BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILIITES AND TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a AVISTA UTILITIES,

Respondent.

DOCKET NOS. UE-190334 and UG-190335, UE-190222 (*Consolidated*)

RESPONSE TESTIMONY OF GLENN A. WATKINS ON BEHALF OF THE WASHINGTON STATE OFFICE OF THE ATTORNEY GENERAL PUBLIC COUNSEL UNIT

EXHIBIT GAW-1T

October 3, 2019

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I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Glenn A. Watkins. My business address is 6377 Mattawan Trail, Mechanicsville, VA 23116.

Q. By whom are you employed and in what capacity?

A. I am President and Senior Economist with Technical Associates, Inc., which is an economics and financial consulting firm with an office in Mechanicsville, Virginia.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Public Counsel Unit of the Washington Attorney General's Office ("Public Counsel").

Q. Please describe your professional qualifications.

A. Except for a six-month period during 1987 in which I was employed by Old Dominion Electric Cooperative as its forecasting and rate economist, I have been employed by Technical Associates continuously since 1980.

During my 39 year career at Technical Associates, I have conducted marginal and embedded cost of service, rate design, cost of capital, revenue requirement, and load forecasting studies involving numerous gas, electric, water/wastewater, and telephone utilities, and have provided expert testimony in Alabama, Arizona, Delaware, Georgia, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Montana, North Carolina, New Jersey, Ohio, Illinois, Indiana, Pennsylvania, Vermont, Virginia, South Carolina, Washington, and West Virginia. I hold an M.B.A. and B.S. in Economics from Virginia Commonwealth University. I am a member of several professional organizations

as well as a Certified Rate of Return Analyst. A more complete description of my education and experience is provided in Exhibit GAW-2.

Q. What is your ratemaking experience within Washington State?

A. I have testified on behalf of Public Counsel in numerous electric and gas rate cases over the last several years including the last four Avista general rates cases, the last four rate cases involving Puget Sound Energy, and three Pacific Power and Light cases.

Q. What is the purpose of your testimony is this proceeding?

A. Technical Associates has been engaged to review and evaluate the appropriateness of Avista's natural gas class cost of service study (CCOSS), its proposed natural gas class revenue allocations (rate spread), and proposed Residential customer charges for electric and natural gas. The purpose of my testimony is to present my findings and recommendations based on the studies I have undertaken in this matter.

II. CLASS COST OF SERVICE

Q. Please briefly explain the concept of a CCOSS and its purpose in a rate proceeding.

A. Generally there are two types of cost of service studies used in public utility ratemaking: marginal cost studies and embedded, or fully allocated, cost studies. Consistent with the practices of this Commission, Avista has utilized a traditional embedded cost of service study for purposes of establishing the overall revenue requirement in this case, as well as for class cost of service purposes.

Embedded class cost of service studies are also referred to as fully allocated cost studies because the majority of a public utility's plant investment and expense is incurred to serve all customers in a joint manner. Accordingly, most costs cannot be specifically

attributed to a particular customer or group of customers. To the extent that certain costs can be specifically identified and attributed to a particular customer or group of customers, these costs are often directly assigned in the CCOSS. The costs jointly incurred to serve all or most customers, therefore, must be allocated across specific customers or customer rate classes.

It is generally accepted that to the extent possible, joint costs should be allocated to customer classes based on the concept of cost causation. That is, costs are allocated to customer classes based on analyses that measure the causes of the incurrence of costs to the utility. Although the cost analyst strives to abide by this concept to the greatest extent practical, some categories of costs, such as corporate overhead costs, cannot be attributed to specific exogenous measures or factors, and must be subjectively assigned or allocated to customer rate classes. With regard to those costs in which cost causation can be attributed, there is often disagreement among cost of service experts on what is an appropriate cost causation measure or factor; e.g., peak demand, energy or throughput usage, number of customers, etc.

