Service Date: April 26, 2018

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

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<tr><td>WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION, d/b/a AVISTA UTILITIES,

Respondent.</td><td>DOCKETS UE-170485 and UG-170486 (consolidated)

ORDER 07</td></tr>
<tr><td>In the Matter of the Petition of

AVISTA CORPORATION, d/b/a AVISTA UTILITIES,

For an Order Authorizing Deferral of Federal Income Tax Expenses for the Effects of Revisions of the Federal Income Tax Code Upon Avista's Cost of Service.</td><td>DOCKET UE-171221 (consolidated)

ORDER 02</td></tr>
<tr><td>In the Matter of the Petition of

AVISTA CORPORATION, d/b/a AVISTA UTILITIES,

For an Order Authorizing Deferral of Federal Income Tax Code Upon Avista's Cost of Service.</td><td>DOCKET UG-171222 (consolidated)

ORDER 02

FINAL ORDER REJECTING TARIFF SHEETS, APPROVING PARTIAL SETTLEMENT, AND DIRECTING COMPANY TO FILE TARIFF SHEETS IN COMPLIANCE WITH THIS ORDER</td></tr>
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Synopsis*: The Commission rejects the tariff sheets filed by Avista Corporation, d/b/a Avista Utilities (Avista or the Company) on May 26, 2017, including the Company's proposed multi-year rate plan. The Commission, considering the full record, authorizes and requires Avista to file tariff sheets that will result in an increase in revenue of approximately $10.8 million, or 2.19 percent, for its electric operations and a decrease in revenue of approximately $2.1 million, or 2.41 percent, for its natural gas operations, in accordance with the decisions below. These figures include a reduction in Avista's federal corporate tax rate starting May 1, 2018, and a 36-year amortization of the plant-related, protected, excess deferred income tax collected as of December 31, 2017. Avista will continue to defer the unprotected excess deferred income taxes of approximately $10.4 million for resolution and distribution in Docket U-170970 utilizing the accounting petitions consolidated with this instant proceeding. Further, we direct Avista to amortize the January to April 2018 excess deferred income tax through its previously proposed Schedule 74 – Temporary Federal Income Tax Rate Credit over a one-year amortization period. Because the Company withdrew its electric tariff filing in Docket UE-180176, we direct Avista to refile this request prior to May 1, 2018.*

The Commission leaves unchanged the Company's return on equity at 9.50 percent and does not authorize a flotation cost adjustment. The Commission accepts Avista's cost of debt of 5.62 percent. On a going-forward basis, Avista is expected to observe in its Interest Rate Risk Management Plan the risk mitigation approach as provided in the Commission's March 2016 policy statement on natural gas interest rate hedges. The Commission rejects the Company's proposed hypothetical capital structure and instead authorizes and sets rates with a capital structure of 48.5 percent equity, 48.6 percent long-term debt, and 2.9 percent short-term debt. This results in a rate of return for Avista of 7.50 percent.

The Commission authorizes an increase of $14.5 million to the energy recovery mechanism baseline to account for the increases in Washington's allocated share of power costs and transmission costs, and for the lost revenue of the Portland General Electric contract. While the Commission allows the power cost baseline to be reset in this proceeding, the Commission will consider carefully any future adjustments to the baseline and will change it only under extraordinary circumstances. Avista is ordered to engage the Commission's Staff, Public Counsel, the Alliance of Western Energy Consumers (formerly the Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users), and other interested stakeholders in a discussion to simplify and improve the Company's power cost modeling. The Commission also directs the Company to engage peer utilities, independent *experts in the power cost modeling industry, Staff, and the other parties in this case on ways in which Avista may document the functionality and rationale of its power cost modeling and make changes to eliminate its directional bias. Avista must report on this process and identify any resulting changes to its methodology in its next general rate case filing.*

The Commission adopts Staff's August 31, 2017, cutoff deadline for inclusion of pro forma capital additions. Three projects, while below the threshold proposed by Staff for major projects, still merit recovery: the Little Falls Powerhouse Redevelopment; the Wood Pole Management project; and the Gas Replacement for Roads project. The Commission accepts Staff's capital additions adjustment, with these three additional inclusions, and authorizes the Company to receive its annualized depreciation expense for these adjustments.

The Commission approves the Company's operations and maintenance (O&M) offsets corresponding to the capital additions authorized above. This results in authorized O&M offsets associated with Wood Pole Management for the Company's electric operations and associated with Information Technology Refresh for Avista's electric and natural gas operations.

After a thorough review of testimony and evidence on the cost-of-service ratios presented, rate spread, and rate design by all parties, the Commission approves the Multi-Party Partial Settlement Stipulation addressing these issues. Additionally, Staff shall schedule meetings in the generic cost-of-service proceeding in Dockets UE-170002 and UG-170003 as soon as possible and report to the Commission its progress in this proceeding every three months from the effective date of this Order.

The Commission determines it is premature to impose any additional conditions on the Line Extension Allowance Program (LEAP) pilot. The Company has expressed its willingness to discuss the matter further, and we encourage the Company, Commission Staff, Public Counsel, and other stakeholders to discuss the metrics used to evaluate the success of the program, as Avista considers whether to continue LEAP at the end of the pilot.

While the Commission continues the Fuel Conversion program, the Commission determines it is not appropriate for electric ratepayers to subsidize the conversion from electric to gas. The Commission directs the Company and Staff to work with the Conservation Advisory Group on a plan that gradually transfers the funding obligation for the Fuel Conversion program from the electric conservation rider to the natural gas conservation rider by December 31, 2019. In developing this plan, the parties also should assess the effectiveness *and sustainability of the Fuel Conversion program under a new funding structure going forward.*

The Commission authorizes the inclusion of working capital amounts as proposed in Avista's rebuttal filing that contains a relatively small total amount of interest-bearing accounts. The Commission cautions that, in the future, even small or inconsequential interest-bearing accounts will be classified as non-operating and excluded from any working capital adjustment.

The Commission approves an increase of $350,000 in the funding for low-income weatherization for Company's electric operations.

The Commission authorizes Avista to recover increases in union and non-union wages for 2017 and union wages for 2018. Non-union wage adjustments for 2018 are rejected.

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SUMMARY

1 **PROCEEDINGS:** On May 26, 2017, Avista Corporation, d/b/a Avista Utilities (Avista or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its currently effective Tariff WN U-28, Electric Service in Docket UE-170485 and Tariff WN U-29, Natural Gas Service in Docket UG-170486. Avista proposes a three-year rate plan that would increase the Company's rates for electric service according to the following schedule:

- $61.4 million or 12.5 percent, effective May 1, 2018,[1]
- $14.0 million or 2.4 percent, effective May 1, 2019, and
- $14.4 million or 2.5 percent, effective May 1, 2020.

