WUTC DOCKET: UE-190334
EXHIBIT: ACC-1T
ADMIT ☑ W/D ☐ REJECT ☐

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 ANDREA C. CRANE
ON BEHALF OF THE
WASHINGTON STATE OFFICE OF THE ATTORNEY GENERAL
PUBLIC COUNSEL UNIT

EXHIBIT ACC-1T

October 3, 2019

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is 2805 East Oakland Park Boulevard, #401, Ft. Lauderdale, Florida 33308.

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

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989. I became President of the firm in March 2008.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 400 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, West Virginia and the District of Columbia. These proceedings involved electric, gas, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony over the past five years is included in Exhibit ACC-2.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On April 30, 2019, Avista Utilities ("Avista" or "Company") filed a Petition with the Washington Utilities & Transportation Commission ("Commission") requesting increases in its base rates for electric and natural gas utility services. In addition, the Company is requesting approval of a two-year, multi-year rate plan, which would provide additional increases effective April 1, 2021. Finally, the Company is requesting authorization to continue a revenue decoupling mechanism, with certain modifications, for an additional five years.

The Columbia Group, Inc. was engaged by the Washington Office of Attorney General, Public Counsel Unit ("Public Counsel") to review the Company's Petition and to provide recommendations to the Commission regarding the Company's revenue requirement claims, its request to implement a multi-year rate plan, and its request for a modified decoupling mechanism. In developing my recommendations, I relied upon the cost of capital and capital structure testimony of Public Counsel witness, Mr. David Garrett. Testimony on behalf of Public Counsel is also being filed by Mr. Glenn Watkins on class cost of service/rate design issues and by Mr. Corey Dahl on certain policy issues regarding the proposed multi-year rate plan.

Q. Please provide a brief summary of the Company's filing.

A. Avista is seeking an electric base rate increase of $45.8 million and an increase in its base rates for gas service of $12.9 million. In addition, Avista is proposing that the Commission authorize a two-year rate plan for the Company, whereby additional increases of $18.9 million for electric and of $6.5 million for gas operations would be implemented in Year Two. The Year Two increases are based on studies performed by the Company regarding typical cost increases in various components of the ratemaking equation over the past several years. In addition to these increases, Avista is requesting that the Commission resolve certain issues relating to the early retirement of the Colstrip Units 3 and 4 generating units.

Finally, Avista is seeking authorization to continue a decoupling mechanism for both its electric and gas operations. The Commission initially approved the current decoupling mechanisms for Avista in November 2014 for a period of five years. The Company is seeking to continue this revenue decoupling mechanisms for an additional five years, although it is proposing certain modifications to the currently-authorized mechanism.

The Company's filing would result in electric base revenue increases of approximately 9.12 percent, in Year 1 and of an additional 3.46 percent in Year 2. The Company's filing would result in gas base revenue increases of approximately 13.80 percent in Year 1 and of an additional 6.05 percent in Year 2. These rate increases would constitute the ninth electric and gas rate increases for Avista's Washington's ratepayers since 2009.

Q. What are the most significant issues in this rate proceeding?

A. The most significant revenue requirement issues in this case are 1) the Company's claim for a return on equity of 9.90 percent and a capital structure reflecting 50 percent common equity, 2) Avista's request to include significant post-test year plant in rate base, 3) Avista's proposals to include speculative post-test year operating expenses in utility rates, 4) inclusion of significant incentive compensation costs in rates, including costs for officers and executives, and 5) and the Company's proposal to offset undepreciated Colstrip investment with certain refunds due to ratepayers.

Q. Is there a basic theme that permeates the Company's testimony?

A. Yes, there is. Avista's filing is essentially a three-pronged approach: 1) include numerous post-test year adjustments in order to effectively extend the test year as far out into the future as possible, 2) get a two-for-one rate increase by implementing a multi-year rate plan, and 3) promote decoupling so that the Company will be guaranteed to receive its revenue stream. Each of these three components is designed to increase shareholder earnings and reduce risk, to the detriment of Washington electric and gas ratepayers.

As discussed later in this testimony, many of my adjustments are based on the traditional test-year concept, whereby various ratemaking components are matched to an historic 12-month period. While I have reflected certain post-test year adjustments in my recommendation, any such adjustments should be known and measurable, should be related to price changes, and be effective relatively close in time to the test year reflected in the filing. Allowing a utility to make adjustments that are speculative, that will not occur for many months after the end of the test year, or that otherwise distort the relationships established in the test year will unfairly burden ratepayers and dilute the regulatory process.

III. SUMMARY OF CONCLUSIONS

Q. What are your conclusions concerning the Company's revenue requirement and its need for rate relief?

A. Based on my analysis of the Company's filing and data request responses, on the testimony submitted by other Public Counsel witnesses, and on other relevant documentation in this case, my conclusions are as follows:

1. The 12 months ending December 31, 2018, is a reasonable test year to use in this case to evaluate the reasonableness of the Company's claims.
2. Based on the testimony of Mr. Garrett, the Company has a cost of equity of 9.0 percent, a capital structure consisting of 47 percent common equity, and an overall cost of capital of 6.96 percent.
3. Avista has pro forma electric distribution rate base of $1.629 billion and a pro forma gas distribution rate base of $373.732 million.
4. The Company has pro forma electric distribution operating income at present rates of $105.085 million and pro forma gas distribution operating income at present rates of $23.171 million.
5. Avista has a pro forma, electric distribution revenue deficiency of $11.022 million and a pro forma, gas distribution revenue deficiency of $3.762 million.
6. The Commission should deny Avista's request to implement a multi-year rate plan at this time.
7. The Commission should modify Avista's revenue decoupling mechanism and

should limit any decoupling mechanism to compensate for lost sales resulting from energy efficiency programs.

Q. How is the remainder of your testimony organized?

A. My testimony addressed the Company's requested base distribution revenue increases for the electric and gas utilities. In Section IV, I first summarize Public Counsel's cost of capital and capital structure recommendations. I then address the Company's proposed accounting adjustments, identify areas of disagreement between the Company and Public Counsel, and provide Public Counsel's proposed revenue requirements for the electric and gas utilities. In Section V, I address Public Counsel's recommendations regarding the Company's proposed multi-year rate plant. Finally, in Section VI, I discuss Public Counsel's concerns regarding the Company's proposed revenue decoupling mechanism.

Q. Please explain how your schedules are structured.

A. I have attempted to mirror the adjustment schedules presented by Ms. Andrews in Exhibit EMA-2 and EMA-3 for electric and gas respectively. Ms. Andrews began with the actual test year Results of Operation (1.00). She then made a series of adjustments that she states on page 27 of her testimony reflect "[i]ndividual normalizing and restating adjustments that are standard components of our annual reporting to the Commission …"[1] These adjustments are shown in the 1.XX and 2.XX series of adjustments on Exhibits EMA-2 and EMA-3 of her testimony. Finally, Ms. Andrews

[1] Direct Testimony of Elizabeth M. Andrews, Exh. EMA-1T at 27:10-11.

reflected a series of post-test year, pro forma adjustments, which are shown in the 3.XX series of adjustments in her exhibits.

My schedules provide similar information. Exhibit ACC-3 (for electric) and Exhibit ACC-6 (for gas) summarize Public Counsel's recommended Revenue Requirement. Exhibit ACC-4 (for electric) and Exhibit ACC-7 (for gas) show the accounting adjustments proposed by Avista. I highlighted those individual normalizing, restating, and pro forma adjustments with which I disagree by labeling each of Ms. Andrews' adjustments that I propose to modify as "Adjusted" at the top of each relevant column. Exhibits ACC-3, ACC-4, ACC-6, and ACC-7 are all based on Avista's excel models, adjusted for Public Counsel's recommendations. In Exhibit ACC-5 (for electric) and Exhibit ACC-6 (for gas), I have summarized each of my proposed adjustments, and I have provided the revenue requirement difference between each of my recommendations and those of Ms. Andrews. I have also prepared workpapers for my adjustments that are being provided to the parties in this case. These workpapers were also based on the underlying excel models provided by Ms. Andrews. Following is a discussion of Public Counsel's revenue requirement recommendations.

IV. REVENUE REQUIREMENT ISSUES

A. Capital Structure and Cost of Capital

Q. What is the cost of capital and capital structure that Avista is requesting in this case?

A. The Company utilized the following capital structure and cost of capital in its filing:

Table 1: Avista Requested Cost of Capital

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	50.00%	5.15%	2.57%
Common Equity	50.00%	9.90%	4.95%
Total	100.00%		7.52%

Q. What is the capital structure and overall cost of capital that Public Counsel is recommending for Avista?

A. As shown in Mr. Garrett's testimony, Public Counsel is recommending an overall cost of capital for Avista of 6.96 percent based on the following capital structure and cost rates:

Table 2: Public Counsel Recommended Cost of Capital

	Percent of Total	Cost Rate	Weighted Cost
Long Term Debt	53.0%	5.15%	2.73%
Common Equity	47.0%	9.00%	4.23%
Total	100.00%		6.96%

Mr. Garrett recommends that the Commission apply the Company's actual capital structure, which contains less equity than the capital structure proposed by Avista. In addition, he is recommending that the Commission authorize a cost of equity of 9.0 percent. Mr. Garrett's adjustment results in a pro forma overall cost of capital of 6.96 percent, which is the overall cost of capital that I have used to determine the Company's pro forma required income, as shown on summary Exhibits ACC-3 and ACC-6 for electric and gas respectively.