Q. In your opinion, how should the results of a CCOSS be utilized in the ratemaking process?

A. Although there are certain principles used by all cost of service analysts, there are often significant disagreements on the specific factors that drive individual costs. These disagreements can and do arise as a result of the quality of data and level of detail available from financial records. There are also fundamental differences in opinions regarding the cost causation factors that should be considered to properly allocate costs

to rate schedules or customer classes. Furthermore, and as mentioned previously, cost causation factors cannot be realistically ascribed to some costs such that subjective decisions are required.

In these regards, two different cost studies conducted for the same utility and time period can, and often do, yield different results. As such, regulators should consider CCOSS only as a guide, with the results being used as one of many tools to assign class revenue responsibility.

Q. Have the higher courts opined on the usefulness of cost allocations for purposes of establishing revenue responsibility and rates?

A. Yes. In an important regulatory case involving Colorado Interstate Gas Company and the Federal Power Commission (predecessor to FERC), the United States Supreme Court stated: "But where, as here, several classes of services have a common use of the same property, difficulties of separation are obvious. Allocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science."[1]

Q. Does your opinion, and the findings of the U.S. Supreme Court, imply that cost allocations should play no role in the ratemaking process?

A. Not at all. It simply means that regulators should consider the fact that cost allocation results are not surgically precise and that alternative, yet equally defensible, approaches may produce significantly different results. In this regard, when all cost allocation approaches consistently show that certain classes are over or under contributing to costs

[1] *Colorado Interstate Co. v. Comm'n*, 324 U.S. 581, 65 S. Ct. 829 (1945).

and/or profits, there is a strong rationale for assigning smaller or greater percentage rate increases to these classes. On the other hand, if one set of cost allocation approaches show dramatically different results than another approach, caution should be exercised in assigning disproportionately larger or smaller percentage increases to the classes in question.

Q. Please explain the basic concepts of cost allocation for public utilities and natural gas local distribution companies (NGDCs).

A. As I mentioned earlier, the majority of a NGDC's plant investment serves customers in a joint manner. In this regard, the NGDC's infrastructure is a system benefiting all customers. If all customers were the same size and had identical usage characteristics, cost allocation would be simple (even unnecessary). However, in reality, a utility's customer base is not so simple. Customers (or customer groups) tend to vary greatly in the amount of service required throughout the year such that there are small usage and large usage customers. Therefore, differences in usage should be considered. Because different groups of customers also utilize the system at varying degrees during the year, consideration should also be given to the demands placed on the system during peak usage periods.

Q. With regard to NGDCs, is there any aspect of class cost allocations that tends to overshadow other issues or is often controversial?

A. Yes. For virtually every NGDC, the largest single rate base item (account) is distribution mains. Furthermore, several other rate base and operating income accounts are typically allocated to classes based on the previous assignment of distribution mains. As such, the

methods and approaches used to allocate distribution mains to classes are usually by far the most important [in terms of class rate of return (ROR) results] and tend to be the most controversial.

Q. Which method, or methods, did the Company use to allocate costs to customer classes for this case?

A. Company witness, Mr. Joseph Miller conducted Avista's natural gas cost allocation study, which utilizes a modified version of the Peak and Average ("P&A") method to allocate mains. I refer to this as a modified method due to the fact that Mr. Miller has separated the Company's investment in distribution mains between those that are four inches and greater ("large mains"), mains that are two and three inches in diameter ("medium mains"), and those that are less than two inches in diameter ("small mains").

Q. In general, is there a preferred method to allocate natural gas distribution mains costs?

A. Yes. The P&A approach is the most fair and equitable method to assign natural gas distribution mains costs to the various customer classes. This method recognizes each class's utilization of the Company's facilities throughout the year, yet also recognizes that some classes rely upon the Company's facilities (mains) more than others during peak periods.

Q. Has this Commission provided guidance as to a preferred approach to be used in natural gas local distribution company class cost of service study?

A. Yes. Based on my experience in Washington State, the P&A method has been the accepted natural gas distribution cost allocation approach and has been utilized by virtually every natural gas distribution company in the state for many years.

