added).
[172] Nightingale, Exh. No. 6:13-17.
[173] Rosentrater, HLR-9T 5:16-18.
[174] Nightingale, TR. 247:5-6.
[175] *See* Nightingale, TR. 247:11-25 (testifying, inter alia, that "there was a Coyote Springs gas plant that was approved, and . . . then the ratepayers ended up paying for it for a substantial number of months before it [came] into service because the transformer failed before they got it on line").

is installed and beneficial up to that point.[176] This would be consistent with the Commission's guidance in the prior Avista decision that the Commission would consider prudence in a future rate case when the Company presents actual costs for partial or full deployment. At that point, not only would costs be known and measurable but, as Mr. Nightingale testified, "you can actually quantify the benefits" because some meters would actually be in service.[177] So even though Avista has now entered into contracts and appears to have spent some money on the AMI project,[178] the record for review of prudence and of costs and benefits will be appropriately robust only after a substantial number of meters are in service and the resulting benefits can be quantified and compared with costs. Accordingly, the time is not ripe for a prudence finding, and the Commission should not accept Avista's post-attrition adjustment for AMI costs.

VI. POLICY ISSUES

A. A Rate Plan Is Unnecessary But Shifting the Rate Case Cycle Is Sensible

75 Staff supports a single rate increase because it is more straightforward, provides for more predictable customer bills, and avoids the irksome experience of back-to-back-to-back rate increases for customers. The Company continues to push for a multi-year rate plan with rate increases on January 1, 2017, and January 1, 2018.[179] Mr. Hancock explains that the Company's proposal is administratively more burdensome and would have customers experience three separate rate increases over an 18-month period.[180] Staff's position is more reasonable: the Commission should allow one rate increase for the 18-month period from

[176] Nightingale, TR. 249:4-9.
[177] *See* Nightingale, TR. 248:6-18.
[178] Note, here, that Staff's attrition allowance covers all kinds of capital investment.
[179] Andrews, EMA-6T 3:18 - 4:3.
[180] Hancock, CSH-1T 11:19 - 12:3.

January 1, 2017, to June 30, 2018. Staff's proposal reduces administrative burden, avoids a second mid-heating season increase, *and* the rate case cycle shifts as soon as possible.

76 Both Staff and the Company testify that Avista should shift from filing general rate cases in the early part of the year to the late summer or early fall.[181] Staff supports a shift in Avista's rate case cycle because a change away from wintertime filing dates would help spread workload across the year and reduce pressures caused by coincident filings from multiple companies.[182] Mr. Hancock also testifies to the benefits for filings that coincide with the Company's construction season.[183]

B. Preserving the ERM Balance Protects Ratepayers

77 Staff believes misuse of the ERM is a bad idea. As Mr. Hancock notes, the Commission authorized a rebate from the ERM deferral account in Dockets UE-120436 and UE-140188, but those cases were settlements and those ERM rebates should be viewed as part of the non-binding give and take that occurs in settlement discussions. The Commission has never, to Staff's knowledge, authorized such a rebate in a fully litigated rate case.[184]

78 Mr. Hancock explains that there is no compelling reason to interfere with the function of the ERM.[185] The ERM is meant to mitigate power cost variation, not temporarily obscure an increase in revenue requirement. As Mr. Hancock also notes, the ERM is not above the Commission-determined threshold for a rebate.[186] The ERM balance is allowed for recovery in base rates when the deferred power costs reach a defined total of $30 million. The ERM is currently about $18 million in the rebate direction.[187] Mr. Hancock explains

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[181] Morris, Exh. No. SLM-1T 3:13-17; Hancock, Exh. No. CSH-1T 7-10.
[182] Hancock, Exh. No. CSH-1T 8:7-23.
[183] Hancock, Exh. No. CSH-1T 9-10.
[184] Hancock, Exh. No. CSH-1T 5:14-18.
[185] Hancock, Exh. No. CSH-1T 6:6-19.
[186] *See* Hancock, Exh. No. CSH-1T 6:10-11, 7:1.
[187] Norwood, Exh. No. KON-1T 2:22-13; Hancock, Exh. No. CSH-1T 7:1-7.

that if the Pacific Northwest has a low water year, natural gas and other fuel costs will increase and that ERM rebate could change to a surcharge within only a handful of months.[188] Staff thus recommends the Commission leave the ERM to function as designed and not allow a special rebate in this case.

79 Similarly, the Commission should reject Avista's proposed second power cost update. Avista proposes to re-set baseline power costs not only in late 2016 for the 2017 rate year but again in 2017 for the remaining six months of the rate effective period.[189] One adjustment to the ERM baseline, in 2016, is sufficient for the rate effective period.[190] Moreover, allowing another change in 2017 would result not only in burdensome process but also in re-setting the baseline twice in 2018.[191] Such frequent changes to the power cost baseline frustrate the purpose of the ERM.

