

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND	)	DOCKET NOS.
TRANSPORTATION COMMISSION,	)	UE-160228 & UG-160229
	)	
Complainant,	)	NORTHWEST INDUSTRIAL GAS
	)	USERS' POST-HEARING BRIEF
v.	)	
	)	
AVISTA CORPORATION dba AVISTA	)	
UTILITIES,	)	
	)	
Respondent.	)	

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November 7, 2016

## I. INTRODUCTION

1. Pursuant to the Prehearing Conference Order dated March 28, 2016, Northwest Industrial Gas Users (“NWIGU”) submits this Post-hearing Brief.
2. Avista Corporation, d/b/a Avista Utilities (“Avista” or Company”) requests a general rate increase for gas service to its customers of \$4.4 million in the first 12 months of an 18-month rate period, and \$941,000 over the last 6 months of that rate period. As it did in its prior general rate case, Avista derives its request from the results of an attrition study, seeking cost recovery during the rate effective period based on a projection of historical trends rather than utilizing Washington’s traditional historic-year ratemaking methodology.
3. NWIGU acknowledges the Commission’s willingness to utilize innovative ratemaking to address concerns by local distribution companies (“LDCs”) like Avista that traditional ratemaking may not provide adequate cost recovery under some circumstances. However, the use of innovative methodologies like attrition-based rate increases does not absolve Avista of its burden of proof, nor does it alter the Commission’s obligation to make decisions based on substantial evidence in the record. As explained in more detail below, Avista’s case relies too heavily on simply replicating the methodology the Commission utilized in the prior general rate case, without addressing the evidence in the current record that warrants a different approach and outcome. Based on the evidence in the record, and adhering to the principles Avista, Staff, and even the Commission have relied on to support attrition-based ratemaking, Avista’s revenue requirement for gas service should be *reduced* by \$2,010,000 as calculated in the testimony Bradley Mullins presented on behalf of NWIGU.
4. Avista’s request also includes a rate spread that would shift the burden of cost recovery more heavily to industrial gas transportation customers. Avista’s supporting cost of service

study, however, is flawed and fails to recognize that industrial transportation rate schedules are already out of parity and over-recover from transportation customers. Although NWIGU prefers for the Commission to rely on the cost of service study Brian Collins submitted to the record on behalf of NWIGU, much of the disparity between the various cost of service studies in the record can be traced to the fact that it has been decades since this Commission has analyzed the guiding principles that should be used for cost of service studies. NWIGU therefore supports Staff's proposal urging the Commission to apply any rate changes in this case on an equal percent of margin basis and to initiate a generic proceeding to establish clearer guiding principles for cost of service studies to be used in future rate cases.

5. Finally, Avista's case is centered around a request for an authorized return on equity ("ROE") of 9.9%. Although NWIGU did not sponsor a cost of capital witness in this proceeding, NWIGU has reviewed the record on this issue. Based on the evidence in the record provided by Staff and the Industrial Customers of Northwest Utilities ("ICNU"), it is clear Avista's requested ROE is unreasonably high and that only an ROE in the range of 9.1% or 9.2% as presented by the other parties can be supported.

## **II. ARGUMENT**

### **A. Attrition**

6. There is no dispute that rates for Washington utilities have traditionally been developed using an historic test year modified with limited pro forma adjustments to reflect known and measurable changes. NWIGU fully supports the Commission's use of a modified historic test year for purposes of general ratemaking. The fundamental principle of ratemaking is that rates should provide the utility with a reasonable opportunity to recover the costs incurred for

providing service. The best measure of a utility's costs is an analysis of the actual, verifiable costs the utility incurs, which can only be determined by the use of an historical test year.

7. Even where it is appropriate to modify an historical test year, for example by adding pro forma adjustments, it is this Commission's practice to allow modifications that are not speculative. As the Commission recently explained, when pro forma adjustments are added to the historic test year, those adjustment are not to be based on "budgeted or projected changes," and they typically account for changes the Commission has determined will occur within a short, reasonable time after the test year.<sup>1</sup> A future test year, in contrast, requires rates to be based on budgeted amounts, which are necessarily speculative. Avista's filing continues to propose rates that are based almost entirely on speculative amounts, essentially moving to a future test year.

