WUTC DOCKET: UE-190334
EXHIBIT: BGM-12T
ADMIT ☑ W/D ☐ REJECT ☐

Exhibit BGM-12T
Dockets UE-190334/UG-190335/ UE-190222
Witness: Bradley G. Mullins

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION	)	DOCKETS UE-190334, UG-190335, and UE-190222 (*Consolidated*)
Complainant,	)	
v.	)	
AVISTA CORPORATION	)	
Respondent.	)	

ERM RESPONSE TESTIMONY OF BRADLEY G. MULLINS

ON BEHALF OF

THE ALLIANCE OF WESTERN ENERGY CONSUMERS

October 28, 2019

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TESTIMONY OF BRADLEY G. MULLINS

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Bradley G. Mullins, and my business address is 1750 SW Harbor Way, Ste 450, Portland, Oregon 97201.

Q. ARE YOU THE SAME WITNESS THAT FILED RESPONSE TESTIMONY ON BEHALF OF THE ALLIANCE OF WESTERN ENERGY CONSUMERS (“AWEC”)?

A. Yes. I filed testimony on Avista Corporation’s (“Avista”) general rate case on October 3, 2019. Pursuant to the Washington Utilities and Transportation Commission’s (“Commission”) Orders 05 and 06 in these consolidated dockets, testimony on Avista’s Energy Recovery Mechanism (“ERM”) was suspended until October 28, 2019.

Q. WHAT IS THE PURPOSE OF YOUR RESPONSE TESTIMONY?

A. I discuss my review of the ERM. As of December 31, 2018, Avista has calculated an ERM deferral of $34,444,617 in customer’s favor, which Avista proposes to rebate over a 3-year period.[1/] In total, Avista proposes to rebate $39,257,244, after considering interest accruing in the amortization period.[2/]

Q. WHAT WAS THE SCOPE OF YOUR REVIEW?

A. I reviewed Avista’s workpapers and also conducted discovery with respect to the ERM calculations. In conducting my review, I did not consider the prudence of the underlying power costs that go into the ERM calculation.

1/ Ehrbar, Exh. No. PDE-1T at 4:16-19; 6:9-10.

2/ See April 8, 2019 workpaper filing of Avista. 190222-AVA-Workpapers-4-8-19.xlsx, Tab “Forecast Balance”, Cell “B30”

Q. WHAT ARE YOUR RECOMMENDATIONS?

A. Based on my review, I have developed three recommendations. Specifically, I recommend the Commission require Avista to:

- *Amortize the ERM balances over a two-year period beginning April 1, 2020;*
- *Remove the tax adjustment to the cost of debt rate Avista uses to calculate ERM interest accruals; and*
- *Consider increasing the deferral amounts to account for artificially high baseline power costs from Avista's 2015 general rate case.*

Q. WHAT IS THE IMPACT OF THESE RECOMMENDATIONS?

A. Table 1, below, details the impact of these recommendations on Avista's ERM deferral

TABLE 1
Impact of Recommendations

	Total Rebate	Sequential Impact
As Filed: Jul 2019 - 3yr Amort	39,257,244	
Adjustments:		
Step 1: Apr 2020 - 3yr Amort	40,560,511	1,303,267
Step 2: Apr 2020 - 2yr Amort	39,729,120	(831,391)
Step 3: Remove Tax Effect on Interest	40,732,698	1,003,578
Total Adjustments		**1,475,454**

As can be seen from Table 1, I have performed these recommended adjustments sequentially, so that each step includes the impact of the prior step. I have also provided workpapers that detail the rebate amount calculated for each step.

II. AMORTIZATION PERIOD

Q. WHAT AMORTIZATION PERIOD HAS AVISTA PROPOSED?

A. The rates Avista filed in UE-190222 assumed a three-year amortization beginning on July 1, 2019.[3/] In testimony, however, Avista noted an openness to other amortization alternatives, stating "it is our strong belief that the Commission should actually delay implementation of this rebate until the effective date of the Company's general rate case" and was open to the possibility that the balances "be held in the deferral account for later rate mitigation."[4/] Since the Commission accepted Avista's recommendation and has delayed a rebate, it is reasonable to give the amortization period further consideration.