VII. ADDITIONAL POWER SUPPLY ISSUES

80 The Commission should reject Avista's proposed costs of yet-to-be-set BPA rates, Avista's proposed transmission revenue trend period, and Avista's power supply contract escalation estimates. Avista seeks to include estimated power and transmission rates based on a BPA case that is not likely to conclude until sometime in the summer of 2017.[192] These estimated costs are not known and measurable, and Staff witness Mr. Gomez's adjustment removes the estimated portion of the Company's expense.[193]

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[188] Hancock, Exh. No. CSH-1T 7:1-13.
[189] Gomez, Exh. No. DCG-1T 8:18 - 9:3; Johnson, Exh. No. WGJ-6T 4:10-12. Also note this filing will be during the pendency of a general rate case likely to be filed in August 2017.
[190] *Id.* at 9:3-4. In response testimony, Staff supported a single adjustment to the ERM baseline, to be implemented with the new rates resulting from this rate case. Avista filed its proposed power cost update on November 1, 2016, as a motion to supplement the record. Once Staff reviews the filing, Staff will respond to the motion, and it is possible that Staff's position, supporting a single adjustment to the ERM baseline, will change.
[191] Gomez, Exh No. DCG-1T 9:13-21.
[192] Gomez, Exh No. DCG-1T 6:10-12.
[193] Gomez, Exh. No. DCG-1T 6:12-15; Exh. No. DCG-3.

81 Avista's change to its transmission revenue trend period should be rejected because Avista has not adequately supported the change in methodology. Under WAC 480-07-510(3)(i), if a party proposes to change how it calculates an adjustment, it must demonstrate how the adjustment would be calculated under the currently accepted methodology and include a brief narrative describing the change. Avista quietly moved from using a five-year historical average to forecast transmission wheeling revenues to using a three year average several rate cases ago in a case that settled. Avista never explained the change and did not do so in this case either.[194] Moreover, Avista has not demonstrated that a three-year average is accurate.[195] Staff's adjustment incorporates the accepted five-year average.[196]

82 Avista escalated the expense of three purchased power contracts by estimating amounts for inflation. On rebuttal, Avista provided new estimates.[197] Avista's adjustments to these contracts, including the revised adjustments, clearly do not meet the known and measurable standard[198] and should be rejected.

VIII. COST OF SERVICE, RATE SPREAD, DEMAND RESPONSE, AND DEMAND SIDE MANAGEMENT

83 Staff's recommendations are measured, supported by ratemaking principles, and offer the most reasonable options for this case. The Commission should take this opportunity to institute a generic proceeding on cost of service. No party opposes implementing a generic proceeding.[199] The Commission should reject the demand response and demand side management proposals by ICNU.[200] In regard to rate spread, the

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[194] Gomez, Exh. No. DCG-1T 7:7-9.
[195] *Id.* at 7:12-15.
[196] *Id.* at 8:1-2.
[197] Johnson, Exh. No. WGJ-6T 2:11-19.
[198] *See id.* at 8:11-14.
[199] *See infra* Section VIII.A.
[200] *See infra* Sections VIII.C., VIII.D., and VIII.E.

Commission should proceed cautiously when considering any change that will affect the balance between customer classes because the foundation for making such a change would be based upon cost of service studies that Staff has identified as imprecise and outdated.[201]

A. The Commission Should Institute a Generic Cost of Service Proceeding

84 Staff recommends that the Commission institute a generic proceeding to review cost of service and to develop a flexible framework of principles for applying cost of service studies going forward.[202] No party objects to Staff's recommendation. Mr. Collins, witness for NWIGU, and Mr. Stephens, witness for ICNU, expressed their agreement with Staff's recommendation, both stating: "I agree with Staff's recommendation that the Commission institute a generic proceeding to review cost of service methodologies for all investor-owned utilities in Washington."[203] Company witness Mr. Ehrbar stated that "Avista would be an active and engaged participant" if the Commission ordered a generic proceeding.[204] Staff recommends instituting a generic proceeding because it lacks confidence in the precision of the cost of service studies presented in this case.[205] For example, the Company's cost of service study is the same that has been used in Avista's last four general rate cases and continues to be based on the peak credit methodology, a methodology which may have been appropriate for the early 1990s, but has debatable relevance today.[206] It is time for a Commission-guided update to cost of service for all investor-utilities in Washington.

85 Mr. Ehrbar voiced the only concern: that the outcome of such a generic proceeding could lend itself to an inflexible "one size fits all" methodology that would not account for

[201] *See infra* Section VIII.B.
[202] Ball, Exh. No. JLB-1T 2:22-23; Ball, TR. 341:14-19.
[203] Stephens, Exh. No. RRS-12T 2:3-5; Collins, Exh. No. BCC-6T 2:3-5.
[204] Ehrbar, Exh. No. PDE-8T 9:4-5.
[205] Ball, Exh. No. JLB-1T 9:19-21.
[206] Ball, Exh. No. JLB-1T 8:4-7.

differences among the investor-owned utilities in Washington.[207] These differences, however, are minor. Moreover, a generic proceeding would produce a Commission-approved framework that provides flexibility to account for minor variations.[208]

86 Instead of a "one size fits all" approach that would fail to incorporate the minor uniquities of the investor-owned utilities in Washington, Staff advocates for a framework with flexibility: a framework based upon principles accepted by the Commission for setting cost of service in order to help guide cost of service methodologies going forward.[209] Staff foresees many common benefits for the Commission, the utilities, and the intervenors, including a reduction in the analytical burden caused by several disparate methods proposed in each rate case.[210] This burden inhibits the resource efficiency of every party and the Commission.[211]

87 All the parties who offered an opinion on cost of service ultimately understand that some flexibility is achievable. Company witness Ms. Knox agreed that, while the Commission has long approved a peak credit methodology for the utilities in Washington, slight differences are appropriate and that it is even "useful for [the cost of service methodologies] to be similar basically."[212] Mr. Ehrbar added, "Uniformity with flexibility . . . would be good."[213] Additionally, both Mr. Stephens and Mr. Collins explained that a generic proceeding would allow the Commission to provide overarching guidance on cost of service study methods.[214] But they also warned that uniquities among the utilities may