8. Despite the long history of the Commission's use of a modified historic test year, the Commission has acknowledged that there has been a "relaxing" to its typical ratemaking approach during recent years as a means to address regulatory lag concerns.<sup>2</sup> This relaxing began when the Commission re-approved Puget Sound Energy's Expedited Rate Filing.<sup>3</sup> More recently, the Commission approved rate increases based on an attrition analysis in Avista's last general rate case,<sup>4</sup> a decision Avista now heavily relies on. That decision also confirmed that tools like an attrition adjustment are no longer limited to "extraordinary circumstances."<sup>5</sup>

9. The Commission has acknowledged, however, that movement away from the modified historic test year approach is not without risk, and that it has yet to be proven effective. For

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<sup>1</sup> *WUTC v. Pacific Power and Light Company*, Docket UE 140762, Order 8 (Mar. 25, 2015)("Docket UE 140762") at ¶44.

<sup>2</sup> *Id.* at ¶44, n. 57.

<sup>3</sup> *See In re Puget Sound Energy For an Order Authorizing PSE To Implement Electric and Natural Gas Decoupling Mechanisms and To Record Accounting Entries Associated With the Mechanisms*, Docket UE 121697 ("ERF Docket").

<sup>4</sup> *WUTC v. Avista Corporation dba Avista Utilities*, Docket UE 150204 and UG 150205 (*consolidated*), Order 05 (Jan. 6, 2016) ("Avista Order 05").

<sup>5</sup> Avista Order 05 at ¶110.

example, the Commission expressed a concern that alternative approaches to ratemaking risk violating the matching principle.<sup>6</sup> Similarly, even though alternative approaches such as attrition adjustments are intended to address regulatory lag or an erosion in earnings, companies the Commission regulates “continue to file regularly for general rate increases.”<sup>7</sup> This is true for Avista as well.

10. The recent move to attrition adjustments has only upside for the utility to the detriment of ratepayers. Utilities in a cycle of large capital investments like Avista generally file frequent rate cases. These utilities adjust rates to reflect greater amounts of invested capital and rate base. During times of heavy investment, a utility may be impacted by regulatory lag, but the Commission has on multiple occasions concluded that such lag is an acceptable part of ratemaking. Regulatory lag is appropriately mitigated when a utility files frequent rate cases. The Commission has also made other efforts to decrease the impact of potential lag through tools such as pro forma adjustments or the use of end-of-period rate base.<sup>8</sup>

11. One common theme in the Commission’s prior orders, which remains lacking here, is that the Commission has been willing to allow rate increases driven by attrition-like adjustments when the utility will also “stay out” and not file for another general rate revision for multiple years. This was the approach Avista took in its 2012 general rate case when the Commission approved a settlement that imposed a two year stay out provision.<sup>9</sup> Puget Sound Energy is similarly subject to a multi-year stay out with approval of its Expedited Rate Filing.<sup>10</sup>

12. Unlike those earlier cases, Avista proposed no stay-out period as part of its prior general rate case, nor does it propose one now. To date, there is no indication that allowing attrition

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<sup>6</sup> Docket UE 140762 at ¶44, n.57.

<sup>7</sup> *Id.*

<sup>8</sup> See Avista Order 05 at ¶62.

<sup>9</sup> Docket UE 120436 at ¶40.

<sup>10</sup> ERF Docket, Order 15 (June 29, 2015) at ¶157.

adjustments for Avista has had or will have any impact on the frequency or degree of its general rate filings. The present case was filed in the same calendar year that Avista's prior rate case concluded, and the present case contains no stay out period. In light of Avista's claims in its rebuttal testimony that it is not asking for as high of an increase that it feels is warranted,<sup>11</sup> it is reasonable to conclude Avista will file a new general rate case shortly. Avista's customers will therefore continue to bear the burden of frequent rate changes and the only difference is the Company gets to increase rates based on speculative future rates of spending rather than confirmed historical expenses.

13. Because the Commission has indicated a willingness to allow a new, untested approach of authorizing rate changes based on attrition adjustments, it is imperative that the Commission continue to refine the methodologies used for that purpose. Further, the Commission should continue to adhere to its earlier decisions that its consideration of an attrition adjustment must be based on the record in each case.

14. As it did in its prior case, Avista's proposed attrition adjustment relies on the use of escalation factors for various cost categories to project future spending and, from that projection, develops a revenue requirement to recover the projected costs. Those escalation factors, while based on a similar methodology the Commission approved in Avista's prior general rate case, are inconsistent with the evidence in this record.

15. Avista agrees that an attrition study utilizing escalation factors should use the "best trending data."<sup>12</sup> This includes choosing both an appropriate time period for analyzing a trend, as well as an appropriate calculation to determine if the trend is linear or non-linear. At heart,

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<sup>11</sup> Exhibit No. EMA-6T at 15:5, Table No. 5.

<sup>12</sup> Exhibit No. EMA-1T at 22:7.

the goal is to find a trend line that is representative of the Company's actual expenditure trend.<sup>13</sup> Contrary to these stated principles, Avista's attrition study does not utilize the best trending data and is not representative of the Company's actual spending trends over time.