Q. What is the revenue requirement impact of the cost of capital adjustment?

A. As shown on Schedule ACC-3, the Company's actual Results of Operation demonstrate an overall rate of return of 7.37 percent for the electric utility, well above the 6.96 percent being recommended by Mr. Garrett. Therefore, Public Counsel's capital structure and cost of capital recommendations indicate that the Company's electric utility had a revenue surplus of $8.623 million, based on the actual Test Year Results of Operation. Avista is claiming that the Results of Operation indicated a revenue shortfall of $3.216 million. Therefore, cost of capital and capital structure issues will reduce the Company's revenue claim by a total of $11.839 million, as shown in the Summary of Recommended Electric Adjustments provided on Exhibit ACC-5. In addition, there will be impacts to certain other components of the revenue requirement as discussed below.

With regard to the gas utility, Avista's Results of Operations indicate an earned return of 7.07 percent, again above the cost of capital recommended by Mr. Garrett. Applying Mr. Garrett's recommended capital structure and cost of capital to the Results of Operation, results in a revenue surplus for the gas utility of $460,000, while the Company is claiming a revenue shortfall of $2.126 million. Therefore, the difference between Public Counsel's overall cost of capital and Avista's recommended cost of capital results in a revenue difference of $2.586 million based on the Actual Results of Operation, in addition to the impact on other post-test year adjustments.

Table 3: Adjustment to Results of Operations to Earn Recommended ROR ($000)

	Public Counsel (6.97%)	Avista (7.07%)	Difference
Electric	($8.623)	$3.216	($11.839)
Gas	($0.46)	$2.126	($2.586)

Q. What other adjustments are impacted by the modifications that Public Counsel is recommending in this case for capital structure and cost of capital?

A. There are several rate base adjustments that I have accepted, but where the revenue requirement impact of the adjustment differs between Avista and Public Counsel due to the different recommended capital structures and costs of capital. Since the revenue requirement impact of rate base adjustments depends on the overall cost of capital and capital structure, the revenue requirement impact of these adjustments will differ even though we have accepted the underlying rate base adjustment. For the electric utility, these include the Deferred FIT Rate Base adjustment (1.01), the Removal of AMI from Rate Base (1.04), the Restatement of Interest Expense (2.14), the Restatement of 2018 AMA Rate Base to End of Period (EOP) (2.19), and Deferred Debits, Credits, and Regulatory Assets (3.02). For the gas utility, these include Deferred FIT Rate Base (1.01), Removal of AMI from Rate Base (1.04), the Restatement of Interest Expense (2.14), and the Restatement of 2018 AMA Rate Base to End of Period (2.15). Following is a comparison of these revenue requirement adjustments as quantified by Public

Counsel and Avista:

Table 4: Electric Revenue Requirement Impact ($000)

	Public Counsel	Avista	Difference
Deferred FIT Rate Base (1.01)	($165)	($180)	$15
Remove AMI Rate Base	($1,621)	($1,772)	$151
Restate Interest Expense	$799	$1,510	($711)
Restated 2018 AMA Rate Base to EOP	$9,076	$9,563	($487)
Deferred Debits, Credits, Regulatory Assets	($2,366)	(2,371)	$5

Table 5: Gas Revenue Requirement Impact ($000)

	Public Counsel	Avista	Difference
Deferred FIT Rate Base (1.01)	($105)	($115)	$10
Remove AMI Rate Base (1.04)	($511)	($558)	$47
Restate Interest Expense (2.14)	$175	$330	($155)
Restated 2018 AMA Rate Base to EOP (2.15)	$4.373	$4.627	($254)

For these items, our disagreement with Avista is limited to the use of a different capital structure and cost of capital.

B. Injuries and Damages Expense (2.05)

Q. How did the Company determine its claim for injuries and damages expense?

A. Avista calculated its claim based on a six-year rolling average of injuries and damages expenses not covered by insurance.

Q. What is the rationale for normalizing injuries and damages expense based on a six-year average?

A. Injuries and damages expense can vary significantly from year-to-year. The purpose of a normalization adjustment is to smooth out fluctuations that occur from year-to-year so that a "normal" level of injuries and damages expense can be reflected in prospective rates. In normalizing these costs, it is not unusual for a multi-year average to be utilized in order to mitigate the impact of normal fluctuations that occur from year-to-year.

Q. Do you believe that a six-year average is a reasonable normalization period for these costs?

A. A six-year average may be reasonable if the data utilized did in fact represent normal year-to-year fluctuations in injuries and damages expenses. However, in this case, I do not believe that the use of a six-year average is reasonable. A review of the data suggests that the 2013 gas expense does not represent normal annual fluctuations – rather it appears to represent an abnormal or extraordinary year. The 2013 gas expense was more than 10 times the cost in the next highest year. Abnormal or extraordinary costs should be excluded from the normalization mechanism. Therefore, in this case, I recommend that the five-year average be utilized for both electric and gas injuries and damages costs. My adjustment will result in a slight increase in electric expense but a significant drop in gas expense, as shown below:

Table 6: Injuries and Damages Expense

	Electric	Gas
2013	$135,313	$324,872
2014	$295,491	$23,907
2015	$82,249	$29,008
2016	$143,873	$5,992
2017	$202,277	$21,509
2018	$129,573	$9,318
6 Year Average	$164,796	$69,101
5 Year Average	$170,693	$17,947

These adjustments are shown in Exhibit ACC-5 (electric) and Exhibit ACC-8 (gas).

C. Incentive Compensation Expense (2.13)

Q. Please explain the Company's adjustment relating to incentive compensation.

A. The Company's adjustment restates incentive compensation to reflect a six-year average of actual incentive compensation payments. The Company claims that this treatment is consistent with Staff's methodology approved by the Commission in Order No. 07 in Dockets UE-170485 and UG-170486.[2] In addition, the Company stated that incentive compensation awards that are dependent on financial benchmarks have been excluded from its revenue requirement claim. We are recommending that 100 percent of executive officer incentive compensation expense and 50 percent of non-executive incentive compensation expense be excluded from the revenue requirement and borne by

[2] *Wash. Util. and Transp. Comm'n v. Avista Corp. d/b/a Avista Util.*, Dockets UE-170485 and UG-170486 (*Consolidated*), Order 07, Final Order (Apr. 26, 2018).

shareholders.

Q. Please describe the Company's incentive compensation programs.

A. The Company's executive incentive compensation plan includes two incentive compensation programs – a Short Term Incentive Compensation Plan (STIP) and a Long-term Incentive Compensation Plan (LTIP). The LTIP itself has two components. First, performance shares, which account for 75 percent of the LTIP, are based on financial metrics related to cumulative earnings per share and total shareholder return. Second, restricted stock units, which are based on continued service at Avista. Costs for the LTIP are not included in the Company's claim in this case, since these awards are based on financial parameters or metrics that otherwise do not necessarily benefit ratepayers.

With regard to the STIP for officers, these awards are limited to 13 individuals, as stated in the response to Public Counsel Data Request No. 33.[3] Annual salaries in 2019 for these individuals range from $242,000 to $864,000 according to the Company's workpapers. While we are recommending an adjustment to the allocation of officer salaries between the utility and non-utility operations, we are not otherwise recommending any adjustment to these underlying base salary levels.

In addition to these base salaries and the LTIP, these 13 executives are eligible for STIP awards. Sixty percent of the STIP awards for officers is based on an earnings-per-share criteria. The remaining 40 percent is based on O&M (20 percent), Customer

[3] Crane, Exh. ACC-9 (Avista Response to Public Counsel Data Request No. 33).

Satisfaction (eight percent), Reliability (eight percent), and Response Time (four percent). With regard to non-executive STIP awards, 50 percent of these awards are based on O&M costs per customer, 20 percent on customer satisfaction, 20 percent on a reliability index, and 10 percent on response time.

Q. Do you believe that the incentive compensation program costs are appropriate costs to pass through to ratepayers?

A. No, I do not. I have several concerns about including costs for these types of programs in regulated utility rates. First, with regard to Avista executives, these individuals are well compensated, even without consideration of incentive compensation awards. Moreover, incentive compensation programs proliferated as the result of tax changes that imposed limitations on the amount of compensation that was tax deductible unless such compensation was performance-based. Thus, to some extent, it appears that the growth in performance-based compensation was an attempt by companies to circumvent limitations on the tax deductibility of executive compensation. The more generous tax treatment afforded performance-based compensation was eliminated by the TCJA, and it will be interesting to see if the popularity of performance-based programs erodes with the new tax law. Third, performance-based compensation is clearly less transparent than base salary programs. Therefore, it is more difficult for ratepayers to evaluate a utility's compensation programs if incentive compensation awards comprise a significant component of total compensation.