2 Avista also requests an increase in its natural gas rates for each of the three years as follows:

- $8.3 million or 9.3 percent, effective May 1, 2018,
- $4.2 million or 2.6 percent, effective May 1, 2019, and
- $4.4 million or 2.7 percent, effective May 1, 2020.

3 The Company states that it would not file another general rate case until June 1, 2020, if the Commission approves its multi-year rate plan. Avista based its revenue requests on a test year from January 1, 2016, through December 31, 2016. The filing includes proposals for the following:

- An overall rate of return (ROR) of 7.76 percent.[2]
- A return on equity (ROE) of 9.9 percent.[3]
- A capital structure consisting of 50 percent equity and 50 percent debt.[4]

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[1] Avista's proposal for the first year increase includes the expiration of the September 1, 2017, Power Cost Rate Adjustment.

[2] Morris, Exh. SLM-1T at 4:14-15. This would be a 0.47 percent increase relative to Avista's currently effective ROR.

[3] Morris, Exh. SLM-1T at 4:14-15. This would be a 0.4 percent increase relative to the Company's currently effective ROE.

[4] *Id.*

In Order 01, entered on June 2, 2017, the Commission suspended the tariff filings and consolidated the two dockets.

4 **PARTY REPRESENTATIVES:** David J. Meyer, Vice President and Chief Counsel for Regulatory and Governmental Affairs, Spokane, Washington, represents Avista. Lisa W. Gafken, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Unit of the Washington State Attorney General's Office (Public Counsel). Jennifer Cameron-Rulkowski, Brett Shearer, Julian Beattie, Andrew O'Connell, Jeff Roberson, and Christopher M. Casey, Assistant Attorneys General, Olympia, Washington, represent the Commission's regulatory staff (Staff).[5]

5 Patrick J. Oshie, Riley G. Peck, and Tyler C. Pepple, Davison Van Cleve, P.C., Portland, Oregon, represent the Industrial Customers of Northwest Utilities (ICNU).[6] Chad M. Stokes and Tommy A. Brooks, Cable Huston, Portland, Oregon, represent the Northwest Industrial Gas Users (NWIGU). Simon ffitch, attorney, Bainbridge Island, Washington, represents The Energy Project.

6 **COMMISSION DETERMINATION OF REVENUE REQUIREMENT:** Based on the decisions we have made in this Order, and accounting for the effects of the The Tax Cuts and Jobs Act of 2017 (TCJA) described in this Order, we authorize an increase in Avista's revenue requirement in the amount of $10.8 million, or 2.19 percent over base rates, for the Company's electric operations and a decrease in the amount of $2.1 million, or 2.41 percent of base rates, for its natural gas operations. Summaries of both the electric and natural gas revenue requirements are attached hereto at Appendix B.

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[5] In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See*, RCW 34.05.455.

[6] On April 3, 2018, ICNU and NWIGU informed the Commission that they had merged and changed their name to Alliance of Western Energy Consumers. Because the majority of the proceeding has seen the participation of the groups as ICNU and NWIGU, and to avoid confusion by anyone not having been notified of the modification of the group's name, we will refer to the organizations as ICNU and NWIGU in this Order.

MEMORANDUM

I. Procedural History

7 As summarized above, Avista filed its general rate case (GRC) with the Commission on May 26, 2017.

8 On October 27, 2017, Staff, Public Counsel, The Energy Project, ICNU, and NWIGU[7] filed response testimony and exhibits opposing the Company's rate and revenue requests. Staff, Avista, The Energy Project, and NWIGU filed a Multi-Party Partial Settlement Stipulation (Partial Settlement) on November 1, 2017,[8] reaching agreement on the issues of rate spread, rate design, expansion of the Company's natural gas transportation service, and reservation of all issues and agreements of the cost-of-service methodology to be utilized in future proceedings. On December 1, 2017, the Company filed rebuttal testimony and exhibits, while Staff, ICNU, NWIGU, The Energy Project, and Public Counsel filed cross-answering testimony and exhibits on select issues.

9 The Commission held public comment hearings in both Spokane and Pullman, Washington, on November 8, 2017, and November 28, 2017, respectively. The Commission received 194 comments regarding the proposed rate increases from Washington customers, with 184 comments opposing the increases, no comments supporting the increases, and 10 comments that were neither supporting nor opposing the increases. Public Counsel filed these comments and the six comments that it received, as the response to Bench Request No. 7.[9] The Commission conducted evidentiary hearings on January 16-17, 2018, at its headquarters in Olympia, Washington. The Company, Public Counsel, Staff, ICNU, NWIGU, and The Energy Project filed post-hearing briefs on February 22, 2018.

10 On December 22, 2017, approximately seven months into this proceeding, President Donald J. Trump signed into law the TCJA.[10] Significantly, the TCJA reduced the federal corporate

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[7] NWIGU sponsors witness Bradley G. Mullins jointly with ICNU.

[8] Public Counsel takes no position on the Partial Settlement. Letter from Lisa Gafken, Assistant Attorney General, Public Counsel, to Steven V. King, Executive Director and Secretary, Commission (December 15, 2017). ICNU did not join the Partial Settlement.

[9] Of the six comments received by Public Counsel, three were duplicative. Exh. BR 7.

[10] Pub. L. No. 115-97, 131 Stat. 2054 (2017). https://www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf.

income tax rate from a maximum 35 percent to a flat 21 percent rate. Investor-owned public utilities regulated in the State of Washington recover the costs of the applicable federal taxes from utility customers through rates established by the Commission in periodic rate cases. The tax rate reduction, which took effect January 1, 2018, requires utilities to revalue deferred income taxes at the lower rate, thus creating excess deferred income taxes. Some of these excess deferred income taxes (referred to as "protected" excess deferred taxes) relate to depreciable property and must be returned to customers over a specified time period under provisions in federal law governing the flow back of the excess under principles of normalization.[11] The remainder of the excess deferred income taxes (referred to as "unprotected") are not subject to the same normalization provisions, and the Commission retains authority in determining the disposition of those monies. As a result, we must determine the fate of those excess deferred income tax monies, and on a permanent, going-forward basis, we must lower the Company's revenue requirement to reflect the reduced tax rate for the protected excess deferred income tax monies.