16. In response to Avista's filed case, NWIGU's expert witness Mr. Mullins conducted his own attrition analysis, as did Staff witness Mr. Hancock. These separate analyses demonstrate the flaws in Avista's analysis and provide an improved methodology that is more reflective of the actual costs that could support Avista's claim of attrition.

17. One major flaw in Avista's analysis is that it arbitrarily uses a data set that includes the Company's expenses only from the time period between 2007 and 2015. That time period is the same time period the Commission approved as the basis for Avista's attrition adjustment in the prior general rate case. However, Avista offers only two bases for using that time period. First, Avista asserts that, on an "aggregated" basis, there's a clear "kink point" in 2007, after which its costs rose at a different rate than they did prior to that point.<sup>14</sup> Second, Avista chooses this time period because it is consistent with the Commission's approval in the prior rate case.

18. The problem with Avista's first argument is that it is inconsistent with the goal of an attrition adjustment, which is to capture the Company's likely future spending with actual expenditures from the past and to do so with the best trending data. Avista, on the other hand, has attempted to find the best trend within the data it analyzed rather than first determine what the best trending data is. The testimony of Avista witness Ms. Andrews illustrates how Avista's approach is flawed. For example, in response to questions about "kink points," Ms. Andrews acknowledges that a single data set may have more than one kink point – meaning that the costs

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<sup>13</sup> Exhibit No. GDF-1T at 6:2.

<sup>14</sup> See, e.g., Andrews, TR 130:8.

the company incurred change significantly over time more than once.<sup>15</sup> Yet, as Ms. Andrews acknowledged, if a second kink point occurs after 2007, that kink point would not be reflected in Avista's analysis.<sup>16</sup> Thus, older data that Avista admits is not truly reflective of its recent trends, would be included with, and skew, the more recent and more relevant data.

19. One example of a second kink point that shows the skewed nature of Avista's analysis relates to Underground Storage Net Plant. As shown in a figure of Mr. Mullins' exhibits,<sup>17</sup> the Company experienced a major shift in spending beginning in 2007, just as the Company claims. However, a second major shift occurred in 2012 and the recent trend for that category has been very consistent since that time. Avista's methodology ignores this "very clear kink point" and continues to analyze this cost category to include the earlier data. The result is a steeper slope that projects higher levels of spending than if only the more recent data (occurring after the kink point) were used.

20. To be clear, Avista could have placed evidence in the record to explain why future expenses relating to Underground Storage Net Plant are more likely to mirror those on a trend line that includes 2007 and 2008 expenses rather than the more recent trend line that has existed since 2012. However, Avista chose not to provide such evidence, relying instead on the arbitrary decision to begin with 2007 data no matter what cost category was being analyzed.

21. A similar flaw exists for cost categories for which no clear kink point exists. For example, the Distribution Depreciation Expense for gas service has grown at a fairly steady rate since 2000.<sup>18</sup> For this cost category, no clear kink point exists, especially in 2007 since the Company' costs in this category rose less than \$70,000 the following year. By arbitrarily

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<sup>15</sup> Andrews, TR 128:1.

<sup>16</sup> Andrews, TR 133:22.

<sup>17</sup> Exhibit No. BGM-12 at p.16.

<sup>18</sup> Exhibit No. BGM-12 at p.10.



choosing to include data going back only to 2007, Avista's analysis becomes skewed and is informed only by the higher, more recent numbers even though the longer-term trend has been so steady. Again, Avista offers no evidence to explain why the costs in this specific category will not follow the trend that has been in place for nearly two decades.

22. The problem with Avista's second argument – relying on the Commission's decision in the prior rate case – is that it ignores the facts before the Commission in that case, as well as the facts in this case. There is no dispute that the Commission must make its decision based on the facts in the present record. Indeed, Avista Witness Mr. Norwood adamantly claimed that the only relevant evidence is the evidence that is in the current record.<sup>19</sup>

23. In the prior rate case, the Commission did review evidence and argument over the relevant time period to be analyzed. Specifically, Staff asserted that the Commission should utilize data from 2009 to 2014. Avista, on the other hand, insisted that the Commission should use data from 2007 to 2014. Both Staff and Avista used their preferred time periods for each category, and it is undisputed that no other party offered any argument or evidence that a longer or shorter time period should be used.<sup>20</sup> Nor did any party assert in that case that the time period to be analyzed is different between cost categories. Thus, based on that record, the Commission had only two choices presented to it – either a time period for all categories beginning in 2007, or a time period for all categories beginning in 2009.