Q. Doesn't the Company use a compensation consulting firm to benchmark its compensation programs?

A. Yes, it does. As discussed in the response to Public Counsel Data Request No. 25,[4] Avista utilizes a compensation consulting firm to benchmark its compensation relative to other companies with similar business profiles, similar revenue size and market capitalization. However, in my view, the use of such benchmarks has a detrimental effect on ratepayers as compensation costs spiral, especially at the executive level. In the case of Avista, it uses Meridian Compensation Partners as noted in the response to Staff Data Request No. 9[5] as its compensation consultant.

Q. Why do you believe that the use of benchmarking results in spiraling executive compensation costs?

A. Companies state that they must benchmark their compensation in order to be competitive. However, such benchmarking actually results in ever-increasing executive compensation levels. This is because companies generally target their compensation to the 50th percentile of companies in the proxy group selected for benchmarking. Such practices tend to escalate increases in compensation, especially for highly-paid officers. These studies compare the subject company's compensation to compensation in a broad range of other firms. Since most companies do not want to find themselves in the lower half of the benchmark group, companies that typically fall below the average raise their

[4] Crane, Exh. ACC-10 (Avista Response to Public Counsel Data Request No. 25).
[5] Crane, Exh. ACC-11 (Avista Response to Staff Data Request No. 9 (non-confidential version)).

compensation – and hence the average of the benchmark companies continually increases. This sets off a chain of events that results in ever-increasing compensation levels as additional companies must increase their compensation to avoid falling below the 50th percentile. The Commission should be particularly wary of any compensation plans that utilities attempt to justify by means of comparison to benchmark studies. It is not surprising that concurrent with the practice of benchmarking, executive compensation levels have risen dramatically over the past several years.

Q. Do you have similar concerns about incentive compensation awards for non-executive employees?

A. Yes, I do. Although the issues are a bit different, the use of benchmarking studies also means that non-executive employee salaries tend to suffer from the same upward spiral as compensation programs for executives. There is no indication that the employees of Avista are underpaid or that the Company would have difficulty attracting qualified employees in the absence of these programs. In addition, at least 50 percent of the STIP award criteria for non-executives relates to financial criteria (O&M per customer) that directly benefits shareholders between base rate case filings.

Q. What do you recommend?

A. I recommend that the Commission disallow 50 percent of incentive compensation awards for non-executive employees. The Company's employees are already well compensated and the level of service being received by Washington ratepayers does not justify the payment of additional incentive awards. I have not disallowed 100 percent of incentive compensation award costs for non-executive personnel because the Company does consider non-financial factors in the incentive compensation awards made to many of its non-executive employees. My adjustment to disallow 50 percent of the non-officer incentive compensation costs is shown in Exhibit ACC-4 (electric) and Exhibit ACC-7 (gas), Adjustment 2.13.

In addition, I recommend that 100 percent of the Company's claim for officer incentive compensation awards be denied. My adjustment to eliminate officer incentive compensation costs is also shown in Exhibit ACC-4 and Exhibit ACC-7, Adjustment 2.13.

These officers are already well compensated in their base salaries. Therefore, I believe it is appropriate to eliminate 100% of the officer incentive compensation awards reflected in the Company's filing. This increases the transparency of the compensation paid to Avista's officers for Washington ratepayers, particularly compensation paid through rates.

D. Non-Executive Salary and Wage Expense (3.04)

Q. How did the Company determine its salary and wage claim in this case?

A. The Company's methodology is described beginning on page 48 of Ms. Andrews' testimony. To develop its salary and wage claim for non-executive employees, Avista first annualized the impact of a March 2018 non-union increase and included further adjustment that was effective in March 2019. The Company did not include an increase for non-union employees for 2020.

For union employees, the Company annualized the impact of the three percent increase in 2018, and then included additional increases of three percent in 2019 and 2020. The Company's adjustments included increases of $2,181,226 for the electric utility and of $684,837 for the gas utility.

In addition to these adjustments relating to salary and wage increases, the Company also made an adjustment to reallocate labor costs that had been allocated to Hydro One activities in the test year. On July 19, 2017, Hydro One announced its plans to acquire Avista. The transaction was the subject of intense regulatory review and the acquisition of Avista by Hydro One was ultimately rejected by state regulators. Avista announced the termination of the merger agreement on January 23, 2019. During the test year, many Avista employees were involved in merger-related activities and charged their time to the Hydro One project, instead of charging or allocating those hours to normal operations, including utility projects. Now that the merger agreement has been terminated, Avista is proposing to reallocate those costs prospectively to other activities, including utility activities. The Hydro One labor adjustment increases the Company's electric expense by $255,749 and increases the Company's gas expense by $45,414.

Q. Are you recommending any adjustment to the Company's claim for non-executive labor costs?

A. Yes, I am recommending that the Company's 2020 payroll increase be eliminated from rates resulting from this case. The test year in this case ended on December 31 2018. In my view, reaching out to 2020, more than a year past the end of the test year, violates the test year matching principle. While I have included salary and wage adjustments for 2019 in my revenue requirement recommendation, reflecting labor adjustments that will occur in 2020 reaches too far beyond the end of the test year.

Q. Did the Company reach well beyond the end of the test year with regard to many of its pro forma adjustments?

A. Yes, it did. Many of Avista's expense adjustments are based on projected costs in 2020. I have attempted to consistently eliminate these 2020 increases, including the 2020 increase projected for labor costs.

Q. Are you also recommending an adjustment relating to the Hydro One activity?

A. Yes, I am. Since these employee hours were not required by the utility during the test year, there is no reason why they will be required prospectively. Avista has not demonstrated that its service suffered or that it otherwise failed to meet its obligations to ratepayers during the test year, when many employees were engaged in merger activities. Therefore, the Company has not demonstrated that these additional costs are necessary for the continued provision of safe and reliable utility service. Accordingly, I recommend that the Hydro One adjustment included by Avista be disallowed. My adjustment is shown in Adjustments 3.03 in Exhibit ACC-4 (electric) and Exhibit ACC-7 (gas).

E. Executive Labor Expense (3.04)

Q. How did the Company determine its salary claim related to executive labor costs?

A. As described on page 49 of Ms. Andrews' testimony, Avista's revenue requirement claim includes the executive base salaries approved by the Board of Directors effective March 2019. Ninety percent of these salaries was then allocated to utility operations. As noted earlier, these approved base salaries range from $225,000 to $864,000, depending on position. There are 13 positions included in the Company's claim for executive labor costs.

Q. Please describe your adjustment to executive labor costs.

A. I am not making any adjustment to the Company's claim for base executive salary levels, but I am recommending that only 78 percent of these costs be allocated to utility operations. This is the actual allocation of executive payroll costs allocated to utility operations in the test year. As previously discussed, the Company argues that now that the Hydro One merger has been terminated, costs that were allocated to the merger in the test year should be reallocated to other activities. However, ratepayers should not be the payee of last resort for these costs. If these executive hours were not needed in the test year to manage and direct utility operations, there is no reason why they would be needed prospectively. In addition, it is possible that the management of Avista will pursue another strategic partnership or merger in the future. Therefore, at Exhibit ACC-4 (electric) and Exhibit ACC-7 (gas), I have made adjustments to allocate executive labor costs (Adjustments 3.04) based on the actual test year allocations of these costs.

F. Employee Benefits Expense (3.05)

Q. What is included in Employee Benefits Expense?

A. The Company's employee benefits expense adjustment includes health insurance costs, pension costs, other post-employment benefit costs (OPEBs), and 401k costs.

Q. How did the Company determine its claim in this case?

A. Avista included 2020 estimated costs in its claim. Health insurance estimates were provided by Mercer while pension and OBEP estimates were provided by Willis Towers Watson. 401K costs were internally developed by the Company.

Q. What adjustments are you recommending to the Company's claim?

A. With regard to pension and OBEP costs, as discussed on page 52 of Ms. Andrews' testimony, the Company closed its defined benefit pension plan to all non-union employees hired on or after January 1, 2014. The Company's claims for pension and OBEP costs were based on the most recent actuarial studies when the case was filed. Avista subsequently updated its claim for pension and OBEP costs in the response to Public Counsel Data Request No. 53,[6] based on revised information provided by Willis Towers Watson. I have reflected these revised costs in my revenue requirement

[6] Exh. ACC-12 (Avista Response to Public Counsel Data Request No. 53 (non-confidential version)).

recommendation.