11 On February 27, 2018, Avista filed its response to Bench Request No. 9 (BR 9), including the Company's Accumulated Deferred Federal Income Tax balance as of December 31, 2017; the total excess deferred income tax reserve as of December 31, 2017, to comply with the TCJA; the total excess deferred income tax expense Avista is collecting as of January 1, 2018, until the anticipated effective date of this general rate case; a proposed amortization schedule for the above; and for the current proceeding an updated revenue requirement based on Avista's rebuttal position that accounts for the change in corporate tax rate for the going-forward tax rates. The Commission entered Order 06/01 on March 1, 2018, consolidating Avista's general rate case proceeding, Dockets UE-170485 and UG-170486, with the Company's requests for an order authorizing the deferral of Federal Income Tax expenses for the effects of revisions to the income tax code upon Avista's cost-of-service, Dockets UE-171221 and UG-171222. On March 21, 2018, Staff filed its reply to Avista's response to BR 9.

12 On March 19, 2018, after the parties submitted post-hearing briefs in this proceeding, Avista informed the Commission that the parties to the Hydro-One merger proceeding, Docket U-170970, had reached a settlement-in-principle. One of the conditions in that agreement, according to the Company, would provide for a portion of the deferred federal income taxes,

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[11] This specific time period is prescribed as the average remaining life of the underlying assets, or Average Rate Assumption Method.

which Avista had previously advocated in this proceeding be returned to ratepayers, to accelerate the depreciation schedule for Colstrip Units 3 and 4.[12] On March 27, 2018, Avista filed the written settlement stipulation in Docket UE-170970. That docket is not consolidated with the dockets that are the subject of this Order.

13 Altogether, the record includes more than 350 exhibits admitted during the evidentiary hearing. The transcript of this proceeding exceeds 460 pages in length.

II. Tax Cut and Jobs Act

14 ***Avista's Response to Commission Bench Request.*** On February 27, 2018, Avista responded to the Commission's BR 9, providing detailed information regarding the revaluation of deferred income tax balances and proposed its preferred amortization schedules. The Company states the protected portion of the deferred income tax as of December 31, 2017, for its Washington operations is revalued at $208.3 million for electric and $45.01 million for natural gas, and must be amortized over approximately 36 years in accordance with the TCJA's Average Rate Assumption Method (ARAM).[13] The Company asserts that the reduction of on-going income tax rates from May 1, 2018, going-forward, would decrease its revenue requirement by $21.2 million and $4.9 million for electric and natural gas, respectively.[14]

15 The Company reports that the remaining unprotected excess deferred income taxes for its Washington operations, revalued as of December 31, 2017, is $10.4 million and $1.2 million for electric and natural gas, respectively.[15] Additionally, Avista provides an estimate for the excess deferred income tax from January 1, 2018, the date the tax decrease became effective, to April 30, 2018, the day before the Company proposes new rates resulting from this case go into effect. Those estimates for electric services and natural gas services, are $6.3 million and $1.5 million, respectively. Avista proposes a one year amortization schedule for both the unprotected excess deferred income tax balances and the estimates for

[12] Email from David Meyer, Vice President and Chief Counsel for Regulatory and Governmental Affairs, Avista, to Judge Marguerite Friedlander, Commission (March 19, 2018).

[13] Avista's Response to BR 9 at 3.

[14] *Id.*

[15] *Id.*

the January to April 2018 balances.[16] The Company states, "[a]ny difference, up or down, in the tax benefit deferral balance could be updated by revising and extending the tariff Schedules 74/174 in Year 2 of the [multi-year rate plan], if necessary, or deferred until the next [GRC]."[17]

16 ***Staff's Reply.*** Staff filed its Reply to Avista's Response to BR 9 on March 21, 2018. Staff suggests that some of Avista's calculations in its Response were not accurate. Specifically, Staff alleges Avista erred in its calculation of an estimated overcollection between January 1 and April 30, 2018, asserting Avista: (1) used an incorrect rate base; (2) used an incorrect rate of return; and (3) based its calculations on average load, not normalized load.[18]

17 According to Staff, the Company based its excess tax calculation on the rate base figures pending in the instant case. Staff asserts Avista should be using the figures from the 2015 GRC because it is currently collecting rates based on the rate base determination in that proceeding.[19] For the same reason, Staff argues the Company should have used the rate of return from the 2015 GRC, instead of the rate of return it proposed in this case.

18 Staff contends, moreover, that Avista should have used its normalized load for the January to April 2018 time period, not the annual load from four-twelfths of the year.[20] This distinction is important to Staff because January through April 2018 contain four of the coldest months, and while they only represent one-third of a year chronologically, those months represent almost one-half of all natural gas sales for the year.[21]

19 Staff acknowledges that the Commission has little discretion in the length of amortization for protected funds; however, for the unprotected excess deferred income tax and January through April excess deferral, Staff disagrees with the Company's proposed one-year amortization period for electric operations. As an alternative, Staff recommends that the

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[16] On February 27, 2018, the Company filed tariff revisions with the Commission to pass back these benefits to customers through temporary rate Schedules 74 and 174 in Dockets UE-180176 and UG-180177 for electric and gas services, respectively.

[17] Avista's Response to BR 9 at n.4.

[18] Staff's Reply to Avista's Response to BR 9 at 3.

[19] *Id.*

[20] *Id.*

[21] *Id.* at 3-4.

Commission direct Avista to continue to defer these funds given that all of the parties in the Company's merger application proceeding, Docket U-170970, reached a full settlement-in-principle utilizing the distribution of these funds as one of the conditions.[22]

20 Avista filed a Supplemental Response to BR 9 on March 27, 2018. The Company states that a Settlement Stipulation was filed on the same date in its merger proceeding in Docket U-170970, in which the settling parties agreed to use the unprotected excess deferred income tax and the deferral of the January to April 2018 excess deferred tax expense for an acceleration of the depreciable lives of Units 3 and 4 of the Colstrip generating facility. It asserts that the settling parties apportioned these monies in an effort to accelerate the depreciation expense associated with Avista's 15 percent ownership in these units from 2034 and 2036, respectively, to 2027 for both units.[23]

21 ***Discussion and Decision.*** Staff and Avista agree that the Commission should lower its revenue requirement increase by the going-forward corporate tax reduction and should authorize the Company to amortize the protected excess deferred income tax as of December 31, 2017, over 36 years in accordance with the ARAM methodology. None of the parties voiced disagreement over this approach, and in the interest of returning these monies back to ratepayers as soon as practicable, we agree. We find that the revenue requirement approved in this Order shall be decreased by the going-forward corporate tax reduction amount and the protected plant-related excess deferred income tax as of December 31, 2017, the latter being amortized over a period of 36 years.[24]

22 With regard to the unprotected excess deferred income tax as of December 31, 2017, and the deferral from January 1, 2018, to April 30, 2018, for electric operations, the parties have proposed that these balances continue to be deferred, rather than returned to customers over a single year, with the resolution of any issues associated with these monies and their distribution to be determined in the merger proceeding in Docket U-170970. While the Commission finds this approach reasonable for the unprotected excess deferred income tax, we do not agree with a continued deferral of the January to April 2018 excess deferred income tax. The Commission has previously indicated its expectation that customers should

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[22] *Id.* at 5. Staff provided no further information as the agreement had not yet been filed with the Commission.