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[207] Ehrbar, Exh. No. PDE-8T 9:6 - 10:1.
[208] Ball, TR. 335:6-17.
[209] Ball, TR. 341:16 - 342:10.
[210] *See* Ball, Exh. No. JLB-1T 9:12-15, 12:9-16; Ball, TR. 326:18-23.
[211] *See* Ball, Exh. No. JLB-1T 9:12-15, 12:9-16; Ball, TR. 326:18-23.
[212] Knox, TR. 267:5-6.
[213] Ehrbar, TR. 299:17-18.
[214] Stephens, Exh. No. RRS-12T 2:6-12; Collins, Exh. No. BCC-6T 2:6-12.

necessitate non-identical approaches.[215] Staff does not recommend, or envision, identical applications of cost of service studies. Instead, it envisions flexible yet consistent guidance for Washington's investor-owned utilities.[216]

B. The Commission Should Approve a Uniform Spread of any Increase in Rates Among the Classes

88 It appears that the greatest, if only, opposition to Staff's recommendations discussed in this section arises from Staff's showing that the best course of action for the Commission is to "defer all major decisions regarding any specific cost of service methodology in the present case to that generic proceeding," and "maintain[] the current status quo with respect to rate spread and rate design."[217] Staff's reasoning is sound.

89 All of the cost of service studies presented in this case are, in Staff's opinion, imprecise.[218] Making drastic changes to rate spread and rate design based upon imprecise and outdated methodologies is ill-advised.[219] Staff agrees with the Commission's historical support for gradual movements towards parity for the customer classes.[220] But relying upon any of the methodologies proposed by the other parties could have the opposite impact due to the lack of precision in the methodologies.[221] A uniform distribution of any increase to rates—keeping the status quo—is the best result when considering all factors.

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[215] Stephens, Exh. No. RRS-12T 2:6-12; Collins, Exh. No. BCC-6T 2:6-12.
[216] *See* Ball, TR. 327:4-21; *see also* Ball, Exh. No. JLB-1T 4:11-19.
[217] Ball, Exh. No. JLB-1T 3:1-4. ICNU and NWIGU "conditionally agree" with deferring all major decisions on cost of service methodology, but disagree with maintaining the status quo with respect to rate spread. Stephens, Exh. No. RRS-12T 2:28 - 3:3; Collins, Exh. No. BCC-6T 2:26 - 3:3.
[218] Ball, TR. 319:24 - 320:2. Staff believes that, of the methodologies presented, the Company's is the one that can be most relied upon because of its directional accuracy for the purpose of setting rates. Ball, Exh. No. JLB-1T 9:21-22; Ball, TR. 320:3-7.
[219] *See* Ball, TR. 320:8-17. If the Commission feels compelled to make a change based upon the factors presented in this case, Staff recommends that the change be small.
[220] *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Consolidated Dockets UE-140762, UE-140617, UE-131384, UE-140094, Order 08, ¶ 197 (Mar. 25, 2015); *see Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08, ¶¶ 336, 350 (May 7, 2012).
[221] Ball, TR. 320:8-17, 321:22 - 322:4.

90 There are many factors to weigh when establishing rate spread, including the appearance of fairness, perceptions of equity, economic conditions in the utility's service territory, gradualism, and rate stability.[222] These factors support Staff's recommendation. A uniform rate spread treats all customers equally in the application of any rate increase and increases the appearance of fairness in this case.[223] Because the precision of the presented cost of service studies is uncertain, any drastic changes to rate spread may have the opposite of the intended impact or may actually create an inequity among the impacted classes.[224] Preserving the status quo of rate spread by uniformly distributing any rate increase would preserve perceptions of equity, until after the generic proceeding on cost of service. Also, the economic conditions in the utility's service territory would not be negatively affected by Staff's recommendation because the bulk of any increase under Staff's recommendation would be included in the demand and volumetric charges, which are based on usage.[225]

91 Gradualism describes making measured moves towards parity[226] for a customer class that is found to be contributing significantly more or less through rates than the actual cost of providing service to that customer class, but balanced with the other ratemaking principles.[227] At hearing, opposing parties implied that Staff's recommended rate spread was unfair, engineered to achieve a particular outcome, and overly beneficial to the residential

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[222] Ball, Exh. No. JLB-1T 13:20 - 14:19; *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08, ¶ 350 (May 7, 2012); *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Consolidated Dockets UE-140762, UE-140617, UE-131384, UE-140094, Order 08, ¶¶ 197, 202 (Mar. 25, 2015).
[223] Ball, Exh. No. JLB-1T 14:3-4.
[224] Ball, Exh. No. JLB-1T 14:5-9.
[225] Ball, Exh. No. JLB-1T 14:10-14.
[226] For an explanation of parity, in general, *see* Ball, Exh. No. JLB-1T 6:13 - 7:21.
[227] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049, Order 08, ¶ 336 (May 7, 2012).

class.[228] Staff's proposal is none of those things. Staff's rate spread follows the principle of gradualism as well as the other ratemaking principles explained above.