A defined contribution plan (401K plan) replaced the defined benefit plan for employees hired on or after January 1, 2014. In addition to the defined contribution 401K plan, Avista also matches a portion of payroll that is contributed on a discretionary basis by each participant. With regard to the 401K costs, we accepted the Company's claim for the non-discretionary contribution. Since we reflected the Company's 2019 labor costs, it is reasonable to also reflect the 2019 defined contribution costs. However, with regard to the match on discretionary contributions, I have reflected the actual test year amount in my revenue requirement recommendation.

Finally, I have utilized the actual test year level of medical insurance costs. The Company is self-insured for its share of medical, dental, and vision costs. As discussed on page 53 of Ms. Andrews' testimony:

> [f]or the past several years, actual expense has been lower than our premium cost estimates, resulting in lower costs for the Company and our customers. Some reasons could include the effects of the Company's wellness programs, the severity of flu season in a given year, the level of acute or chronic illness, or for a variety of other reasons.[7]

The Company goes on to state that it does not expect this trend to continue, but included an increase of approximately 12 percent over the actual test year costs.

The Company's post-test year medical cost adjustment is speculative and does not meet the known and measurable standard required for post-test year adjustments,

[7] Andrews, Exh. EMA-1T at 53:23 – 54:3.

especially since the Company is self-insured for medical benefit costs. Therefore, I recommend that the Company's adjustment be rejected and instead that the Commission reflect the actual test year level of costs in the revenue requirement authorized for the Company in this case. Exhibit ACC-4 (electric) and Exhibit ACC-7 (gas) reflect my recommended adjustments to employee benefit costs (Adjustments 3.05).

G. Insurance Expense (3.06)

Q. How did the Company develop its claim for pro forma insurance costs?

A. Avista reflected the 2019 pro forma insurance expense in its claim. With regard to Directors and Officers Insurance, the Company allocated 10 percent of these costs to non-utility operations.

Q. What are you recommending with regard to pro forma insurance expense?

A. I am recommending that 50 percent, instead of 10 percent, of the Directors and Officers insurance costs be excluded from the Company's revenue requirement. This is consistent with the Company's adjustment to exclude 50 percent of Directors fees and other related Directors' costs from utility rates. Directors and Officers insurance provides significant benefit to the Company's shareholders and this benefit should be recognized by a reasonable allocation of these costs to non-utility parties. Therefore, in Adjustment 3.06, I have reflected a 50 percent allocation of Directors and Officers expense to shareholders. My adjustments are shown in Exhibit ACC-4 (for electric) and Exhibit ACC-7 (for gas).

H. Information Systems/Information Technology (IS/IT) Expense (3.07)

Q. How did the Company determine its claim for IS/IT Expenses?

A. According to Ms. Andrews, the Company adjusted its test year IS/IT expenses to reflect the level of costs expected during the rate period beginning April 1, 2020. As shown on her workpapers, the Company's claim is based on projected costs that are more than 34 percent higher than the actual test year costs. Total test year costs were $11,440,101. Avista projected cost increases of $1,626,526 in 2019 and increases of another $2,298,319 in 2020. This represents total increases of $3,924,845 over the test year actual costs of $11,440,101.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I believe that once again Avista has reached too far past the end of the test year with regard to its claim for IS/IT costs. While I have accepted certain post-test year adjustments to IS/IT costs, I recommend that these incremental costs be limited to 2019 cost increases. Therefore, at Exhibit ACC-4, I have made an adjustment to Adjustment 3.06 (electric) to exclude 2020 cost increases from my revenue requirement recommendation. A similar gas adjustment is reflected in Exhibit ACC-7.

I. Property Tax Expense (3.08)

Q. How did the Company develop its property tax claim?

A. According to Ms. Andrews' testimony at page 55, the Company's claim is based on projected 2020 property tax expense. Ms. Andrews goes on to state that the property on which the tax is calculated reflects the property value at December 31, 2018.[8]

Q. What pro forma property tax level have you included in your revenue requirement recommendation?

A. I have reflected the actual test year property tax expense in my revenue requirement. The Company's post-test year claim is speculative at this time. There are many factors that impact on a utility's annual property tax expense – including plant balances, tax rates, retirements, changes in assessments, and others. In addition, while Ms. Andrews states that the Company's claim is based on property values at December 31, 2018, her workpapers indicate that the 2020 estimated property tax expenses were actually calculated based on estimated gross assessed values at December 2019, a full year past the end of the test year. Therefore, I recommend that the actual test year property tax expense be reflected in the Company's revenue requirement. My adjustment is shown in Exhibit ACC-4 (electric) and Exhibit ACC-7 (gas).

J. Capital Additions (3.10)

Q. Please describe the Company's claim for 2019 major capital additions.

A. Avista is seeking to include in rate base 20 capital projects that are projected to go into service in 2019. This request includes $84.9 million of electric projects and $26.5 million of gas projects. Approximately 27 percent of the Company's electric claim and more than 31 percent of its requested gas increase relate to post-test year capital additions.

[8] Andrews, Exh. EMA-1T at 55:12-17.

Q. What is the Company's rationale for including this post-test year plant in rate base?

A. Avista states that the Company is undertaking substantial capital investments in its electric and gas utilities "to address customer growth, replacement and maintenance of Avista's aging system, and to sustain reliability and safety."[9] The Company claims that it is necessary for the Commission to include at least certain post-test plant projects in rate base in order to mitigate regulatory lag associated with these projects.

Q. What concerns do you have regarding the Company's proposal?

A. Allowing the Company to reflect post-test year capital additions in rate base results in a serious mismatch among the components of the regulatory triad – revenues, expenses, and investment, used to set utility rates through the base rate case process. Ratesetting is based on a regulatory triad that attempts to match revenues, expenses, and rate base investment during a 12-month test year period. If any one of these components is substantially modified, then the relationship that existed during the test year is not being properly incorporated into prospective rates. While I have accepted the Company's claim to use an end-of-period rate base, which already reduces the alleged regulatory lag, including post-test year additions in rate base would unfairly benefit the Company's shareholders and would require Washington ratepayers to pay utility rates that are higher than necessary.

9 Andrews, Exh. EMA-1T at 20:10-13.

Q. Have you included any post-test year capital projects in your revenue requirement recommendation?

A. No, I have not. While the Commission has the authority to authorize the inclusion of post-test year capital additions in rate base, it is my understanding that they are not obligated to do so. I urge the Commission to reject the Company's efforts to further extend the test year by including significant amounts of post-test year plant in rate base.

Regulatory lag is not new. However, the Company is under increased pressure to grow shareholder earnings, a situation that is complicated by the fact that annual energy sales are not increasing as quickly as they did in the past. In addition, the current focus on energy efficiency and demand side management efforts puts further pressure on utility earnings. If revenues are not growing as quickly as they were in the past, utilities must seek alternative ways to grow shareholder earnings. Avista's stock dividend has grown each year over the past five years, and is currently 17 percent above 2015 levels. Moreover, Avista indicated that it expects continued growth in earnings and dividends.[10] However, given the very low interest rates we have experienced over the past several years, along with reductions in the return on equity awards made by many state regulatory commissions, utilities are focusing their efforts on increasing rate base as a means to increase shareholder earnings. To put this issue in a broader context, for most of the past century, utilities had traditionally recovered the cost of their investment in

[10] Avista Corp. Presentation, *Positioned for Performance: 2019 and Beyond, 2019 AGA Financial Forum, Fort Lauderdale, Florida, May 21-23, 2019,* http://investor.avistacorp.com/static-files/c56f1e3a-7c79-4f69-a46f-6fc5aff8f239 (last visited Oct 1. 2019).

infrastructure through base rate cases using a historic test year. Between base rate cases, utilities funded infrastructure investment that was necessary to provide safe and reliable utility service to regulated ratepayers. As plant was completed and placed into utility service, the utility began to record depreciation expense, which reflected recovery of the investment over its useful life. When new utility rates were established in a subsequent base rate case, the utility began to recover its annual depreciation expenses from ratepayers. In addition, the new utility rates also reflected a return on the undepreciated investment included in rate base. It was up to the utility to decide when it would file for a base rate increase. Between base rate cases, utility shareholders took the risk of under-earning but shareholders also benefitted from any overearnings during this period.

Contrary to economic theory and good ratemaking practice, allowing utilities to include speculative post-test year adjustments in rate base increases shareholder return while significantly reducing risk. Shareholder return is directly proportional to the amount of investment made by the utility. Since shareholders benefit from every investment dollar that is spent by a utility, the Company's proposal to include post-test year plant in rate base will increase overall return to shareholders and accelerate recovery of that return.