[23] Avista's Supplemental Response to BR 9 at 1-2.

[24] This applies to both electric and natural gas operations.

realize the benefits of the reduced tax rate following the enactment of the federal tax legislation.[25] Therefore, we order the continued deferral of the unprotected excess deferred income taxes of approximately $10.4 million for resolution and distribution in Docket U-170970 utilizing the accounting petitions consolidated with this instant proceeding. Further, we direct Avista to amortize the January to April 2018 excess deferred income tax through its previously proposed Schedule 74 – *Temporary Federal Income Tax Rate Credit* over a one year amortization period. Since the Company withdrew its electric tariff filing in Docket UE-180176, we direct Avista to refile this request prior to May 1, 2018.

23 Staff and Avista also agree with regard to the unprotected excess deferred income tax as of December 31, 2017, and the deferral from January 1, 2018, to April 30, 2018, for gas operations. The parties have proposed that these balances are returned to customers over a one year amortization period through Schedule 174 – *Temporary Federal Income Tax Rate Credit.* The Commission finds this approach reasonable and orders these funds returned to ratepayers as proposed by the parties.

24 Finally, we turn to Staff's concerns regarding the Company's calculation methods from the January to April 2018 excess deferred income taxes. Staff took issue with the rate base, ROR, and load used in deriving the estimated tax over-collection. We agree with Staff, that using the rate base and ROR authorized in the 2015 GRC, and normalized load, is the appropriate methodology to calculate the excess deferral. This appropriately matches the rate at which taxes were collected and the time period over which they were collected.

III. Contested Issues

25 There are 10 contested issues in this general rate case: (1) the Company's proposed multi-year rate plan (Rate Plan), (2) capital structure and cost of capital, (3) the Partial Settlement, (4) Capital Additions, (5) Pro Forma O&M offsets, (6) Power Supply expenses, (7) Working Capital, (8) Low Income Assistance, (9) the Line Extension Allowance Program pilot and Fuel Conservation Program, and (10) Pro Forma Non-Executive Labor Costs.

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[25] See Commission Press Release, dated Jan. 8, 2018.

A. Multi-Year Rate Plan

26 ***Avista.*** The Company proposes a three-year Rate Plan utilizing four revenue requirement studies to demonstrate its need for rate relief.[26] For the period May 1, 2018, through April 30, 2021, it requests an overall increase in base revenues of $81.8 million and $14.2 million for electric and natural gas, respectively.[27] For the first year of the Rate Plan, Avista proposes an increase of $54.4 million for its electric operations and $6.6 million for gas operations. For the second year of the proposed Rate Plan, the Company proposes an increase in electric revenues of $13.5 million and an increase in gas revenues of $3.7 million. In the third and final year of the Rate Plan, Avista proposes an electric increase of $13.9 million and a natural gas increase of $3.8 million.[28]

27 Mr. Scott Morris, Chairman and Chief Executive Officer of Avista, testifies the proposed Rate Plan achieves several objectives beneficial to ratepayers, the Commission and all parties involved in rates cases, including: (1) changing the cycle of rate case effective dates and moving away from potential rate increases affecting consumers during the high-bill heating months, (2) reducing the burden of annual rate filings for all parties and the Commission, (3) providing rate predictability for consumers, and (4) providing an incentive for Avista to manage it costs.[29]

28 The Company's witness, Ms. Elizabeth Andrews, presents four revenue requirement studies to demonstrate Avista's need for the requested increases and proposes a three-year Rate Plan with a stay-out provision such that Avista would not file another rate case prior to 2020 for rates effective May 2021.[30] The studies include a Traditional Pro Forma Study, Rate Year

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[26] The Rate Plan would not preclude tariff filings authorized or contemplated by the terms of the Energy Recovery Mechanism (ERM), Purchased Gas Adjustment (PGA), Public Purpose Rider Adjustment including the Demand Side Management, Low-Income Rate Assistance Program or similar adjustments. The Company proposes that the Rate Plan also not preclude it from filing for rate relief or accounting treatment for major changes in costs not reflected in this filing, such as the potential costs associated with participation in the Energy Imbalance Market, or new safety or reliability requirements imposed by regulatory agencies. Morris, Exh. SLM-1T, n.10.

[27] Andrews, Exh. EMA-10T at 4:1-12.

[28] *Id.* at 4:4-12.

[29] Morris, Exh. SLM-1T at 3:11-21.

[30] Avista's Post-Hearing Brief, ¶ 32.

Study, End-of-Period (EOP) Rate Base Study, and a K-Factor Study. [31] Although the Company provides four studies, its revenue requirement request is based on the EOP Rate Base Study for year one, and then utilizes an annual revenue escalator, as determined in its K-Factor Study, to determine the revenue requirement for years two and three of the Rate Plan.[32]

29 Ms. Andrews stresses the importance of setting year-one rates appropriately because the revenue requirement for years two and three are based on the Commission's authorization for year one. She states that if the Commission understates the Company's rate base and rate relief in year one, "[t]his 'under-earning opportunity' imposed on the Company would then be <u>compounded</u> in [y]ears 2 and 3 of the Rate Plan, causing the Company to continue to under-earn at a significant level, year-after-year, during the Rate Plan."[33] At hearing, she explained that:

> the level of rate base that we are proposing for rate year one, for example, this points out the importance of that, that if we are – if staff's example – or level of rate base, for example, was approved, that would mean, based on this, we'd have over a hundred million of regulatory lag on an annual basis over a three year rate plan. So it's important, it's very important the first year gets set appropriately.[34]

30 Responding to Public Counsel criticism, Avista argues that its proposed merger with Hydro One Limited, to be heard in Docket U-170970, should not affect the Rate Plan because any potential savings "will be more than offset through the proffered 'rate credit' in the merger proceedings."[35] Further, Avista contends that the "changes in the tax law [should not] impact the three-year rate plan – they are what they are, and benefits will flow through to customers irrespective of the Rate Plan."[36]

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[31] Andrews, Exh. EMA-1T at 18.

[32] *Id.* at 25:10-13; *Id.*, n 11.

[33] Andrews, Exh. EMA-10T at 31:13-17. (Emphasis in original).

[34] Andrews, TR 154:12-21.

[35] Avista's Post-Hearing Brief, ¶ 94.