92 The Company agrees that the residential schedules should be moved only gradually towards parity in order to avoid rate shock.[229] Mr. Ehrbar presents a table of the resulting parity ratios, comparing Staff's rate spread with the Company's.[230] While the Company's proposal would more quickly move the parity ratio for the residential schedules closer to parity by 0.08, Staff's proposal provides a more measured move towards parity of 0.06.[231] The Commission has historically preferred more gradual moves towards parity.[232]

93 Staff's proposal moves the parity ratio for Schedule 25 by 0.03, a move *half* as great as Staff's residential schedules' move.[233] Keep in mind that this minimal move is based upon the Company's cost of service study, which remains somewhat imprecise, and therefore it may not actually represent a move away from parity at all.[234] As Mr. Ball testified, adjusing the rate spread to account for such a small difference necessitates "the most precise cost of service study."[235] Even with this inconsequential move, the ratio for Schedule 25 (1.06) is still the closest to parity of all the schedules and remains within ten

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[228] *See* Ehrbar, TR. 279:13 - 281:14; Ball, TR. 321:1 - 325:15.
[229] Ehrbar, TR. 291:7-9.
[230] Ehrbar, Exh. No. PDE-8T 4:18-24, "Table No. 3 – Cost of Service Results using Rate Spreads of Avista and Staff."
[231] *Id.* Prior to this rate case, the parity ratio for the Residential Schedules as 0.55. *Id.* The Company's proposal would move this parity ratio to 0.63, whereas Staff's proposal would move this parity ratio to 0.61. *Id.*
[232] *See e.g. Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Consolidated Dockets UE-140762, UE-140617, UE-131384, UE-140094, Order 08, ¶ 202 (Mar. 25, 2015), rejecting Staff's proposed rate spread that would have moved more quickly towards parity and accepting Pacific Power & Light Company's proposal because it presented "a more measured move in the direction of greater parity."
[233] *See id.* This is the only schedule that Mr. Ehrbar presents in his comparison of electric parity ratios that, under Staff's proposal, moves away from parity in even the slightest, yet still acceptable, margin. *Compare* Ehrbar, TR. 280:17-25, *with* Ehrbar, Exh. No. PDE-8T 4:18-24, "Table No. 3 – Cost of Service Results using Rate Spreads of Avista and Staff." Prior to this rate case, the parity ratio for Extra Large General Service Schedule was 1.03. Ehrbar, Exh. No. PDE-8T 4:18-24, "Table No. 3 – Cost of Service Results using Rate Spreads of Avista and Staff." Staff's proposal results in a move of this parity ratio to 1.06. *Id.*
[234] *See* Ball, TR. 319:24 - 320:11, 321:4-12.
[235] *See* Ball, TR. 344:8-11.

percent of parity, which Mr. Ball explained is an acceptable margin.[236] Given the inherent imprecision existing in the cost of service studies presented, Staff believes its proposal is the best option until after the Commission has had the opportunity to provide guidance on cost of service through a generic proceeding.[237]

94 The Commission is very familiar with the merits of a uniform rate increase.[238] In Avista's last general rate case, Dockets UE-150204 and UG-150205, the Commission determined that a uniform percentage rate increase—or decrease—was lawful and consistent with the public interest in light of all the information available to the Commission.[239] Staff's recommendation in the current case is to maintain that status quo by distributing any increase to rates among the customer classes uniformly.

C. The Commission Should Reject ICNU's Proposal for a Demand Response Program

95 ICNU wants the Commission to impose a demand response program upon Avista in this general rate case. This is not the appropriate process for instituting a demand response program. Instead of trying to craft a demand response program during a general rate case, the process should be initiated by issuing a request for proposals.[240]

96 Neither the Company nor Staff supports ICNU's proposed demand response program. There is no need for capacity at this time: Mr. Norwood, on behalf of Avista, testified that ICNU's proposal has "very limited value" because the current value of capacity

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[236] Ball, TR. 341:10-13, 343:2-16; *see Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Docket UE-100749, Order 06, ¶ 316 (Mar. 25, 2011), concluding that a rate spread with customer classes within 107 percent of parity (within 7 percent of parity, if used in similar context to that explained in Mr. Ball's testimony) did not warrant greater moves towards parity.
[237] Ball, TR. 320:8-17.
[238] *See e.g. Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Docket UE-100749, Order 06, ¶ 317 (Mar. 25, 2011).
[239] Avista GRC Order at 12, ¶¶ 23-25.
[240] Ball, Exh. No. JLB-5T 3:18-21; Exh. No. JLB-6CX, 2:d; *see* WAC 480-107-007(2), WAC 480-107-015, WAC 480-107-065.

is low and the single customer only has a "limited opportunity to stay down for very many hours."[241] Mr. Ehrbar elaborated, stating that the Company does not currently have the need for a capacity resource and that he believes the Company must have the enabling technology infrastructure (AMI) in service *prior to* "going down [the demand response] road."[242]

97 Staff supports the implementation of demand response programs, generally.[243] Demand response is an option for conservation.[244] Conservation must be considered in a utility's IRP.[245] Despite the growing importance of demand response in a utility's resource mixes, Staff disapproves of the course of action that ICNU has taken in regard to this proposal. Instead, Staff believes that the proposal should be discussed with the DSM and IRP Advisory Groups, or be presented as a special contract between the Avista and the single customer that ICNU's proposal would benefit.[246] Staff believes it is inappropriate to compel Avista to implement ICNU's unneeded and ill-conceived proposal at this time.

D. The Commission Should Reject ICNU's Proposal for a Self-Direct Program

98 Mr. Stephens, on behalf of ICNU, advocates for implementation of certain changes to Schedule 91 for demand side management: a self-direct option, and a reduction in contributions by Schedule 25 customers.[247] Neither option should be required by the

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[241] Norwood, TR. 99:9 - 100:3.
[242] Ehrbar, TR. 295:5 - 296:9.
[243] Ball, Exh. No. JLB-5T 2:17 - 3:3.
[244] WAC 480-107-007(2).
[245] *See* RCW 19.280.030.
[246] Ball, Exh. No. JLB-5T 2:13-15, 3:5-15.
[247] Stephens, Exh. No. RRS-1TC, 41:20 - 42:15. Mr. Stephens states, "Ultimately, ICNU believes that both the second and third options should be approved," and fails to clarify that ICNU would disclaim the implementation of either of these options in this current case, should the Commission seek to approve either option. Stephens, Exh. No. RRS-1TC, at 42:10-15.