Q. WHAT DO YOU RECOMMEND?

A. I recommend a two-year amortization. Avista's ERM was established in Docket No. UE-011595. Paragraph 4.f. of the Stipulation in that docket states that "[t]he rate adjustment shall be in effect for a twelve-month period." Given the magnitude of the rebate, AWEC is not opposed to a slightly longer amortization period and would not object to a two-year amortization of the ERM rebate funds. Notwithstanding, I view Avista's proposed three-year amortization to be too much of a departure from the UE-011595 Stipulation and accordingly, request the Commission adopt a shorter amortization period. Further, the amortization is already starting 9 months later than it would have otherwise, due to Avista's proposal to consolidate this docket, which is another reason to adopt a shorter amortization period.

3/ Ehrbar, Exh. No. PDE-1T at 8:7-17.
4/ Id. at 8:4-6.

Q. ARE REBATES EFFECTIVE RATE MITIGATION TOOLS?

A, When dealing with a one-time amortization, such as the ERM rebate, rate stability is important. After the rebate expires, ratepayers will be subject to an automatic rate increase, all else being equal. Using the rebate funds as a rate mitigation tool may be fine in the short term, but the effect of such a strategy is just to delay the timing of the rate increase. The rate increase will still occur when the rebate expires.

Because the rate mitigation afforded by a rebate is just a delaying effect, one must consider the potential for future rate cases, if using a rebate for rate mitigation purposes. If the rebate were to expire at the same time the utility filed a future rate case, the impact of the future rate change will be compounded, resulting in large rate impacts to customers in the future. In such instances, using a rebate for rate mitigation purposes can lead to less rate stability, not more. For this reason, rebates are not necessarily very effective rate mitigation tools.

Q. DOES THE AMORTIZATION PERIOD IMPACT ACCRUED INTEREST IN THE ERM?

A. Yes. Accordingly, it is necessary for interest to be updated to reflect the amortization period that the Commission ultimately selects. Even if the Commission accepts a three-year amortization, the interest accrual will be different than what the Company proposed, since the amortization will start later than the July 1, 2019 date in Avista's filing. Due to the consolidation of this docket, amortization on will not begin until April 1, 2020, so more interest will have accrued than is reflected in Avista's filing, even using a three-year amortization.

Using a two-year amortization, as I recommend, will also impact the resulting interest calculation. The impact of using a two-year amortization will result in a higher annual rebate amount, but will also result in reduced interest expense, which I consider when determining the impact of my amortization recommendation.

Q. WHAT IS THE IMPACT OF YOUR AMORTIZATION RECOMMENDATION?

A. As noted in Table 1, I have broken the adjustment into two components. First, I detail the impact of recalculating interest based on a three-year amortization beginning April 1, 2020. I then calculate the impact of going from a three- to two-year amortization on a separate line item. As can be seen in the table, relative to Avista's initial filing, the impact of using a three-year amortization beginning on April 1, 2020 results in a $1,303,267 increase to the rebate amount due to the additional interest that accrued over the 9-month period since July 1, 2019. Further, using a two-year amortization beginning on April 1, 2020 has the effect of reducing interest expense by $831,391, since the ERM funds will be returned to ratepayers more quickly than with Avista's proposal.

III. ACCRUED INTEREST

Q. WHY IS A CARRYING CHARGE APPLIED TO THE ERM BALANCE?

A. The carrying charge represents capital cost savings, or costs, to Avista that arise due to the fact that there is a timing difference between when Avista paid the ERM power costs and when the amounts are collected from, or refunded to, customers. In the case of the refund at issue in this docket, the interest expense represents the fact that Avista has paid less for power costs than the amount it has recovered in rates over several years. Based on the design elements defined in the ERM Stipulation, Avista will have benefitted from the ERM funds for several years, without immediately returning the amounts to ratepayers. Avista receives a benefit from the funds in the form of reduced capital costs. Instead of issuing debt or equity, Avista has been able to use the ERM dollars in its operations for several years, and therefore, has avoided material amounts of financing costs.