[36] *Id.*

31 ***Staff.*** Staff supports a three-year rate plan based on a modified historical test year for year one and an escalation factor model for years two and three as a way to "break the pattern of annual rate filings."[37] For Avista's electric operations, Staff recommends an increase in the Company's revenue requirement of approximately $10 million in year one, $9.5 million in year two, and $9.7 in year three.[38] As for its natural gas operations, Staff proposes an increase in Avista's revenue requirement of approximately $1.1 million in year one, $2.7 million in year two, and $2.8 million in year three of the Rate Plan.[39]

32 Staff's witness, Mr. Christopher Hancock, provides testimony in support of a Rate Plan and develops a proposed revenue escalation factor for years two and three. He testifies that Staff's analysis is neither based upon an attrition analysis nor contains an attrition adjustment,[40] but instead is a ratemaking tool that provides for "deliberate use of regulatory lag."[41] Regulatory lag, he states, "occurs between the time in which a cost to a utility changes, and the time when that change is reflected in customer rates."[42]

33 Mr. Hancock maintains that regulatory lag is beneficial when it incentivizes companies to control their costs.[43] He states, "[r]egulatory lag imposes discipline on utility operations and investment decisions, thus encouraging efficiency."[44] However, if the utility experiences unavoidable cost increases that threaten its financial position, he says, regulatory lag leads to the utility experiencing attrition.[45]

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[37] Staff's Post-Hearing Brief, ¶ 7.

[38] *Id.*, ¶11.

[39] *Id.*

[40] Hancock, Exh. CSH-1T at 8:1-3.

[41] *Id.* at 13:9-14.

[42] *Id.* at 6:21-7:1.

[43] *Id.* at 7:14-17.

[44] *Id.* at 9:11-12.

[45] *Id.* at 7:14-17. In his direct testimony, Mr. Hancock defines "attrition" as "a scenario in which a utility's costs grow at a faster rate than the utility's revenues, thus eroding the regulated utility's opportunity to achieve a reasonable rate of return." *Id.* at 7:20-23.

34 Mr. Hancock contends that a well-designed Rate Plan "allows the regulator to anticipate and provide for future conditions within a single rate case."[46] He goes on to state that this type of rate plan benefits investors because it "improves the utility's opportunity to earn its authorized rate of return."[47]

35 Finally, in response to an argument from Public Counsel, Staff cautions against consideration of the Hydro One Limited merger in the Commission's evaluation of the Rate Plan.[48] It notes that any "short-term customer benefits [resulting from the merger] in the form of rate credits […] will be handled in Docket U-170970 [the merger proceeding]."[49]

36 ***Public Counsel.*** On behalf of Public Counsel, Mr. Mark Garrett recommends the Commission reject the Company's Rate Plan. He instead offers a single-year revenue requirement based on the Company's Traditional Pro Forma Study with several contested adjustments.[50]

37 Mr. Garrett provides several arguments in opposition to Avista's Rate Plan. He testifies that the Company's EOP Study goes beyond the end of the test year and includes all plant (not just major) through 2017.[51] Second, he argues the Traditional Pro Forma Study offered by Ms. Andrews in her direct testimony reflects a future test year by inclusion of projected 2018 expenses.[52] Mr. Garrett likens years two and three of the Company's Rate Plan to an attrition adjustment. He believes the requested increases do not warrant such extraordinary ratemaking treatment as the revenues requested do not arise from environmental mandates or costs beyond the Company's control.[53] Finally, he argues Avista's Rate Plan ignores potential cost savings for the rate effective period including: (1) savings realized in the

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[46] Staff's Post-Hearing Brief, ¶ 19.

[47] *Id.*, ¶ 20.

[48] Staff's Post-Hearing Brief, ¶ 38.

[49] *Id*.

[50] M. Garrett, Exh. MEG-1T at 22:13-23:7. Public Counsel does not contest the capital threshold limit proposed by the Company, nor does it contest any individual major plant additions within the Traditional Pro Forma Study.

[51] *Id.* at 5:15-6:1.

[52] *Id.* at 4:18-23.

[53] *Id.* at 10:2-4; *Id.* at 7:19-22.

pending merger, (2) anticipated 2018 debt refinancing at lower levels than current instruments, (3) unknown impacts of the expected depreciation study, and (4) probable federal tax reform implications.[54]

38 Public Counsel asserts that the Company's "earnings are strong and have been for several years."[55] In last year's GRC order, the Commission held that "strong earnings factor against setting rates based on projections" such as those in years two and three of the Rate Plan.[56] Through Mr. Garrett's analysis, Public Counsel proposes an overall increase in base revenues of $7.5 million and $1.6 million for electric and gas, respectively.[57]

39 ***ICNU/NWIGU.*** On behalf of ICNU and NWIGU, Mr. Bradley Mullins also recommends that the Commission reject the Company's request for a Rate Plan. Mr. Mullins argues that Avista is not in need of extraordinary rate relief as evidenced by its historical pattern of healthy earnings.[58] He instead offers a single-year revenue requirement based on a modified historical test year with limited pro forma adjustments.

40 In his arguments opposing Avista's Rate Plan, Mr. Mullins echoes many of the same concerns as Public Counsel. First, Mr. Mullins equates the Company's K-Factor Study to an attrition adjustment.[59] However, he goes further than Public Counsel, identifying the escalation factors in this proceeding as even less precise than in prior cases.[60] These included the use of a single escalator instead of detailed trend analysis, net plant escalation not based on discrete plant additions, historical trends for depreciation that will be irrelevant with a new depreciation study, and the exclusion of deferred debits and credits and working capital.[61]

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[54] *Id.* at 13:2-11.

[55] Public Counsel's Post-Hearing Brief, ¶ 34.

[56] *Id.* (citing to *WUTC v. Avista Corp.,* Dockets UE-160228 and UG-160229, Order 06, ¶ 66 (December 15, 2017)).

[57] M. Garrett, Exh. MEG-1T at 25, Table 6.

[58] Mullins, Exh. BGM-1T at 6:13-7:14.

[59] *Id.* at 13:18-14:1.

[60] *Id.* at 14:8-15:2

[61] *Id.* at 14:20-15:2; 16:13-14; and 18:19-21.