Commission. Staff addresses the proposal for a reduction in DSM contributions from Schedule 25 customers in section VIII.E., but addresses the self-direct option here.

99 Mr. Stephens, on behalf of ICNU, states that ICNU ultimately wants the Commission to adopt a self-direct option for Avista's large customers, wherein the customers "either on their own, or through the utility, establish reserve accounts where they periodically deposit funds that can only be withdrawn and used for energy efficiency or demand-side management measures."[248] Mr. Stephens admits in his testimony, however, that such a program could not be properly designed and implemented within the confines of the current proceeding.[249]

100 Both the Company and Staff agree with Mr. Stephens in that regard: the self-direct option should be presented to Avista's DSM Advisory Group, with all of its various stakeholders and interest groups, prior to any consideration for implementation.[250] Avista is obligated to update the DSM Advisory Group and allow an opportunity for it to review conservation programs and measures, like this self-direct option. Again, Staff disagrees with ICNU's proposal and encourages ICNU to follow the established processes for pursuing new demand response and demand side management programs. The Commission should not approve a self-direct program before Avista's DSM Advisory Group has had an opportunity to investigate and evaluate it as a potential option.[251]

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[248] Stephens, Exh. No. RRS-1TC, 41:20 - 42:15.
[249] Stephens, Exh. No. RRS-1TC, 42:11-13.
[250] Ehrbar, Exh. No. PDE-8T 14:1-5; Ball, Exh. No. JLB-5T 5:1-8.
[251] *See* Ehrbar, Exh. No. PDE-8T 14:2-4; Ball, Exh. No. JLB-5T 5:1-8.

E. The Commission Should Reject ICNU's Proposed Changes to Schedule 91

101 The benefits of demand side management flow through to each kilowatt-hour.[252] The more kilowatt-hours that a customer consumes, the more of these benefits a customer receives.[253] ICNU proposes that contributions from Schedule 25 customers should be reduced, resulting in Schedule 25 customers paying fewer of the costs of demand side management and retaining more of the benefits.[254] This would violate the cost causation principle and the Commission should not allow it to happen.[255] As a customer increases the amount of kilowatt-hours it consumes, the benefits it receives from demand side management increases proportionally, and the customer should proportionally increase its contributions towards those benefits. Otherwise, inequity between customers would result, as one customer would receive a greater portion of the benefits from DSM without making a comparable amount of contributions vis-à-vis another customer.

102 Mr. Stephens provides analysis to support his recommendation that Schedule 25 should reduce its contributions, but this analysis is incomplete, misleading, and fundamentally flawed because Mr. Stephens' analysis of benefits flowing to Schedule 25 includes only direct benefits and fails to include indirect benefits.[256] This is contrary to both the Company's and Staff's testimony.[257] Mr. Ball completed Mr. Stephens' analysis by including the indirect benefits received by Schedule 25 customers.[258] Mr. Ball's analysis comprehensively includes a variety of ways (designated as "allocators" in his testimony and

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[252] Ball, TR. 314:2-23; Ehrbar, Exh. No. PDE-8T 14:16-19; *see also* Ehrbar, TR. 285:19-23.
[253] Ball, TR. 317:8-11.
[254] *See* Ball, TR. 314:2-23; Ball, Exh. No. JLB-5T 4:12-18, 5:12-15; *see also* Stephens, Exh. No. RRS-1TC 41:7 - 42:15.
[255] Ball, TR. 315:17-19.
[256] Ball, Exh. No. JLB-5T 5:10 - 6:17; *see* Stephens, Exh. No. RRS-1TC, 39:17 - 43:20.
[257] Ball, TR. 317:15, 317:19; Ehrbar, TR. 285:3, 286:5-9, 289:3-6; Exh. No. PDE-10CX, p. 2.
[258] Ball, Exh. No. JLB-5T 6:19 - 8:2.

in Exhibit No. JLB-7CX) to calculate these benefits.[259] With every allocator that Mr. Ball used, the data showed that "the total direct and indirect benefits of DSM programs far exceed the level of contributions provided by Schedule 25."[260] Mr. Ball's analysis shows that altering Schedule 91 to enable Schedule 25 customers to contribute less towards demand side management would serve only to create an imbalance between costs and benefits.

103 Mr. Ehrbar presented a compromise, or half-measure, in response to ICNU's proposal, suggesting that the single customer served in the third energy block of Schedule 25 could have its contributions reduced by one-half.[261] The Company has not recommended that the Commission adopt Mr. Ehrbar's idea, but has merely presented it as an option.[262] This half-measure should be rejected by the Commission for the same reasons as ICNU's proposal: no evidence exists in the record to justify allowing a single customer to avoid contributing any, let alone half, of its share to demand side management funding.[263]

IX. ADJUSTMENTS AND OTHER ISSUES

104 Staff and the Company agree that the Commission should support an attrition adjustment for Avista, and that attrition and the modified historical test-year should be used to complement each other.[264] This means that, regardless of the Commission's decision on attrition, the Company must correctly perform its other adjustments under the Commission's

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[259] Ball, Exh. No. JLB-5T 6:19 - 8:2; Exh. No. JLB-7CX, 2:b.
[260] Exh. No. JLB-7CX, 2:b.
[261] Ehrbar, Exh. No. PDE-8T 15:2-5.
[262] Ehrbar, TR. 277:17-20.
[263] Ball, Exh. No. JLB-5T 6:19 - 8:2; Exh. No. JLB-7CX, 2:b.
[264] *See* Andrews, TR. 136:17 - 137:25; Hancock, TR. 414:2-12.

modified historical test-year. Staff explains its position on a number of these adjustments in the following sections.