24. In the present case, the Commission has a much more robust record. Instead of competing attrition studies from Avista and Staff, the record also contains attrition studies submitted on behalf of NWIGU for gas service and ICNU for electric service. One of the stated benefits of Staff's attrition study is that it adds more granularity, for example by analyzing

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<sup>19</sup> Norwood, TR 96:7.

<sup>20</sup> Andrews, TR 135:18; Forsyth, TR 154:4; Hancock, TR 410:14.

historic trends for each component of Net Plant rather than the totality of that category.<sup>21</sup> The attrition studies provided by NWIGU and ICNU provide even more granularity, looking at different time periods to determine which time period provides the best indicator of the Company's likely future spending. Avista, in contrast, paints a picture using the broadest brush it has at its disposal, aggregating data both to determine the time period it chose to analyze and to analyze each cost component without regard to trends in actual spending for specific categories.

25. The Commission should choose a more granular attrition methodology because it allows the Commission to isolate and to address the actual drivers of attrition. As the Commission explained in Order 05, the common sources of earnings attrition are “abnormal or excessive inflation and exceptional and prolonged levels of plant additions.”<sup>22</sup> And, although the Commission has determined that it is not necessary to show “extraordinary circumstances,” the Commission does require the utility to “demonstrate that the cause of the mismatch between revenues, rate base and expenses is not within the utility’s control.”<sup>23</sup> The Commission should also choose a more granular attrition methodology because it allows the Commission to exercise informed judgment on each of the attrition drivers.<sup>24</sup>

26. Consistent with Order 05, Avista asserts that its need for an attrition adjustment is based on prolonged levels of plant additions relating to aging infrastructure and reliability needs.<sup>25</sup> Increases in costs to those types of expenses may largely be outside of Avista’s control. Avista, however, seeks attrition adjustments to all cost categories, not just additions to plant. Thus,

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<sup>21</sup> Exhibit No. CSH-1T at 27:9.

<sup>22</sup> Avista Order 05 at ¶62.

<sup>23</sup> Avista Order 05 at ¶110.

<sup>24</sup> Avista Order 05 at ¶115 (the use of escalation factors from attrition studies to set rates is “a matter of informed judgment”).

<sup>25</sup> Norwood, TR 108:6 to 110:3.

Avista seeks an increase even where a cost category has been markedly flat in recent years<sup>26</sup> or, like increases to investments in general plant, are completely within the Company's control.<sup>27</sup> Moreover, Avista's approach is in places internally consistent. For example, Avista seeks an attrition adjustment for increases in O&M costs. At the same time, Avista witness Mr. Norwood claimed that by investing in ageing infrastructure the Company is actually optimizing O&M expenses.<sup>28</sup>

27. Avista's broad-brush approach simply does not allow the Commission to exercise informed judgment, especially in light of the other evidence that is in the record. The Company's system is complex and it is simply not reasonable under these circumstances to apply a methodology that does not grapple with the nuances of that complex system. The Commission should therefore adopt the more granular approaches of NWIGU, ICNU and Staff, which have provided more information on which the Commission can base its judgment.

## **B. Rate Spread**

28. A fundamental principle of setting rates is to design rates that accurately reflect the cost-causation nature of the distribution system. An appropriate rate will provide customer with clear price signals for making economic consumption decisions.<sup>29</sup>

29. In support of its proposed rates, Avista developed a rate spread based on a cost of service study as described in the testimony of Company witness Mr. Miller.<sup>30</sup> Using that study, Avista asserts that both Schedule 101 and Schedule 146 are being served at less than their respective costs of service, and that other customer classes (Schedules 111, 121, and 132) are subsidizing

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<sup>26</sup> Exhibit No. BGM-1CT at 19:12.

<sup>27</sup> Exhibit No. BGM-1CT at 19:21 to 20:4.

<sup>28</sup> Norwood, TR 109:22.

<sup>29</sup> Exhibit No. BCC-1T at 5:7.

<sup>30</sup> Exhibit No. JDM-1T.

that service.<sup>31</sup> Avista’s proposed rate spread, however, does not attempt to bring all customer classes to cost of service and, instead, “proposed to move customers only 25% closer to unity.”<sup>32</sup>

30. Avista’s original cost of service study, however, contains several flaws and weaknesses. For example, as described in the testimony of NWIGU expert Mr. Collins, the Company’s cost of service study improperly addressed the treatment of AMI related gas distribution plant and expenses.<sup>33</sup> The Company also used a methodology that overstates the cost to serve industrial customers.<sup>34</sup> Utilizing a methodology that more appropriately ties the cost to serve industrial customers to their actual use of Avista’s system, NWIGU’s expert concluded, as Avista did, that residential customers are being subsidized by other customer classes, but also concluded that Schedule 146 customers are being served at rates that are higher than cost of service.<sup>35</sup>

31. Staff has also identified critical flaws in the Company’s cost of service study. For example, when Staff analyzed the parity ratios among customer classes, it determined that the parity ratio for Schedule 146 indicates the revenue collected from that customer class is actually in balance with the cost of providing service – that is, a parity ratio of 1.00.<sup>36</sup> When compared to the Company’s calculated parity ratio of 0.82, Staff determined that this discrepancy demonstrates a flaw in the precision of the Company’s cost of service study.