41 Second, Mr. Mullins agrees with Staff and Public Counsel that Avista's EOP Study is not an appropriate application of the EOP rate base concept. Further, he argues the forecast of capital expenditures violates the used and useful standard.[62]

42 Third, Mr. Mullins notes that the full amortization of the Washington Public Power Supply System's Washington Nuclear Project 3 (WNP-3) settlement exchange power costs next year is not factored into the Rate Plan.[63]

43 ICNU argues that the Company's long-awaited depreciation study is important in determining its rates:

> The return of investment resulting from depreciation rates determines the major area of cost for most facilities. In turn, the costs returned to [a utility] via depreciation determines, in significant part, the rates to be charged ratepayers that use those facilities. When depreciation rates are changed by [a commission], the rates for services will follow.[64]

44 The last depreciation study Avista prepared and the Commission reviewed was completed on plant balances as of December 31, 2010.[65] Mr. Mullins cites to the Company's response to ICNU Data Request No. 49, in which Avista states its intent to file "an application for the approval of updated depreciation rates associated with the study" by the end of 2017.[66] The Company actually made these filings on February 22, 2018, the same day the post-hearing briefs were due in this proceeding.[67] ICNU and NWIGU point out that the Company's new depreciation expenses, as determined by the study, will make the historical trends used to

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[62] *Id.* at 10:17-19 and 11:9-19.

[63] *Id.* at 19:1-21. WNP-3 was a nuclear project that was terminated prior to its completion. In Cause No. U-86-99, the Commission approved recovery of 64.1 percent of Avista's portion of the project investment in the WNP-3 settlement. The Commission approved a 32.5-year amortization period for this amount beginning in 1987, resulting in full recovery during 2019.

[64] ICNU's Post-Hearing Brief, ¶ 79 (citation omitted).

[65] Mullins, Exh. BGM-1T at 32:18-19.

[66] *Id.* at 32:15-16 (citing Mullins, Exh. BGM-7 at 3 (the Company's Response to ICNU DR 49)).

[67] See, Dockets UE-180167 and UG-180168, respectively, for the gas and electric petitions for an order that authorizes the Company to revise its electric and natural gas book depreciation rates and authorizing deferred accounting treatment for the differences in depreciation expense.

forecast future depreciation expenses for years two and three of the Rate Plan irrelevant.[68] Stated another way, if the Rate Plan is approved, Avista's 2012 depreciation study will form the basis for rates into 2021.[69]

45 ICNU and NWIGU also maintain that the effects of the Company's merger with Hydro One Limited argue against the adoption of an extended rate plan.[70] While ICNU and NWIGU acknowledge that some impacts of the merger, if approved, could be addressed through a tariff rider outside of a GRC, the organizations contend that "the merger docket is another overlay of predictable change to Avista's future circumstances."[71]

46 Finally, in its post-hearing brief, ICNU and NWIGU take the position that Avista's tax rate decrease resulting from the TCJA will materially affect its costs, revenues, and returns during the proposed Rate Plan. The parties argue that the TCJA has created a "financial uncertainty" that "highlights the inherent inability of linear trend projections to capture very real and obvious changes to Avista's future operations."[72]

47 ***Discussion and decision.*** Multi-year rate plans are a tool that the Commission has used in prior rate cases to stop the annual cycle of rate cases, halt attrition of the Company's earnings, and remove the risk associated with regulatory lag.[73] We continue to welcome the use of multi-year rate plans in appropriate circumstances to control the seemingly unending annual filing of rate cases. That said, the circumstances surrounding Avista's proposed Rate Plan do not support the imposition of an extended duration rate plan at this time.

48 Neither Avista nor Staff, the only parties in favor of a multi-year rate plan, contend that the Company is suffering from attrition.[74] Instead, both parties assert that the Rate Plan will

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[68] ICNU's Post-Hearing Brief, ¶ 80.

[69] *Id.*, ¶ 81.

[70] *Id.*, ¶ 84.

[71] *Id.*, ¶ 86.

[72] *Id.*, ¶ 77.

[73] *See*, *WUTC v. Pacific Power & Light Company*, Docket UE-152253, Order 12 (Sept. 1, 2016) and *WUTC v. Puget Sound Energy*, Dockets UE-121697 and UG-121705 et al, Order 07 (June 25, 2013).

[74] In fact, Avista confirmed at the evidentiary hearing that its returns for 2017 have been better than expected. As it happens, the Company earned a 9.5 percent normalized ROE for its electric operations and an 11.4 percent normalized ROE for its natural gas operations. These results meet or,

alleviate the time and resources spent on annual rate proceedings by the Commission and parties, provide ratepayers with rate stability, and diminish the threat of regulatory lag.

49 While it is true that annual rate case filings impact the resources of the Commission and parties, approval of the Rate Plan will not forestall our work on other Avista filings nor will it result in the rate stability for consumers that the Company suggests. As Public Counsel and ICNU discuss, in addition to the instant case, we currently have two proceedings pending before us that will potentially affect Avista's rates. In Docket U-170970, we are reviewing the Company's request to merge with Hydro One Limited. Further, in Dockets UE-180167 and UG-180168, Avista filed its first depreciation studies since 2012. Finally, the TCJA will impact the Company's revenue requirement in this case significantly, and we will continue to address other issues raised by the change in tax rates in other proceedings.

50 Throughout this case, the Company has repeatedly emphasized the importance of setting the first year rates of its proposed Rate Plan appropriately. An important consideration of any multi-year rate plan must be sufficient comfort that the anticipated relationship between costs and revenues is predictable and reasonably accounts for utility operations over the course of the rate plan's anticipated timeframe. Here, certain aspects of the TCJA, the proposed settlement in the merger proceeding, and potential changes to the Company's depreciation schedules, including those for the Colstrip Units, inject a level of uncertainty that weighs against approval of a multi-year rate plan at this time.

51 Accordingly, we reject Avista's proposed Rate Plan as inconsistent with the public interest for rate payers. Our rejection does not reflect a change in our recognition of the value of multi-year rates plans either to end the cycle of annual rate filings or to support the utilities' efforts at efficiency. The Commission will carefully consider any proposals made for a multi-year rate plan in future proceedings.

B. Cost of Capital and Capital Structure

1. Return on Equity (ROE)

52 Each party bases its ROE recommendations on traditional financial models to observe trends in capital market conditions. Avista, Staff, Public Counsel, and ICNU provide results

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in the case of its natural gas operations, greatly exceed Avista's authorized return on equity of 9.5 percent. We note that the Company achieved and over-achieved its ROE despite our rejection of its previous rate request in 2016 and our rate decrease for Avista's electric operations in its 2015 GRC.

supporting their recommendations based on the discounted cash flow (DCF)[75] and Capital Asset Pricing Model (CAPM)[76] methods. Avista's witness, Mr. Adrien McKenzie, also presents results incorporating the Empirical CAPM (ECAPM), Risk Premium (RP),[77] and Comparable Earnings (CE) [78] methods. Staff's witness, Mr. David Parcell, includes a CE evaluation as part of his analysis. Finally, ICNU's witness, Mr. Michael Gorman, employs the RP approach to supplement his analysis, while Public Counsel's witness, Mr. David Garrett, uses the DCF and CAPM methods.