A. Incentive Expense

105 Commission rule provides the basis for conducting a restating adjustment.[265] Avista's "Restate Incentive Expenses" adjustment fails to follow the rule for a restating adjustment.[266] Restating adjustments can be used for adjusting from an as-recorded basis to one that is acceptable for rate making, including adjustments "from book estimates to actual amounts" and eliminating or normalizing "extraordinary items recorded during the test period."[267] The Company rejects using actual amounts in this adjustment, instead preferring to use estimates for 2016 operations and maintenance (O&M) expenses.[268] The Company implies that this adjustment need not follow the rule for restating adjustments, but then fails to explain how the adjustment meets the requirements of any other type of adjustment.[269] The Company's original adjustment claims to "restate[] actual incentives included in the Company's test period ending September 30, 2015, to reflect a six-year average of payout percentages."[270] But instead of using actual O&M labor expenses from the test year (data that the Company provided to Staff and that Staff provided in testimony), the Company uses *projected* 2016 O&M labor expenses.[271] The corrections that Staff witness, Ms. Cheesman, made to the Incentive Expense adjustment were accepted by the Company, except for the

[265] WAC 480-07-510(3)(e)(ii).
[266] Exh. No. JSS-1T 27:11 - 28:7; Exh. No. MC-1T 6:12 - 7:2; *see* WAC 480-07-510(3)(e)(ii).
[267] WAC 480-07-510(3)(e)(ii).
[268] Exh. No. JSS-1T 28:1-5; Exh. No. MC-1T 6:12 - 7:2.
[269] Smith, Exh. No. JSS-4T 14:20 - 15:14.
[270] Smith, Exh. No. JSS-1T 27:11-13.
[271] Cheesman, Exh. No. MC-1T 6:12 - 7:2; *see e.g.* Smith, Exh. No. JSS-1T 28:1-5, using an estimation of 2016 labor expense "determined in 'Pro Forma Labor Non-Exec' adjustment 3.02."

use of test year O&M labor expenses.[272] The Company's adjustment fails to abide by Commission rule, is fundamentally flawed, and the Commission should either reject the adjustment entirely or accept Staff's principled corrections.

B. Pipeline Safety Labor Expense (Full-Time Employees)

106 The Company should only recover the costs of hiring full-time employees that are known and measurable.[273] By the time of hearing, the Company had hired only two of the proposed full-time employees for pipeline safety.[274] Staff supports recovery of the known and measurable costs associated with the positions that have been filled.[275] The Company did not produce the costs of the hired employees and show them to be known and measurable as part of its initial, prefiled case.[276] The Company submitted information concerning the QA/QC program administrator position in response to Bench Request No. 7.[277] Staff believes that the Company's response correctly updates its adjustment to pipeline safety labor expense. The evidence presented still does not support the allocation of costs between capital and O&M for these positions but, as Staff has testified, the impact on the Company's revenue requirement is minor.[278]

C. Employee Benefits Expense

107 A pro forma adjustment must give effect for the test period to all known and measurable changes that are not offset by other factors, and cannot be mere estimates of

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[272] Cheesman, Exh. No. MC-1T 7:17 - 8:8; *see* Smith, Exh. No. JSS-4T 14:13 - 15:9. The Company may have misstated the update to the adjustment that Staff is recommending. Staff would refer the Commission to Staff's direct testimony.
[273] *See* WAC 480 07 510(3)(e)(iii) and *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Docket UE-090134, Order 10, ¶ 45 (Dec. 22, 2009).
[274] Smith, Exh. No. JSS-4T 17:11-17; Smith, TR. 183:23 - 185:17; Bench Request 7.
[275] *See* Cheesman, MC-1T 15:10-14.
[276] *See* Cheesman, MC-1T 15:3 - 17:19.
[277] Response to Bench Request No. 7.
[278] Cheesman, Exh. No. MC-1T 17:1-10; *see* Response to Bench Request 7.

future expenses.[279] The Company pro forms its retirement and medical benefits using estimations and forecasts of future retirement and medical benefits.[280] This does not meet the requirements for pro forma adjustments.[281] Staff recommends the Commission update this adjustment with the known and measurable recorded expenses for retirement and medical benefits in calendar year 2015.[282] With Staff's recommendation, this adjustment would meet the requirements of a pro forma adjustment.