The Commission should not lose sight of the fact that the there are two primary ways that shareholders can increase their returns – by increasing the rate base on which a return is earned or by increasing the rate of return that is applied to that rate base. Given the low interest rate environment, regulatory commissions are unlikely to increase return on equity awards in the near future. In fact, in this case, Public Counsel is recommending that the Commission adopt a return on equity that is lower than the currently authorized return, which was the result of a stipulation among the parties in the Company's last rate case. Given the strong possibility that the return on equity award will not be increased by the Commission, then Avista must increase its earnings by increasing the amount of investment on which it can earn a return. Every dollar of investment made by Avista results in greater potential earnings for shareholders.

If Avista can increase its investment <u>and</u> accelerate the return of that investment, then shareholders benefit in two ways while ratepayers are left facing higher utility bills.

Q. What is the impact of the Company's proposal on its customers?

A. Pursuant to traditional ratemaking practice, plant additions are only included in rate base, and therefore in utility rates, once the plant is completed and placed into service and the Company files a subsequent base rate case. Allowing post-test year plant additions to be included in rate base requires Washington ratepayers to bear higher utility costs sooner than they otherwise would. The Company's proposed mechanism would shift risk from shareholders, where it properly belongs, to ratepayers without any commensurate reduction in the Company's return on equity.

Q. What do you recommend?

A. I recommend that the Commission reject Avista's proposal to include significant amounts of post-test year capital expenditures in rate base. Therefore, in Exhibit ACC-4, I have eliminated Adjustment 3.10 from the Company's electric revenue requirement. I have included a similar gas adjustment in Exhibit ACC-7.

K. Operating and Maintenance ("O&M") Expense Offsets (3.11)

Q. Please describe the Company's adjustment relating to O&M offsets.

A. As noted above, Avista included significant post-test year capital expenditures in its rate base claim in this case. Avista also included a small amount of operating expense reductions to reflect on-going cost savings relating to these post-test year capital projects. Since I am recommending that post-test year capital expenditures be excluded from the Company's rate base claim, it is necessary to also eliminate any operating and maintenance expense savings associated with these projects. Otherwise, ratepayers would benefit from an expense reduction without paying for the underlying capital investment that made the expense reduction possible. Accordingly, at Exhibit ACC-4 and Exhibit ACC-7, I have made adjustments to eliminate the electric and gas O&M offsets included by Avista in its revenue requirement claim (Adjustments 3.11).

L. Colstrip Amortization (3.13)

Q. Please describe the Company's proposal for recovery of Avista's investment in Colstrip Units 3 and 4.

A. Colstrip Units 3 and 4 are coal-fired generating units that currently have remaining useful lives of 2034 and 2036 respectively. In an effort to reduce emissions from coal-fired generating stations, the parties have been exploring efforts to accelerate the shutdown of

Colstrip Units 3 and 4 and to provide for recovery of stranded investment by Avista. This issue was addressed in two prior proceedings – The Hydro One acquisition proceeding (U-170970) and the recent Depreciation proceeding (UE-180167). The proposal put forth by the Company in this case is similar to the agreements reached in the Hydro One and Depreciation proceedings regarding Colstrip.[11]

Avista is proposing to retain the current level of depreciation expense, approximately $4.533 million, for the Colstrip units in utility rates. The unrecovered Colstrip investment, including additional capital investment associated with the units, would be amortized as a regulatory asset over 33.75 years. The amortization period of 33.75 years coincides with the period of time over which the Company is amortizing the plant-related excess deferred income taxes that resulted from the Tax Cut and Jobs Act of 2017 (TCJA). In addition, Avista is proposing that the non-plant EDIT balance of $11.709 million be used to reduce the unrecovered investment in Colstrip effective with this rate case.

Q. How much is the estimated unrecovered investment in Colstrip?

A. As shown in Table No. 8 of Ms. Andrews' testimony, the undepreciated balance of Colstrip at March 31, 2020, is estimated to be $105.0 million. This includes both the net book value of the Colstrip investment as well as the estimated asset retirement obligation. It also includes capital additions through 2019. The Company estimates that it will collect

[11] The Hydro One acquisition was terminated and the Commission chose not to resolve the Colstrip depreciation issue in the Depreciation case, deferring the issue to this rate case.

$35.135 million in additional depreciation expense from ratepayers by December 31, 2027, which would leave an unrecovered balance of $69.865 million. The actual unrecovered balance would also include capital additions that are made by the Company between 2019 and the date that the units terminate operations.

Q. Have there been any new developments with regard to the Colstrip depreciation issue?

A. Yes. In the Depreciation case, the parties had agreed to a depreciation schedule that accelerated the remaining useful life of the Colstrip units to December 31, 2027. However, in May 2019, legislation was enacted that requires the removal of coal-fired generation from rates by 2025. As noted on page 74 of Ms. Andrews' testimony, the Company estimates that accelerating the termination date of the Colstrip units from 2027 to 2025 will result in an additional revenue requirement increase of approximately $236,000.

Q. Are you recommending any adjustments to the Company's proposed treatment for recovery of the Colstrip investment?

A. I am not recommending any adjustment to the general plan for recovery of the Colstrip investment. While I generally believe that shareholders should bear the risk of stranded costs, I recognize that in this case the shut-down of the units has been mandated by legislation. While it may still be appropriate for shareholders to bear some of these costs, at this time I am not recommending any adjustment to the Company's plan to amortize the unrecovered investment over 33.75 years.

However, I am proposing two modifications to the Company's proposal. First, given that the legislation requires the units to be removed from rates by 2025, I recommend that the regulatory asset be revised to reflect the fact that future depreciation will cease at December 31, 2025, two years earlier than the December 31, 2027, date reflected in the Company's filing. The Company indicated in its testimony that it would update its filing to reflect the impact of the further acceleration from 2027 to 2025. Any proposal authorized by the Commission in this case should reflect the legislatively-mandated date of 2025.

Second, I recommend that the non-plant, unprotected EDIT be returned to ratepayers over a five-year period, instead of used to offset some of the Colstrip investment.

Q. What is the basis for your recommendation that the EDIT should be returned to ratepayers over five years?

A. There are several reasons for my recommendation. First, the EDIT that is at issue is unrelated to the Colstrip plant investment. Therefore, there is no rationale for offsetting the recovery of the Colstrip investment with the EDIT credit. The Company argues that amortizing the non-plant, unprotected EDIT over 33.75 years addresses the issue of intergenerational equity. But Avista is incorrect. The unprotected EDIT balances are not related to plant and therefore were not necessarily generated over a long period of time.

Therefore, there is no reason to delay the return of these funds to ratepayers. While the protected, plant-related EDIT balances do relate to long-term plant assets, and therefore the issue of intergenerational equity may apply with regard to protected EDIT, the same is not true of the unprotected EDIT balance.

Moreover, the unprotected EDIT was mandated to be returned to ratepayers as a result of the TJCA of 2017. By the time that new rates are effective in this case, the ratepayers that paid these excess taxes will have already waited more than two years for their refunds. The longer these refunds are delayed, the more likely it is that the customers who ultimately benefit will not be the same customers that actually paid the excess taxes initially.

In addition, the amount of plant-related, protected EDIT already exceeds the total amount of the Colstrip unrecovered investment. As noted on page 77 of Ms. Andrews' testimony, Avista has an electric plant EDIT regulatory liability of $208.3 million, significantly higher than the projected unrecovered Colstrip investment.[12] There is no need to apply additional EDIT to this investment instead of returning these amounts promptly to ratepayers, especially given the fact that the unprotected EDIT does not relate directly to the Colstrip investment – or to any plant investment.

Third, the EDIT balance is already known, while the unrecovered Colstrip investment balance is not. While the Company included Colstrip additions through 2019

[12] Andrews, Exh. EMA-1T at 77:20-23.

in its filing, there is likely to be additional plant investment required between 2019 and the date that the Colstrip units are actually shut down. Avista will no doubt seek recovery of this additional investment as well, to the extent that these investments are deemed prudent by the Commission. Since the amount of the total unrecovered investment is not yet known, there will be greater transparency if the issue of the Colstrip depreciation is addressed separately from the EDIT refunds. For all these reasons, I recommend that the Commission find that the unprotected EDIT balance should be returned to ratepayers over a period of no more than five years instead of being applied to the recovered investment in Colstrip.[13]

Q. Didn't Public Counsel agree to use the unprotected EDIT to offset the costs of the unrecovered Colstrip investment in previous cases?

A. Yes, Public Counsel agreed to this treatment in the Hydro One Merger (Docket U-170970) and 2018 Depreciation proceedings (Dockets UE-180167 and UG-180168). In both instances, Public Counsel's agreement was part of a comprehensive stipulation. In those cases, Public Counsel evaluated the stipulation in its entirety and concluded that the various provisions resulted in a reasonable resolution of those proceedings. However, the Hydro One merger was terminated, and the Commission chose not to address the Colstrip depreciation provision in the Depreciation case. Therefore, it is appropriate to reexamine this issue in this base rate case, given the facts that are currently before the Commission.

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[13] I would not oppose returning these amounts to ratepayers over a period of less than five years, if the Commission determined that a faster refund was appropriate.