53 ***Avista.*** The Company requests an ROE of 9.9 percent, which is 40 basis points higher than its current ROE. Mr. McKenzie asserts that this proposal is below the mid-point of his recommended ROE range of 9.6 to 10.8 percent.[79] The proposed ROE also contains a 10 basis point adjustment for flotation costs.[80] Mr. McKenzie argues his 9.9 percent recommendation is reinforced by a number of factors including: (1) the Company's pressure

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[75] The DCF method is the most commonly used financial method to determine an ROE recommendation. This model's principle is that the market value of stock is the present value of the future benefits discounted back to present value, and it considers stock price, dividends, and long-term growth rates.

[76] The CAPM model describes the relationship between systematic risk and expected returns, particularly for stocks. Generally, CAPM captures the idea that investors need to be compensated for the time value of money and risk. Using this method, analysts essentially determine a "risk free rate" (typically the yield on government bonds like U.S. Treasuries) and then determine the "premium" (beta) that investors would need to receive to purchase the stock.

[77] The RP model is based on the principle that investors require a higher return for common equity investments than bonds, and must be compensated for that additional risk. This is in part because dividends are discretionary, and bond payments will take precedence over common equity in a bankruptcy. Generally, the spread between the return on debt and the ROE is determined, and then this spread is added to the current debt yield to calculate an estimate of current equity return requirements.

[78] The CE method is an econometric approach to estimating the opportunity cost of alternative investments based on an assessment of prospective returns available to investors from alternative investments of similar risk. This method seeks to examine the historical and projected return on book common equity to estimate ROE. To implement this approach, a group of companies comparable in risk to a specified utility is defined, the book return on equity is computed for each company, and the allowed return is set equal to the average return on book value for the sample.

[79] Mr. McKenzie provides no testimony on the rationale of this selection other than it is below the mid-point of his acceptable ROE range.

[80] Flotation costs are incurred when a company issues new securities. No party supports Avista's recommendation to include a flotation cost adjustment.

for funding capital expenditures over the next three years, (2) exposure to greater risk of power cost volatility,[81] (3) the need to mitigate earnings attrition, (4) expectations for higher interest rates, (5) relatively small size of Avista that is perceived to present greater uncertainties for prospective investors, and (6) sensitivity to financial market and regulatory uncertainties.[82]

54 ***Staff.*** Staff recommends a reduction in Avista's current ROE to 9.1 percent. Mr. Parcell asserts this figure is the mid-point of his acceptable ROE range for Avista of 8.7 to 9.5 percent.[83] The ranges of his DCF, CAPM, and CE analysis are 8.4 to 8.7 percent (8.55 mid-point), 6.6 to 6.9 percent (6.75 mid-point), and 9.0 to 10.0 percent (9.5 mid-point), respectively.[84]

55 ***Public Counsel.*** Public Counsel, like Staff, argues in favor of a reduction to the Company's current ROE. Mr. Garrett's ROE range is 8.75 to 9.25 percent, and he recommends an ROE of 9.0 percent.[85] This is significantly above the ROE results of his DCF and CAPM models of 7.2 and 6.8 percent, respectively.[86] While Mr. Garrett does not provide a rationale for his acceptable ROE range, he does explain why there is such a considerable difference between his financial modeling results and his recommended ROE. He contends his financial models "closely estimate" Avista's "true cost of equity."[87] Mr. Garrett argues that utility stocks are less risky than the average stock in the market and should therefore require a lower ROE, but observes that regulated utility returns did not track with the significant economic

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[81] He specifically references as an example Avista's reliance on hydroelectric for 45 percent of total energy requirement and its subsequent need to purchase power from the market to meet hydro shortfalls. McKenzie, Exh. AMM-1T at 9:17-10:19.

[82] McKenzie, Exh. AMM-1T at 6:13-7:15.

[83] Parcell, Exh. DCP-1T at 36:15-16. Mr. Parcell provides no testimony for the rationale behind his ROE range selection. While his CAPM results are well outside of his acceptable ROE range, he testifies that CAPM results should be considered in determining the cost of equity for Avista. *Id.* at 37:4-17.

[84] Parcell, DCP-1T at 4:6-13.

[85] D. Garrett, Exh. DJG-1T at 4:9-13.

[86] D. Garrett, Exh. DJG-4 at 12.

[87] D. Garrett, Exh. DJG-1T at 8:12-13.

changes over the past decade.[88] Therefore, the 9.0 percent ROE recommended in this case is based on the concept of gradualism toward the Company's true cost of capital.[89]

56 ***ICNU.*** ICNU witness, Mr. Gorman recommends an ROE of 9.1 percent, which is the mid-point of his acceptable ROE range of 8.8 to 9.3 percent.[90] He justifies his recommendation on overall reductions in authorized industry ROE, credit rating trends experiencing significant upgrades, and continued access to low-cost external capital for infrastructure.

57 All of the expert witnesses' analytical results are portrayed below in Table 1.

Table 1
Summary of Witness ROE Financial Modeling Results *(in percent)*

Model	Avista[91]	Staff	Public Counsel	ICNU[92]
DCF	8.3 – 9.3 (8.7 mid-pt)	8.4 – 8.7 (8.55 mid-pt)	7.2	8.80
Constant Growth Model (Analysts)				8.78
Constant Growth Model (Sustainable)				7.86
Multi-Stage Growth Model				7.70
CAPM		6.6-6.9 (6.75 mid-pt)	6.8	7.86 – 9.13 9.10 (rec)
Current Bond Yield	9.9			
Projected Bond Yield	10.2			
Empirical CAPM				

[88] *Id.* at 10:8-11:9.

[89] D. Garrett, Exh. DJG-1T at 74:24-75:2.

[90] Gorman, Exh. MPG-1T at 2:4-6.

[91] Averages.

[92] *Id.*

Model	Avista[91]	Staff	Public Counsel	ICNU[92]
Current Bond Yield	10.5			
Projected Bond Yield	10.7			
Risk Premium				9.00 – 9.60 (9.30 mid-pt)
Current Bond Yield	10.1			
Projected Bond Yield	10.9			
Comparable Earnings		9.0-10.0 (9.5 mid-pt)		
Industry	10.7			
Proxy Group	10.3			
Overall ROE Range Recommendation	9.50 – 10.7[93]	8.70 – 9.50		8.80 – 9.30
Flotation Cost Adjustment	0.10	0	0	0
Final ROE Recommendation	**9.90**	**9.10**	**9.0**	**9.10**

58 ***Discussion and Decision.*** The primary issue in dispute concerning Avista's cost of capital is what, if any, adjustment may be necessary to the Company's currently authorized ROE of 9.5 percent.