Q. Is the Company's recommended approach to allocate mains in this case different than the approaches it has used in prior cases?

A. Yes. As noted in the direct testimony of Mr. Miller, he is recommending a different approach than the Company proposed in its 2014 case (Docket No. UG-140189). Prior to the Company's 2014 rate case, no attempt was made to separate mains by various sizes of pipe and allocate these various groups on different bases. In the 2014 case, the Company proposed an allocation method that did separate mains by size of pipe such that all customers would be responsible for large diameter pipe sizes and large volume customer classes would be exempt from the cost assignment of small diameter pipe sizes. During the 2014 rate case, there was considerable disagreement among the parties as to how distribution mains should be allocated.

In this case, Mr. Miller apparently recognized the shortcomings of the Company's approach used to allocate mains during the 2014 rate case as discussed on pages 42 and 43 of his direct testimony. As a result, Mr. Miller is recommending a different approach to allocate mains than was proposed by the Company in prior cases. Mr. Miller describes his new approach on pages 44 through 48 of his direct testimony.

Q. Please explain the general framework of Avista's proposed method to allocate mains for this case.

A. As noted earlier, the Company has utilized a modified P&A approach wherein the percentage weight given to the "peak" and "average" portions are based on the Company's system load factor and results in 61.7 percent allocated based on peak demand and 38.3 percent allocated based on average usage (consumption). With regard to the 61.7 percent of costs allocated based on peak demands, these costs are allocated to every rate schedule. With respect to the 38.3 percent "average" portion, Mr. Miller separates this cost assignment based on pipe sizes. For large diameter pipes, all classes are allocated the average portion of costs. For small diameter pipes, Rate Classes 131/132 and 146 are exempt from an allocation of the average portion of costs. Finally, for medium diameter pipes, 33 percent of the average portion of costs are assigned to all rate classes and the remaining 67 percent exempts Rate Classes 131/132 and 146.

Q. Has Mr. Miller's recommended approach in this case been utilized by other utilities in Washington?

A. Yes. Mr. Miller's recommended approach in this case is identical to the mains allocation method developed and used by Puget Sound Energy (PSE) in every case since 2009. As a brief history, and as a result of PSE's 2007 General Rate Case, a collaborative working group was formed in an attempt to reach consensus on how natural gas distributions mains should be allocated across classes. Unfortunately, the parties could not agree on a particular method or approach. As a result of the various parties' positions expressed during the working group, PSE's witness Ms. Janet Phelps developed what she referred

to as a "compromise" approach in which the various philosophies and positions of the parties were considered.

Q. What is your overall assessment of the mains allocation method utilized by Mr. Miller in this case?

A. While Mr. Miller's approach relies on several subjective decisions, this is true for many aspects of embedded cost studies in which joint cost responsibility must be assigned individual classes of customers. While I do not agree with some aspects of Mr. Miller's approach, i.e., the PSE methodology, and I am reluctant to fully endorse this approach to assign mains cost responsibility, I can inform the Commission that Avista's study is not inherently biased against any customer class and indeed represents a compromise of the philosophies and positions of various parties relating to how distribution mains cost should be assigned across classes.

Q. What are the results of Mr. Miller's CCOSS?

A. Mr. Miller's CCOSS generates the following class rates of return at current rates:

Table 1
Avista Gas
Class RORs at Current Rates

Class	ROR
General Service (Sch. 101)	3.45%
Large General Service (Sch. 111/112)	13.59%
Large General Service HLF (Sch. 121/122) [2]	--
Interruptible (Sch. 131/132)	11.10%
Transportation (Sch. 146)	5.80%
Total Company	5.07%

[2] There are no revenues associated with this rate schedule.

III. NATURAL GAS CLASS REVENUE ALLOCATION

Q. How does the Company propose to assign its requested overall natural gas increases under its proposed two-year rate plan?