Q. WHAT INTEREST RATE WAS INCLUDED IN THE ERM STIPULATION?

A. With respect to the carrying charge, paragraph 4.d. of the ERM stipulation in Docket No. UE-011595 states:

> d. Carrying Charge: Beginning July 1, 2002, the carrying charge on the Energy Cost Deferral Balance will be calculated using the Company's actual cost of debt, updated semi-annually, and applied to the Energy Cost Deferral Balance less associated accumulated deferred income taxes. Interest will be accrued monthly and compounded semi-annually. The Company will notify the Parties of the result of the semi-annual update and provide supporting workpapers upon request.

Various interest rates have been used in calculating carrying charges associated with regulatory accounts in Washington. With respect to the ERM, it was decided that the actual cost of debt would be used as the carrying charge.

In the context of the current ERM rebate, it might be said that the ERM assumes Avista has avoided issuing an amount of debt, due to its ability to use of the ERM rebate money in the period prior to when the funds are returned to ratepayers. By issuing less debt, Avista will have paid less interest, which corresponds to the cost of debt used as the ERM carrying charge calculation.

Q. WHAT INTEREST RATE HAS AVISTA APPLIED?

A. Avista uses its cost of debt, consistent with the stipulation. However, Avista also applies an adjustment for taxes.[5/] This tax adjustment may be identified in Avista's April 8, 2019 workpapers titled "190222-AVA-Workpapers-4-8-19.xlsx" on the Tab "Forecast Balance" Cells "A15:D15"

Q. WHAT IS THE TAX ADJUSTMENT THAT AVISTA HAS APPLIED TO THE COST OF DEBT CARRYING CHARGE?

A. The adjustment Avista applies uses the federal income tax rate. Avista multiplies its actual cost of debt by one-minus the tax rate to apply a sort-of tax effect against the cost of debt. One might say, Avista's calculation uses a "grossed down" cost of debt.

Q. DO YOU AGREE WITH AVISTA'S TAX EFFECT CALCULATION?

A. No. From a revenue requirement perspective, the cost of debt is the same on both a pre- and post-tax basis. Therefore, no tax effect is necessary with respect to the accrued interest calculation in the ERM.

Q. WHY ARE THE PRE- AND POST-TAX COST OF DEBT THE SAME?

A. Interest expense is deductible for tax purposes. Accordingly, when ratepayers pay revenues to Avista for Avista's cost of debt, Avista also deducts the interest expense, netting to zero incremental tax liability.

Stated differently, when Avista returns the interest portion of the ERM rebate to ratepayers, it will also reduce its tax liability on its next tax return. Accordingly, it's not necessary to reduce ERM interest accruals for any amount of incremental taxes.

[5/] See Ehrbar, Exh. No. PDE-1T at 3:10-19.

Q. ARE THERE NORMALLY ANY ACCUMULATED DEFERRED INCOME TAXES ASSOCIATED WITH INTEREST EXPENSE?

A. No. Accumulated deferred income taxes ("ADIT") arise when the treatment of an accounting item is different for book purposes than it is for tax purposes. Interest expense is applied as an offset to net income for book purposes. Interest expense, however, is also deductible against taxable income for tax purposes. Therefore, ADIT generally does not arise in connection with costs, since the book and tax accounting are the same. For this reason, it is somewhat misleading to imply, as the ERM Stipulation does, that Avista's adjustment is reflective of ADIT.

Q. DO TAXES HAVE AN IMPACT ON THE COST OF EQUITY?

A. Yes. Unlike the cost of debt, there is no underlying deduction that the utility can claim to offset the revenues attributable to equity. The equity returns are provided to shareholders, and the utility pays taxes on those funds. Since the cost of equity is stated as a percentage of rate base, the percentage will be different depending on whether the cost of equity is applied before or after taxes, i.e. pre- and post-tax.