Q. How did you quantify your adjustment?

A. My adjustment is quantified in two parts. First, I have modified the Company's Adjustment 3.13 on Exhibit ACC-4 to reflect acceleration of the depreciation life from 2027 to 2025, and removal of the EDIT offset of $11.709 million, thereby increasing the balance to be amortized by a similar amount.

In addition, I have added another electric adjustment to reflect the return of the non-plant, unprotected EDIT balance (along with accrued interest) to ratepayers over five years. Once the amortization begins, I recommend that interest stop accruing and that instead the Company reflect a regulatory liability for the unamortized balance, less the current year of amortization that is being returned to ratepayers through the cost of service. This will provide ratepayers with carrying charges on the unamortized EDIT balance at the same rate as is being used to compensate shareholders for the unamortized Colstrip investment. My adjustment is shown in Adjustment 3.15 in Exhibit ACC-4.

M. Summary of Revenue Requirement Recommendation

Q. What is the result of Public Counsel's revenue requirement recommendations in this case?

A. Public Counsel's recommendations result in an electric revenue increase of $11.022 million (versus the Company's $45.775 million request) and a gas revenue increase of $3.762 million (versus the Company's $12.935 million request). Public Counsel's proposed rates would go into effect April 1, 2020.

V. PROPOSED MULTI-YEAR RATE PLAN

Q. Is the Company requesting authorization for a multi-year rate plan in this case?

A. Yes, Avista is requesting Commission approval of a two-year "rate plan". In addition to electric and gas base rate increases of $45.8 million and $12.9 million respectively, the Company is also seeking additional increases effective April 1, 2021 ("Year 2"), of $18.9 million and $6.5 million. These year two increases would result in revenue increases of 3.46 percent and 6.05 percent for electric and gas respectively, in addition to the 9.12 percent and 13.80 percent increases being requested for Year 1. Thus, Avista is requesting total increases over two years of 13.26 percent and 19.99 percent.

Q. What is the basis for the Company's request?

A. Avista states that authorizing a two-year rate plan will:

- Change the cycle of base rate adjustments from the middle of winter to April 1st, after the end of the winter heating season, eliminating a base rate increase in the middle of the heating season.
- Reduce the burden on all stakeholders of processing a base rate case every year.
- Provide a degree of predictability of retail rates for customers for the next two years.
- Provide an incentive for Avista to manage its costs in order to earn its authorized return during the rate period.[14]

[14] Direct Testimony of Dennis P. Vermillion, Exh. DPV-1T at 6:11-22.

Q. How did Avista determine its proposed year two increases?

A. As shown in Table Nos. 4 and 5 to Ms. Andrews' testimony, Avista's Year 2 increases are based on the 2014-2018 growth rates in four categories – Operating Expenses, Depreciation/Amortization, Taxes Other Than Income, and Net Plant After ADFIT.[15] Avista weighted each of these growth rates by the percentage that each category contributed to the revenue requirement – effectively resulting in a weighted growth rate. In determining the Operating Expense growth rates, Avista included an "efficiency" adjustment of 30 basis points for each utility.

Q. Please comment on Avista's argument that the multi-year rate plan will benefit customers by eliminating a base rate increase in the middle of the winter heating season.

A. Avista does not need to implement a multi-year rate plan in order to change the effective date of new rates. Avista currently has the ability to time its rate case filings so that the effective date of new rates will not fall within the middle of the winter heating season. Accordingly, I fail to see how the multi-year rate plan is necessary in order to impact the effective date of new rates.

[15] Andrews, Exh. EMA-1T at 63.

Q. Please comment on Avista's position that the multi-year rate plan will reduce the regulatory burden on all stakeholders.

A. Avista's argument is a common one for utilities proposing alternatives to the traditional regulatory framework. Utilities use the goal of reducing the frequency and cost of base rate case filings as a frequent argument in support of a variety of alternative ratemaking mechanisms. While I support efforts to reduce the frequency of base rate cases, and to reduce the costs of litigating those cases, the answer is not to simply burden ratepayers with automatic annual increases. That is truly a case of the tail wagging the dog. Similarly, the costs involved in processing base rate case filings should not be used as an excuse to forego the regulatory process and instead provide for automatic rate increases. The ratepayers of Washington State deserve better.

While the costs of litigating base rate increases have, in some cases, become excessive, these costs are a fraction of the savings that typically result from active participation in a base rate case by interested parties. Regulatory commissions have the responsibility to ensure that all costs incurred by the utility are reasonable – and this includes rate case costs. Some regulatory commissions require a sharing of rate case costs between shareholders and ratepayers in recognition of the fact that rate cases also provide benefits to shareholders. However, even without a sharing of rate case costs, for a utility the size of Avista, the cost savings resulting from a scrutiny of the filing and active participation of the parties are likely to be far greater than the rate case costs incurred by the utility.

Finally, it is the role of the regulatory commission to regulate. That is why they were established and that is what they are supposed to do. Regulatory commissions should not abrogate their ratemaking responsibility because they believe that rate cases are being filed too often.

Q. Does a multi-year rate plan provide a degree of predictability of retail rates for customers for the next two years?

A. Yes, however, I do not view the certainty of a rate increase in year two as a particular benefit for ratepayers. While it is helpful for ratepayers to know how much their utility rates will be in the future, it is even more helpful if they know that their utility rates are based on the lowest reasonable costs necessary for the utility to provide safe and adequate service, and to provide the opportunity for the utility to earn a reasonable return for its shareholders. Certainty in and of itself should not be the goal of any regulatory body. Instead, the Commission should ensure that the rates charged to Washington customers are appropriate.

Q. Does the multi-year rate plan provide an incentive for Avista to manage its costs in order to earn its authorized return during the rate period?

A. The degree to which a multi-year rate plan provides an incentive for Avista to manage its costs depends upon the details of the plan. I do not believe that guaranteeing the Company significant rate increases in Year 2 provides much of an incentive to control costs. The Company would have more of an incentive to control costs if the regulatory commission froze rates for some period of time. Continuing to utilize a historic test year and limiting post-test adjustments are other good ways to provide an incentive for utilities to control costs between base rate case filings.

Q. Do you believe that the multi-year rate plan as proposed by Avista meets the stated objectives of the plan?

A. No, the multi-year rate plan is not necessary in order to change the effective date of new rates, it is not a good way to control either the frequency or costs of base rate cases, it is not beneficial to ratepayers in terms of predictability, and it does not provide an adequate incentive to control costs.

Q. Does the Company's proposal constitute a comprehensive multi-year rate plan?

A. No, I do not believe that the term "multi-year rate plan" should even apply to Avista's proposal in this case. Instead, Avista's proposal is simply a mechanism to receive an automatic and substantial rate increase two years in row without the need to demonstrate its actual need in year two. This is not a "plan" at all, but rather just an additional increase that would be imposed on ratepayers without justification.

Q. Should the Commission approve the Company's proposal for an additional rate increase in year two?

A. No, I recommend that the Commission reject the Company's proposal in this case. If the Commission believes that a new regulatory framework is required for utilities in Washington, it should thoroughly analyze alternative proposals and ensure that any new regulatory framework meets its stated objectives and goals. I understand that there is an ongoing investigation whereby alternative forms of regulation are being considered by the Commission. That proceeding is the appropriate forum for an evaluation of whether any multi-year rate plan should be adopted and if so, how such a plan should be structured. The testimony of Mr. Dahl discusses this issue further.

Q. What are some criteria that the Commission should consider in evaluating alternatives to the traditional regulatory framework?

A. In return for receiving a monopoly franchise to provide utility service, utilities should charge rates that are cost-based, and those costs should be the lowest reasonable costs to provide safe and adequate service. Rates should not be based on general inflationary trends that may bear no relationship to the actual costs of the utility. In addition, rates should not be based on speculative costs, but rather should be based on costs that are known and measurable. Ratepayers should not be paying for investment until such time as the investment is in-service and providing benefits to ratepayers. Finally, regulatory commissions should never lose sight of the fact that regulation is supposed to be a substitute for competition. These basic guidelines have served both utilities and their customers well in the past, and any alternative mechanism that may be adopted by the Commission should seek to retain these basic regulatory principles.

VI. PROPOSED REVENUE DECOUPLING MECHANISM

Q. Please summarize the Company's revenue decoupling mechanism.

A. As described in Mr. Ehrbar's testimony at page 4, the Commission initially approved a decoupling mechanism for Avista in November 2014.[16] The decoupling mechanism was part of a settlement agreement in Docket Nos. UE-140188 and UG-140189. The signatories to that settlement agreement agreed to a revenue decoupling mechanism for a period of five-years, from January 1, 2015, through December 31, 2019. The revenue decoupling mechanism was subsequently extended by agreement of the parties through April 1, 2020, or until the end of this general rate case, whichever occurs first.