32. In light of a lack of confidence in the Company’s cost of service study, which is exacerbated by the disagreements inherent in the competing cost of service studies provided by Avista and NWIGU, Staff has proposed that the Commission maintain the *status quo* for rate spread and, instead, initiate a generic proceeding to give all LDCs more guidance in how to

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<sup>31</sup> Exhibit No. JDM-1T at 19:22.

<sup>32</sup> Exhibit No. PDE-8T at 8:6.

<sup>33</sup> Exhibit No. BCC-1T at 3:11.

<sup>34</sup> Exhibit No. BCC-1T at 3:22.

<sup>35</sup> Exhibit No. BCC-1T at 12:7, Table 1.

<sup>36</sup> Exhibit No. JLB-1T at 13:8.

develop cost of service studies and, in turn, to inform rate spread decisions. NWIGU supports this request.

33. Although it appears Avista is willing to participate in a generic proceeding, it expressed some criticism for Staff's approach. For example, Avista witness Mr. Ehrbar expressed concern that the Commission would choose a one-size-fits-all approach when there may be reasons for different LDCs to utilize different cost of service methodologies.<sup>37</sup> However, no part of Staff's recommendation includes having a single methodology be the result of a generic proceeding. Instead, the goal is to develop guiding principles that parties can either agree on or at least understand, which should reduce the number of disputes in future rate cases. There is no recent decision from this Commission that clearly states guiding principles for cost of service studies. The industry in general, and the systems of Washington LDCs specifically, have changed over the past two decades. The method of serving various customer classes and the relative burdens and benefits they draw from the system should be comprehensively reviewed.

34. Avista is likely to urge the Commission to adopt its rate spread proposal even if the Commission initiates a generic proceeding to address cost of service. Avista appears to believe that its rate spread proposal remains reasonable. This may be because, even using Staff's cost of service analysis, Avista's approach is "directionally accurate" and attempts to bring rates somewhat closer to parity. However, that holds true only for some rate classes. For Schedule 146, Avista seeks to impose higher rate increase even though Staff believes that customer class is already at parity, and NWIGU's analysis concluded that rate Schedule 146 is priced above its relative cost of service.

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<sup>37</sup> Ehrbar, TR 298:15.

35. Because of the disputes over the methodology and the outcome of the Company's cost of service study, which then informed the proposed rate spread, the only reasonable approach for the Commission is to apply rate changes on an equal percent of margin. This will give all parties the time to participate in the generic proceeding to inform better methodologies. If Avista must file a new rate case prior to the conclusion of that proceeding, Avista could simply prepare a more complete and precise cost of service study that addresses Staff's concerns.

### III. CONCLUSION

36. If the Commission is going to continue to allow Avista to address attrition claims through the means of a projection of future costs, the Commission should require Avista to provide as much detail as possible to inform both the drivers of attrition and the historical cost trends the Company experiences. Avista's proposal in this case avoids such a deep dive and, instead, simply tries to replicate the broad methodology the Commission allowed it to use in the prior rate case. Instead, the Commission should adopt the more granular approach presented by NWIGU and ICNU, which carefully analyzes each cost category, and the components of those categories, to arrive at the most informed decision for speculating about the Company's future costs.

37. Further, the Commission is urged to recognize the flaws and lack of precision in the Company's gas cost of service study and the reasonable disagreements the parties have over how such a study should be performed. As a resolution to those issues, the Commission can maintain the *status quo* of the Company's rate spread, apply any gas increase on an equal percent of margin basis, and initiate a generic proceeding that will address cost of service issues more comprehensively.

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38. Finally, for the reasons offered by Staff and ICNU, the Commission should reject the Company's request for a 9.9% ROE.

Dated: November 7, 2016

Respectfully submitted,



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Of Attorneys for  
Northwest Industrial Gas Users

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing document upon all parties of record (listed below) in this proceeding by electronic mail and by mailing a copy properly addressed with first class postage prepaid.

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Dated in Portland, Oregon this 7<sup>th</sup> day of November 2016



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