108 The Company attempts to justify its use of estimates and forecasts for this pro forma result in two ways: through copious, but irrelevant, testimony on the history and merits of the medical benefits it offers its employees, and an improper reliance upon distinguishable Commission orders.[283] To address the latter, Staff disagrees with the Company's witness, Ms. Smith, and with ICNU's witness, Mr. Mullins, that fact-specific determinations made in prior Pacific Power & Light Company orders should be relied upon in this case when different circumstances exist.[284]

109 The parties rely upon Order 12 from Docket UE-152253 and Order 08 from Docket UE-140762.[285] Neither would require the Commission to accept the use of estimations and forecasts of retirement and medical benefits in a pro forma adjustment. First, the Commission's determination in both cases went against Company-proposed methods that did not accurately reflect proper pro forma adjustments and, instead, adopted a method

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[279] WAC 480-07-510(3)(e)(iii); *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Docket UE-090134, Order 10, ¶ 45 (Dec. 22, 2009).
[280] Cheesman, Exh. No. MC-1T 12:10-17.
[281] Cheesman, Exh. No. MC-1T 12:19-23; WAC 480-07-510(3)(e)(iii).
[282] Cheesman, Exh. No. MC-1T 13:12-18.
[283] Smith, Exh. No. JSS-4T 19:12 - 27:21; Smith, Exh. No. JSS-4T 18:12-18.
[284] *See* Smith Exh. No. JSS-4T 18:12-18; Mullins, Exh. No. BGM-10T 16:6-13.
[285] *Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Dockets UE-140762 et al., Order 08 (Mar. 25, 2015); *Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Docket UE-152253, Order 12 (Sep. 1, 2016).

proposed by another party that the Commission determined was more likely to reflect known and measurable changes.[286] Second, the cases support Staff's recommendation that a pro forma adjustment should only be allowed "for known and measurable changes—not budgeted or projected changes—that occur."[287] Third, the cases state that for these types of expenses, "each case must be decided exclusively on its own record."[288] Lastly, the Commission required that, if the Commission were to approve an adjustment based upon the most recent actuarial report, that report must be "in the record."[289]

110 All of these factors support Staff's recommended updates to this adjustment. This case should be decided exclusively on its own record, and the Company has not presented any evidence that supports any deviation from the Commission rule on pro forma adjustments. Unlike the situations in the other cases, here, the Company is attempting to increase its revenue requirement by using estimates and forecasts that are not known and measurable. Most importantly, in those cases, when a party requested that the Commission update the pro forma adjustment with the most recent actuarial report, the party also provided the actuarial report in the record. In this case, Avista asserts that Mercer has created an actuarial report predicting future medical benefits and that the Commission should use it to update this pro forma adjustment.[290] Avista has failed, however, to include this report anywhere in the record of this case. It is the Company's burden to support its

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[286] *Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Dockets UE-140762, et al., Order 08, ¶¶ 39-41 (Mar. 25, 2015); *Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Docket UE-152253, Order 12, ¶¶ 185-188 (Sep. 1, 2016).
[287] *Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Dockets UE-140762, et al., Order 08, ¶¶ 44, 45 (Mar. 25, 2015).
[288] *Id.* at ¶ 45.
[289] *Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Docket UE-152253, Order 12, ¶ 188 (Sep. 1, 2016).
[290] *See generally* Smith, Exh. No. JSS-4T 19:8 - 27:21 and accompanying notes.

position.[291] The absence of such support contributed to the Commission's decision to use the in-the-record actuarial reports presented by Public Counsel against Pacific Power & Light Company in the cases that Avista cites as support for updating its current pro forma adjustment using unknown and unmeasurable estimates and forecasts.[292]

111 Staff recommends updating this pro forma adjustment to reflect what is known and measurable.[293] The Commission should update the Pro Forma Employee Benefits Adjustments (Electric 3.04 and Gas 3.02) with the known retirement and medical benefit expenses recorded in calendar year 2015, replacing the 2017 estimations included by Avista in its calculations.

D. Plant Held for Future Use

112 Staff disputes Avista's proposed inclusion in rate base of six parcels of land located in Washington and Idaho.[294] Avista categorizes this land as plant held for future use. Avista witness Ms. Smith testifies that "[f]ive of the parcels are for future substations and one of the parcels is for a natural gas-fired combustion turbine on these properties,"[295] but the Company provides no actual development plans beyond bare assertions of intent. The timeline for development of most of the parcels is approximately 10 years, and Avista apparently does not intend to complete development plans until two years before the eventual construction date.[296] The properties have a total value on a Washington-allocated basis of $4,569,451 and were acquired by Avista between 2008 and 2015.[297] Avista has

[291] *See Wash. Utils. & Transp. Comm'n v. Pacifc Power & Light Co.*, Docket UE-152253, Order 12, ¶ 188 (Sep. 1, 2016).
[292] *See id.* at ¶¶ 186-88.
[293] Cheesman, Exh. No. MC-1T 13:14-18.
[294] *See* Smith, Exh. No. JSS-1T 20:5-6.
[295] Smith, Exh. No. JSS-1T 20:7-9.
[296] O'Connell, Exh. No. ECO-1T 5:8-10.
[297] O'Connell, Exh. No. ECO-1T 5:14-16.

decided to include these properties in rate base now because the Company's investment in plant held for future use is currently larger than it has been in the past.[298]

113 Prior Commission cases indicate that a utility must have an actual written plan for property in order to include it in rates as plant held for future use. In one decision, the Commission conditioned future inclusion in rate base of a parcel of land on Puget Sound Energy's (PSE's) ability to "formalize its intent by producing written plans for the future use of the property."[299] In PSE's subsequent rate case, the Commission removed the land from PSE's rate base, concluding that "law and sound regulation require us to place the burden of its continuing support away from the ratepayers until a definite plan is developed and submitted in writing regarding the property's use."[300] In another PSE case, the Commission removed certain properties from rate base that did not have "specific dates on which they [were] expected to be in service."[301]

114 Avista should not be allowed to include these properties in rate base. The Company has not demonstrated that it has actual plans to use these properties at any definite time to serve rate payers. On rebuttal, the Company claims that, because the FERC accounting rule requires only a plan and not a "definite plan," the properties should be allowed into rate base. [302] The Company, however, does not have a specific date on which these properties