The current decoupling mechanism is a form of per customer decoupling. Avista's actual average revenue per customer (excluding customer charges and power supply/gas costs) are compared with an authorized average revenue per customer from the last base rate case. Deviations between actual average revenue and authorized average revenue per customer, multiplied by the average number of customers, are then either charged to, or credited to, Avista's ratepayers in a subsequent year. The current mechanism is capped at a three percent annual rate adjustment. The decoupling mechanism is also subject to an earnings test. If Avista's actual earnings exceed the authorized return, then 50 percent of the overage is refunded back to ratepayers.

[16] Direct Testimony of Patrick D. Ehrbar, Exh. PDE-1T at 4:15-21.

Q. What modifications to the revenue decoupling mechanism is the Company proposing in this case?

A. In this case, the Company is proposing to extend a revenue decoupling mechanism for an additional five-year period, from April 1, 2020, to March 31, 2025. The Company is proposing further modifications:

- Changes in the costs considered in the decoupling mechanism associated with new customers between base rate case filings,
- Change in the effective date of the decoupling tariff from November 1 to August 1,
- Implementation of an annual true-up to reflect the shaping of actual usage during the year,
- Extension of the natural gas reporting requirement from 45 to 60 days, and
- Approval of a natural gas conservation target of five percent, with penalties.

Q. Do you generally support revenue decoupling mechanisms?

A. No, I do not, for the following reasons. Ratemaking was established as a substitute for competition and designed so that utilities would have an opportunity, but not a guarantee, to earn the return on capital awarded in rates. If revenues are trued-up for fluctuations in actual sales, then the utility is approaching a guaranteed rate of return. Traditional regulation bases rates on normal conditions with the understanding that in some years, a utility may over-earn its authorized return and, in some years, it may under-earn. The utility can file a rate case if it believes it will under-earn in future periods. If the risk of sales volatility is eliminated, then only expenses, often controllable by the utility, can significantly move the bottom-line earnings results. Regulation is supposed to be a substitute for competition. In a competitive market, companies are not guaranteed a certain revenue stream or profit. Fundamentally, I do not believe that such a guarantee should be provided to utilities either.

I also believe that decoupling is generally a detriment to ratepayers, especially residential ratepayers. With a decoupling mechanism, a utility has less incentive to be attentive to its business. If revenues are artificially maintained between base rate cases, then the management of a utility can grow inattentive to certain aspects of its business, knowing that its bottom line is largely cushioned by a guarantee of revenues. With decoupling, a utility can be less concerned with the absolute price of service, since decreases in consumption due to that price will no longer impact the Company's bottom line. When a utility has no incentive to contain costs, it may devote very little attention to providing utility service at the lowest reasonable cost. Ratepayers should pay for attentive management, not cosseted management that is immune from the consequences of its own decision-making.

In addition, decoupling mechanisms add another element of uncertainty to utility rates, since ratepayers may be responsible for additional costs that will be imposed in subsequent years due to usage from a prior year. From the ratepayers' perspective, decoupling provides a disincentive to conserve because rates go up the more they conserve - even if the Company is already earning its authorized rate of return. Therefore, ratepayers will see higher rates as their conservation efforts increase. Decoupling also shifts costs among consumers. Assume a particular customer does not conserve and provides the targeted level of revenue. This customer will still be responsible for paying the surcharge based on the usage of other customers. Thus, additional ratepayer charges, in the form of decoupling adjustments, are possible regardless of the actions of any particular customer. Finally, decoupling mechanisms shift all revenue risk onto ratepayers.

Q. Given your position, are you recommending that the Commission terminate a decoupling mechanism for Avista?

A. No. In spite of my objections to decoupling mechanisms in general, in this case, I recognize that the Commission has previously authorized a decoupling mechanism for Avista. I also recognize that the Commission has authorized decoupling mechanisms for other Washington utilities. Therefore, in this case, my examination will focus on whether the Company's revenue decoupling mechanism meets the objectives of the Commission and whether improvements to the current mechanism will provide a better balance between the goals of the Commission and ratepayer interests.

Q. What were the objectives of the Commission in authorizing a revenue decoupling mechanism for Washington State utilities?

A. The Commission indicated that the purpose of the decoupling mechanism was to promote conservation. As it stated in its *Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets*, decoupling was intended to remove barriers to utilities acquiring and encouraging all cost-effective conservation.[17]

Q. Does the current decoupling mechanism meet this goal?

A. No, the current mechanism is far broader than simply compensating the utility for sales lost to energy efficiency programs. In fact, Avista acknowledges that weather variations, rather than energy efficiency programs, are a major factor in revenue fluctuations for which it is compensated through the revenue decoupling mechanism. In fact, the Commission has consistently permitted decoupling adjustments for all revenue variances without requiring any showing that such variances were related to energy efficiency program.

In addition, the current revenue decoupling mechanism overcompensates the utility for the impact of energy efficiency programs because it allows the utility to recover more than its authorized revenue requirement as the number of utility customers

[17] *In the Matter of the Wash. Util. and Transp. Comm'n's Investigation into Energy Conservation Incentives,* Docket U-100511, Report and Policy Statement on Regulatory Mechanisms, Including Decoupling, to Encourage Utilities to Meet or Exceed Their Conservation Targets (Nov. 4, 2010).

increase. At the same time, the current mechanism does not result in making the utility whole for its authorized revenue requirement if customers decline. In either case, the current earnings test permits the Company to retain excess earnings even if ratepayers are being charged a decoupling adjustment.

Q. Can you provide an illustrative example?

A. Assume that the Commission authorizes a revenue requirement (excluding customer charges and energy costs) of $100,000,000 and that the Company has 200,000 customers. This results in per customer revenue of $500. If the number of customers drops to 190,000, then the total decoupled revenues collected by the utility will be $95,000,000, resulting in a short-fall of $5,000,000. If one assumes that the decoupling mechanism is pegged to fixed costs, then the Company will still be short by $5,000,000.

If, on the other hand, customers increase to 210,000, then the decoupling mechanism will ensure that the Company collects $105,000,000. Again, if one assumes that the Company's fixed costs are $100,000,000, then shareholders will experience a windfall of $5,000,000. In either case, the current decoupling mechanism fails to achieve the stated goal of the Commission, i.e., to protect the Company from shortfalls due to energy efficiency programs. In addition, the current mechanism allows Avista to charge ratepayers, regardless of energy efficiency savings, even if the Company is exceeding its authorized rate of return.

Q. What are the most significant issues with the current mechanism?

A. One of the most significant issues is that the goal of the mechanism is not clearly stated. Therefore, it is very difficult to evaluate whether the Company's current and proposed mechanisms meet the intended goal. If the revenue decoupling mechanism is intended to compensate the utility for sales lost through energy efficiency programs, then there should be some nexus between energy efficiency programs and the decoupling adjustments. That nexus does not exist currently. Alternatively, if the revenue decoupling mechanism is intended to ensure that the Company recovers all of its fixed costs regardless of sales, the current mechanism similarly fails to meet that goal.

Q. Please explain the failure of the current mechanism to compensate the utility for sales lost to energy efficiency programs.

A. Adjustments pursuant to the decoupling mechanism are not tied to verified energy savings resulting from energy efficiency programs. There is simply no direct relationship between energy savings from energy efficiency programs and adjustments under the mechanism. If, as purported, the decoupling mechanism is intended to compensate the utility for lost sales due to energy efficiency, then the mechanism is failing to achieve that goal.

Q. Is the Company legislatively-mandated to pursue energy efficiency programs regardless of whether it has a revenue decoupling mechanism?

A. Yes, it is. As acknowledged by Mr. Ehrbar at page 9 of his testimony, the Energy Independence Act (EIA), which passed as a ballot measure in 2006, requires electric utilities "to pursue all available conservation that is cost-effective, reliable, and feasible."[18] Therefore, the Company is obligated to pursue cost-effective energy efficiency opportunities regardless of the impact on its financial results beginning in 2010.

Q. Please explain the failure of the current mechanism to compensate the utility for deviations from its authorized revenue requirement.

A. If, on the other hand, the intent of the Commission was to permit the Company to recover the authorized revenue requirement, then again the decoupling mechanism falls short. The mechanism is not tied to the authorized revenue requirement, but rather to the average revenue per customer. If customers decline, then the decoupling mechanism will not result in the utility actually recovering its authorized revenues. This means that if all of the costs included in the mechanism are fixed costs, as assumed, then the Company will indeed fail to be adequately compensated. Alternatively, if customers increase, then the decoupling mechanism will allow the Company to recover more than its fixed cost. Either way, there is a mismatch between the costs that are intended to be recovered

[18] Ehrbar, Exh. PDE-1T at 9:10-14.

pursuant to the mechanism and the actual recovery resulting from decoupling. This is due to the basic underlying flaw in design of the Avista mechanism.