Q. ARE THE COST OF EQUITY VALUES CONSIDERED IN A RATE CASE STATED ON PRE-TAX OR POST-TAX BASIS?

A. In the context of a general rate case, the cost of equity values that the Commission reviews and approves are post-tax cost of equity values. In other words, the cost of equity values represents the amount of funds shareholders have the opportunity to recover, after Avista Corporation pays its taxes. This means that the actual revenues required for equity holders exceed the post-tax cost of equity, when viewed as a percentage of rate base. In the revenue requirement, cost of equity must be grossed-up for taxes, resulting in a pre-tax return on equity.

Thus, when the Commission approved the 9.5% post-tax cost of equity in Docket No. UE-170485 (Cons.), it was also approving a 12.0% pre-tax cost of equity. The same adjustment is not applicable for the cost of debt.

Q. WHAT DO YOU RECOMMEND?

A. I recommend Avista recalculate the ERM deferral balance using the cost of debt, with no adjustments for taxes. As noted in Table 1, the impact of this adjustment is $1,003,578. In calculating this impact, I have assumed a two-year amortization beginning April 1, 2020. If a different amortization period were assumed, the impact of using the higher interest rate would be different, but could be easily calculated using my workpapers. Further, in performing this adjustment, I recalculated the interest accruals over the period 2016 through 2018 to remove the tax effect that Avista has been applying to the interest rate calculation. These amounts may be found in my workpapers in the Tab "Forecast Balance" Cells "B19:B21". I calculated that the tax effect reduced interest accruals by $220,615, $419,161, and $324,624 in 2016, 2017, and 2018, respectively.

IV. BASELINE POWER COSTS

Q. IS AVISTA'S ERM DEFERRAL BALANCE ARTIFICALLY LOW?

A. Yes. As discussed in my Response Testimony in the remand phase of Avista's 2015 general rate case, Dockets UE-150204/UG-150205 (*consolidated*), Exhibit BGM-7T ("Remand Testimony"), Avista has been deferring less for the benefit of customers in its ERM since the final order in those dockets was issued. This is because the final rates approved in the 2015 rate case did not reflect a $12.3 million annual reduction to Avista's power costs that Avista identified near the end of that proceeding. I discuss this issue in more detail in my Remand Testimony.

Q. WHAT DO YOU RECOMMEND THE COMMISSION DO IN THIS CASE WITH RESPECT TO THIS ISSUE?

A. My primary recommendation is for the Commission to calculate new rates for Avista in the remand phase of the 2015 rate case by using the attrition model it used in that case, but without including attrition-related rate base. To accurately calculate those rates, Avista's stated power costs from that case will need to be accurately reflected as well. If this occurs, then there is no need for the Commission to take any other action with respect to the ERM.

If, however, the Commission determines not to account for the $12.3 million reduction in power costs in the remand proceeding, then it should increase the deferral balance in the ERM accordingly to ensure that Avista is not provided with a windfall by virtue of operating with baseline power costs that were significantly higher than the utility's own forecasts.

Q. HAVE YOU ATTEMPTED TO CALCULATE THE IMPACT OF CHANGING THE POWER COST BASELINE BASED ON THE LEVEL OF POWER COST MODELED IN THE ATTRITION STUDY?

A. No. The workpapers that Avista supplied were not provided in a way that allowed for the changing of the baseline net power costs. In Data Request 165, AWEC requested Avista provide working copies of its workpapers. Notwithstanding, most of the workpapers Avista supplied were not functional and contained numerous "#REF" errors in almost every single cell. For this reason, I have not attempted to update the baseline power costs for the period when UE-150204 power cost rates were in effect. If the Commission desires to change the baseline to be consistent with the attrition study, I recommend the Commission require Avista to submit a compliance filing providing the updated ERM calculation based on the actual level of power costs used in the UE-150204 attrition study.

Q. DOES THIS CONCLUDE YOUR ERM RESPONSE TESTIMONY?

A. Yes.