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[298] *See* Smith, Exh. No. JSS-1T 19:9-13.
[299] *Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause No. U-80-10, Fifth Supplemental Order, pp. 8-9 (Jan. 2, 1981).
[300] *Id.* at 8.
[301] *Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Dockets UE-920433 and UE-921262, Eleventh Supplemental Order, p. 89; 147 P.U.R.4th 80, 90 (Sept. 21, 1993). These properties were in one of four categories of properties that Staff argued should be removed from rate base.
[302] Smith, Exh. No. JSS-4T 11:9 - 12:9. Note, however, that the distinction between "plan" and "definite plan" in FERC rules is nothing new. *See Accounting Treatment for Land Held For Future Utility Use and For Profits or Losses Realized Through Sales of Those Lands*, Federal Power Commission Docket No. R-379, Order No. 420, 45 F.P.C. 106, 107, 111; 1971 FPC LEXIS 289 (Jan. 7, 1971). And Washington Utilities and Transportation Commission decisions have consistently required an articulated plan with some specifics.

will be used to provide service, and the Company provides information that is subject to change.[303] Without evidence that Avista has committed to using these properties to provide service, there is no evidence of benefits for ratepayers. Accordingly, rate payers should not be required to pay a return on these properties at this time.

E. Montana Riverbed Lease Expense

115 Since reviewing Avista's rebuttal testimony, Staff has changed its position with regard to the Montana Riverbed lease expense. Staff now recommends rejecting the Company's pro forma adjustment only to the extent it consists of estimated escalated amounts, but Staff accepts the test year expense associated with the Montana Riverbed lease.

116 The Montana Riverbed lease is an agreement between Avista and the State of Montana, providing that Avista will pay rent for its use of the Clark Fork river for hydroelectric facilities.[304] Rent is due each February in the amount of $4 million plus an annual inflation adjustment based on the latest Consumer Price Index.[305] The lease obligated Avista and Montana to renegotiate the rental rates no later than June 30, 2016. In addition, the lease contains a "Most Favored Nations Clause," providing that the rental rate could be changed if ongoing litigation over Montana rivers resulted in a rental rate that would be more favorable to Avista.[306] In light of the uncertainty of the rental rate going forward and the dearth of information in the record regarding the required negotiations, Staff witness Ms. O'Connell concluded in her responsive testimony that Avista had not shown that any portion of the expense was known and measurable going forward.[307]

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[303] *See* Exh. No. ECO-4 (brief descriptions from Avista's workpapers of the properties).
[304] O'Connell, Exh. No. ECO-1T 8:6-7, 13-14.
[305] Exh. No. ECO-8, pp. 8-9 (Hydropower Lease, Terms 4.1–4.2).
[306] Exh. No. ECO-8 at 10.
[307] O'Connell, Exh. No. ECO-1T 10:6-19.

117 On rebuttal, Avista provided an update on the status of the negotiations required by the lease and of the ongoing litigation. [308] Further, Avista witness Mr. Norwood testified that Avista is obligated to continue making payments under the lease and that Avista intends to do so.[309] Avista estimates that the portion of the payment charged to Washington will be $3.4 million in 2017.[310] After reviewing the further information and commitments from Avista, Staff is satisfied that Avista will incur a rental expense associated with the Montana Riverbed lease. Because Avista *estimated* the inflation adjustment going forward, however, Staff recommends rejecting this portion of the expense as an unknown amount. Staff has incorporated the Washington share of the test year expense, in the amount of $3,725,126 into its calculation of the modified historical test year results and has updated the attrition adjustment accordingly. Because Staff relies on Mr. Hancock's attrition study, this change to Staff's pro forma adjustment does not modify Staff's recommended revenue requirement.

118 Avista proposes that, if the Commission does not accept the Montana Riverbed lease expense, the Commission should approve deferred accounting for this expense.[311] Under Staff's recommendation, Avista will be recovering most of the expense it estimates, and deferred accounting is, therefore, not necessary. Staff proposes, however, that Avista place into the record all documentation related to new rental rates and to rent payments held in escrow by Montana in the Company's next general rate case.

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[308] Norwood, Exh. No KON-1T 40:4 - 41:13.
[309] *Id.* at 41:14-16. Mr. Norwood testified that Avista and Montana have agreed that Montana will hold Avista's rental payments in escrow until the litigation is resolved. *Id.* at 41:15-17.
[310] Norwood, Exh. No. KON-1T 37:14-16.
[311] Norwood, Exh. No. KON-1T 42:13-16.

F. O&M Offsets

119 Staff's pro forma Operations and Maintenance (O&M) Offsets adjustment is consistent with Staff's 2016 capital additions adjustment. Avista proposed an adjustment for offsets of certain O&M costs that would be reduced or eliminated by investment in the 2016 capital additions.[312] Staff's adjustment removes those offsets associated with plant additions that do not meet Staff's threshold for a "major" capital addition.[313]

X. CONCLUSION

120 The Commission can rely on Staff's case as a thoughtful and reasonable resolution of the issues that remain in dispute. Avista is a financially healthy utility. Even so, Staff's well designed attrition study shows that Avista requires an attrition allowance to earn the return of 7.30 percent that is appropriate for this company through July of 2018. Staff's proposed attrition adjustment together with Staff's proposed rate of return will produce a revenue requirement for Avista that is sufficient at least to forestall another back-to-back rate case.

DATED this 7th day of November 2016.

Respectfully submitted,

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[312] Smith, Exh. No. JSS-1T 38:11-16.
[313] Huang, Exh. No. JH-1T 22:6-14.