Q. What is the underlying flaw in the current design?

A. First, as noted, the intended objective is of the current revenue decoupling mechanism is not clear. Second, the current mechanism does not properly consider the extent to which costs are fixed versus variable. Third, the current mechanism allows the Company to retain higher than authorized earnings even as it charges ratepayers for lost sales.

Q. Please describe your concerns regarding fixed versus variable costs.

B. Utilities generally argue that it is the nature of fixed costs that create the disincentives for energy efficiency. Since most costs are fixed, then every sale lost to energy efficiency programs results in a utility failing to recover its fixed costs, or so the conventional wisdom goes. If one accepts the argument that energy efficiency programs result in the utility failing to recover its fixed costs, then a regulatory commission should ensure that fixed costs are in fact recovered when sales are lost to energy efficiency. But the current program does not necessarily achieve that objective – for two reasons.

First, as indicated, the current program provides an adjustment for usage deviations that may have nothing to do with energy efficiency programs. The decoupling adjustment is calculated completely independently from any energy efficiency impacts. Second, the current per-customer mechanism can still result in a utility failing to recover its fixed costs – at least as fixed costs are identified by the mechanism.

Under the current mechanism, all costs except for those recovered through the customer charge and power supply/energy charges are treated as a hybrid of fixed and variable. Note that this hybrid is not the same as recognizing that certain costs are fixed and certain costs are variable. Instead, the current mechanism essentially treats all costs (except for those recovered from customer charges and energy charges) as fixed per customer, but variable overall. The mechanism is intended to result in a fixed amount of revenue per customer, but not a fixed amount of total revenue. Therefore, the utility can (and will) over-recover or under-recover its authorized revenue requirement, depending on changes in the number of customers between base rate case.

Q. Do the Company's proposed changes to the decoupling mechanism address the concerns expressed above?

A. One of the modifications suggested by the Company is an attempt to address the issue of fixed versus variable costs. The Company is proposing that adjustments for new customers would be more limited in scope than adjustments for existing customers. Specifically, the Company is proposing that the electric decoupling adjustments would exclude costs related to the Production and Transmission functions from adjustment under the revenue decoupling mechanism. It is also proposing that decoupling adjustments for the gas utility would exclude costs related to fixed production and underground storage. In proposing these changes, Avista pointed to concerns raised by Staff in the Idaho jurisdiction, who stated that "certain types of investments are "lumpy" and may not actually be required to serve new customers in between general rate cases."[19] In other words, the true fixed costs will be recovered through decoupling adjustments tied to "existing" customers, i.e., customers authorized in the last base rate case. The implication is that additional costs related to new customers are variable, and not fixed.

While this revision would more closely align recovery with the actual revenue requirement authorized in the last case, it presents additional problems. First, the assumption is that the additional costs being excluded for new customers are truly fixed and are therefore already being recovered from existing customers. However, this proposal is based on a rather broad-brush view of fixed versus variable costs, and not on a detailed examination of which costs in the authorized revenue requirement are fixed versus variable. It is likely the costs attributable to new customers under the new proposed mechanism would still overstate the incremental impact of adding additional customers. For example, there are many administrative and general costs that are undoubtedly fixed, but would still be subject to adjustment under the Company's revised proposal. Officer compensation is one excellent example. Therefore, while the proposed change is an improvement from the current model, it still allows the Company to recover more than the revenue requirement authorized in the last case, and also still permits recovery of certain costs that are almost certainly already being recovered from "existing" customers.

[19] Ehrbar, Exh. PDE-1T at 25:16-18.

Q. What do you recommend?

A. First, I recommend that the Commission determine, and clearly stated, the intent for which any revenue decoupling mechanism is intended. Is the decoupling mechanism intended to compensate the utility for sales lost to energy efficiency programs? If so, then the Commission should authorize a mechanism that ties decoupling adjustments specifically to verified energy savings (lost sales) from approved energy efficiency programs. Each year, the Company should be required to demonstrate verifiable savings relating to electric and gas energy efficiency programs in order to impose a revenue decoupling adjustment on ratepayers. Adjustments should be limited to compensating utilities for changes in sales due solely to energy efficiency programs.

If, on the other hand, the Commission decides that the decoupling mechanism should instead ensure the Company recovers its total authorized revenue requirement, then the Commission can simply reconcile actual revenue by Rate Class (excluding customer charges and energy charges) with total authorized revenue per class. This would ensure that the Company does indeed recover its entire authorized revenue requirement, including both fixed and variable costs, but eliminates the potential for revenue windfalls as is currently in place under the current decoupling mechanism.

Q. Are there other advantages of each of these alternatives?

A. Yes, both proposals are relatively straight-forward to administer and are much less complex than the Company's proposed mechanism. Although the first alternative would require the determination of verifiable energy savings, which can be a controversial exercise, once a method for establishing energy savings was determined then the calculation of any decoupling adjustment would be relatively straightforward. This scenario has the advantage of directly tying decoupling adjustments to energy efficiency results – which was the stated goal of the Commission in its Policy Statement.

The second alternative – tying decoupling adjustments to the total authorized revenue requirement in the last base rate case (excluding customer charges and energy charges), is even more straightforward to administer. This scenario has the additional advantage of directly linking the revenues recovered each year to the level of revenue authorized by the Commission. While this approach still suffers from other flaws – such as shifting the risk of revenue recovery from shareholders to ratepayers – it does at least limit adjustments to the overall revenue requirement authorized in a base rate case review.

Q. If the decoupling mechanism is tied to total authorized revenue, instead of revenue per customer as proposed by Avista, isn't it possible that the Company will not recover its incremental costs of serving new customers?

A. The revenue decoupling mechanism was never intended to make a company whole for all costs associated with serving new customers. In fact, it was never intended to make a company whole for any costs because costs are not generally reviewed as part of a revenue decoupling mechanisms. It is only through a base rate case that a comprehensive analysis of revenues and costs takes place, and that is the appropriate forum for determining if a utility's rates are sufficient to recover the utility's costs, including the costs of serving new customers. Moreover, the utilities argue that revenue decoupling is necessary in order to recover fixed costs. But if costs are truly fixed, then by definition they are not impacted by changes in the number of customers.

Q. Why is it important to link any decoupling mechanism to the level of revenue authorized in a base rate case review?

A. The determination of an appropriate revenue level requires a complex and comprehensive analysis of all factors impacting on the financial results of a regulated utility. The current decoupling mechanism used for Avista, and to a lesser extent the revised mechanism proposed by the Company in this case, imposes rates on Washington ratepayers that are higher than those authorized by the Commission. Moreover, ratepayers can be charged a decoupling surcharge even if the Company earns its authorized rate of return.

Q. Doesn't the decoupling mechanism include an earnings test?

A Yes, but the current earnings test does not prevent the Company from earning more than its authorized return. Instead, the current test institutionalizes overearnings. The current mechanism results in Avista retaining excess earnings and at the same time collecting a surcharge from ratepayers. As shown in the response to Public Counsel Data Request No. 104,[20] in 2015, the Company's electric earnings exceeded its authorized return by eight basis points, or by $1.11 million. However, the decoupling mechanism resulted in a

[20] Crane, Exh. ACC-13 (Avista Response to Public Counsel Data Request No. 104).

charge to residential ratepayers of $6,485,021. While this charge reflected a 50 percent sharing of the excess earnings with ratepayers, there is no rationale for surcharging customers for any revenue shortfall while at the same time the Company is earnings more than its authorized return. In 2016, the Company surcharged residential ratepayers $10,913,950,[21] even though it earned 22 basis points above its authorized rate of return. A decoupling mechanism that permits over $17 million in revenue surcharges when the Company is earning more than its authorized rate of return is certainly flawed. Therefore, if the Commission continues some form of revenue decoupling, it should also apply an earnings test and it should prohibit any decoupling adjustments if the Company has earned its authorized rate of return.

Q. Please summarize your recommendations regarding the proposed decoupling mechanism.

A. Neither the current nor proposed revenue decoupling mechanism meet the stated objectives of the Commission – to compensate the utility for sales lost to energy efficiency programs. Therefore, the Commission should first determine if this is still the goal of Avista's decoupling mechanism. If so, then the Commission should limit decoupling adjustments to verified energy savings resulting from energy efficiency programs.

[21] Ehrbar, Exh. PDE-1T at 14, Table 4.

If, in the alternative, the Commission's intent is to guarantee that the Company recovers its authorized revenue requirement each year, then it should link revenue decoupling adjustments directly to the revenue requirement authorized in the most recent base rate case (excluding customer charges and power supply/gas costs). In no event should the Commission authorize revenue decoupling adjustments that result in Avista recovering more than its authorized revenue requirement, which Avista's proposed mechanism allows. The Commission should not authorize decoupling adjustments if Avista has met or exceeded its authorized rate of return in any given year. Finally, if the Commission authorizes some form of revenue decoupling for Avista, then I recommend that it limit this authorization to a five-year period and retain the three percent cap on annual rate adjustments.

Q. Does this complete your testimony?

A. Yes, it does.