A. Company witness, Mr. Miller sponsors Avista's proposed class revenue allocation and rate design. Under the Company's request, distribution revenues would be increased by $12.935 million in year 1 and another $6.456 million in year 2. Under Mr. Miller's proposal, all classes (except Special Contract Rate 148) would receive an equal percentage increase in margin (distribution) revenues of 14.06 percent. Similarly, in year 2, all rate classes (except Special Contract Rate 148) would receive a 6.15 percent increase in distribution revenues.

Q. Under Mr. Miller's approach, would all rate class rates of return move closer to rate of return parity?

A. Yes.

Q. What are your conclusions and recommendations regarding the allocation of any overall increase authorized by the Commission in this case?

A. I concur and support Mr. Miller's proposed equal percentage increases across all customer classes.

Q. To the extent the Commission authorizes an overall increase less than that requested by Avista and/or if Avista's two-year rate plan is rejected, how should any overall increase be distributed across rate classes?

A. Any overall increase authorized by the Commission should be spread across all rate classes on an equal percentage margin (distribution) revenue basis.

IV. CUSTOMER CHARGES

Q. What are Avista's current residential customer charges?

A. For electric service, the current residential customer charge is $9.00 per month, while the current natural gas customer charge is $9.50 per month.

Q. Is the Company proposing any increases to the residential customer charges in this case?

A. No. The Company proposes to maintain the current residential customer charges such that any increase authorized would be reflected within the usage charges.

Q. Do you support the Company's proposal to not increase residential customer charges in this case?

A. Yes. I am an advocate of maintaining minimal fixed charges in order to promote energy conservation as well as provide a rate structure that is largely variable in nature, which then allows customers a greater ability to control their energy bills.

V. NATURAL GAS SPECIAL CONTRACTS

Q. As part of your investigation, have you examined the special contract customers served under Schedule 148?

A. Yes. In a series of data requests, Public Counsel requested detailed information relating to each of the Company's seven special contract customers.[3] As part of my investigation, I examined each customer's contract, historical utilization, load characteristics, along

[3] Watkins, Exh. GAW-3C (Avista Response to Public Counsel Data Request No. 87C); Exh. GAW-4C (Avista Response to Public Counsel Data Request No. 88C); Exh. GAW-5C (Avista Response to Public Counsel Data Request No. 89C); Exh. GAW-6C (Avista Response to Public Counsel Data Request No. 90C); Exh. GAW-7 (Avista Response to Public Counsel Data Request No. 91); Exh. GAW-8 (Avista Response to Public Counsel Data Request No. 92); and Exh. GAW-9 (Avista Response to Public Counsel Data Request No. 93).

with a review of each customer's proximity to interstate pipelines and their ability to bypass Avista's distribution system. As a result, I have determined that all customers are in reasonably close proximity to an interstate pipeline and the economic potentials to bypass Avista's distribution system are likely absent a negotiated (discounted) rate. Therefore, based on my examination, discounted rates of some magnitude are more than likely justified for each of these customers.

Q. Do you have any concerns regarding the level of discounts offered to these customers below full tariff rates?

A. Yes. I reviewed how long each of these customer's rates have been in effect. As a result of this review, I discovered that the rates for two of these contracts have remained constant for more than 20 years. Furthermore, contracts for two other customers have remained constant since 2003, one contract rate has been constant since 2006, and another has remained constant since 2012.[4] Given the number and frequency of Avista's rate cases, along with general rates of inflation, it is prudent for Avista to re-examine each of these contract rates to ensure that they are maximizing the revenue from these discounted rate customers, since captive ratepayers are paying for the difference between full tariff and discounted rates.

Q. What is your recommendation concerning this issue?

A. I recommend the Commission direct Avista to re-evaluate each of these special contract rates as it relates to the realistic cost of each customer bypassing the Company's distribution system to ensure that revenues are maximized from these discounted rate

[4] It is unclear how long the current rate for one of these contracts has been in place.

customers. In this regard, I recommend the Commission direct Avista to complete this analysis before its next general rate case and no longer than two years from the issuance of an order in this case. The results of these analyses be provided to Commission Staff and Public Counsel.

Q. Does this complete your testimony?

A. Yes.