59 The Commission's long-standing practice is first to identify within the range of *possible returns* shown by expert analyses a range of *reasonable returns* on equity considering all cost of capital testimony in the record. Then, the Commission weighs the analysts' more detailed results and considers other evidence relevant to the selection of a specific point value within the range. The Commission's final determination of an acceptable ROE

[93] This does not include the proposed floatation cost adjustment.

recognizes fully the guiding principles of regulatory ratemaking that require us to reach an end result that yields fair, just, reasonable, and sufficient rates.

60 The Commission benefits significantly from the different perspectives of the witnesses in making their recommendations. However, we must carefully balance their results to establish the end points of a zone of *reasonable returns* within which we can select a specific ROE point value, considering the modeling and other factors in evidence. The witnesses do not dispute that determining an appropriate ROE presents challenges. As discussed above, they rely on familiar analytic tools such as DCF, CAPM, RP, and CE methods. And, as is customary, they use a variety of data sources to populate their models to arrive at and support their respective ROE recommendations. Accordingly, as we have noted in previous proceedings, the results of the analytic models the expert witnesses use to estimate ROE can vary significantly due to subjective judgments they make when selecting specific approaches and data inputs for each model.

61 Based on their individual analyses and modeling, the witnesses establish wide ranging ROE results. As Table 1 above demonstrates, collectively their overall ROE recommendations span 200 basis points between the lowest and highest (ranging from 8.7 percent to 10.7 percent with a mid-point of 9.7 percent). This reflects the end points of the range of *possible returns*. We then turn to an evaluation of the various analytical methods broadly employed by each expert witness to establish a narrower *range of reasonableness*, and ultimately determine an appropriate ROE.

62 We begin with a review of the expert witnesses' application of the DCF method, the method to which the Commission generally has afforded material weight in determining a company's authorized ROE. Here we observe that the expert witnesses for Avista, Staff, and ICNU produce a surprisingly tight range of potential ROE results that span a mere 41 basis points from 8.29 to 8.70 percent. In contrast, Public Counsel's witness, Mr. Garrett, derives a DCF result of 7.2 percent, an outlying result that is 109 basis points below the lowest end of the DCF range derived by the other expert witnesses. Setting aside Mr. Garrett's anomalous result, the remaining expert witnesses' DCF analyses produce a mean of 8.51 percent.

63 In contrast to the tight DCF results, we are presented with an expansive range of results for the CAPM method. On the high end, Mr. McKenzie provides a series of results based on four variations of the CAPM method that produce an average CAPM result of 10.3 percent, while Mr. Parcell and Mr. Garrett's CAPM results are materially lower at 6.75 and 6.80

percent, respectfully.[94] Unlike the DCF results derived by three of the four witnesses, which span a mere 41 basis points, the various witnesses' CAPM results encompass a range of 355 basis points, a circumstance which tempers, somewhat, the weight we traditionally apply to the CAPM method when determining a utility's authorized ROE. Collectively, the mean of the four witnesses' CAPM analysis is 8.24 percent.

64 Another method used to estimate ROE is the RP method. Only two witnesses utilized the RP method in reaching a recommended ROE. For Avista, Mr. McKenzie applied two approaches to the RP method (based on current and projected bond yields) which yielded an average result of 10.5 percent. Similarly, ICNU's witness, Mr. Gorman undertook an RP analysis which produced a range of results (9.0 to 9.6 percent), resulting in a mid-point value of 9.3 percent. The average result between the two witnesses' analysis is 9.9 percent.

65 Finally, as additional data points for our consideration of establishing Avista's ROE, we note that two witness, Mr. McKenzie for Avista and Mr. Parcell for Staff, employ the CE approach to two proxy groups of companies. The respective mid-points of each witnesses' CE analysis are 10.5 and 9.5 percent, respectively, with an average of 10.0 percent. Although we generally do not apply material weight to the CE method, having stronger reliance on the DCF, CAPM and RP methods, we are inclined to include the CE method here given the anomalous CAPM results described previously.

66 The various models the witnesses employed produce a range of *possible returns*. Closer scrutiny of these four specific methods provides a narrower range upon which we can develop a range of *reasonable returns.* On the low end, the average result from the four witnesses' CAPM analysis is 8.24 percent, followed by 8.51 percent for the DCF method, and 9.9 and 10.0 percent for the RP and CE methods, respectively, which frame the higher end of the range. As noted previously, we are concerned about the disparity in the witnesses' CAPM results which vary more than 350 basis points across the various iterations of the modeling. Accordingly, setting the CAPM results aside, we narrow our range of *reasonable returns* to 8.51 to 10.0 percent which, establishes a mid-point of 9.25 percent as a potential authorized ROE for Avista. Such a result is 25 basis points below the Company's currently

[94] For ICNU, Mr. Gorman provides a CAPM range of results from 7.86 to 9.13 percent, and recommends use of a final CAPM result, 9.10 percent, which sits at the higher end of his CAPM range.

authorized ROE of 9.5 percent, which would be a significant reduction absent consideration of other evidence produced by the expert witnesses.

67 However, while each witness considered his range of individual results derived from the analysis and methods employed to arrive at a specific final ROE recommendation to the Commission, several witnesses did not select the results discussed above, finding them in some cases to be too low. In varying degree, the witnesses discuss the range of results arising from their individual examinations and explain how they narrowed their recorded results to a final ROE recommendation. As Table 1 above demonstrates, the final ROE recommendations proffered by each witness ranges from 9.0 to 9.9 percent, producing a mid-point result of 9.45 percent, which is slightly lower than Avista's currently authorized ROE of 9.5 percent.[95]

68 When considering changes to a regulated utility's authorized ROE, we endeavor to avoid material adjustments, upward or downward, in authorized levels to provide stability and assurance to investors and others regarding the regulatory environment supporting the financial integrity of the utility. Based on the evidence produced by the various expert witnesses, we generally determine whether modest increases or decreases, if any, to currently authorized levels are appropriate given the evidence produced in the immediate proceeding. Here, although we note the ample record of analyses and recommendations of four witnesses, we are concerned by the wide ranging results of the witnesses' modeling, results that give us pause in considering whether to change Avista's authorized ROE. Although the detailed results of the witnesses' analyses suggests a modest decrease may be appropriate, the accumulated disparities among results of the individual modeling implies dissimilarity in approach and application of the methods utilized.

69 We note that witnesses addressed current capital market conditions in support of their individual ROE analyses and recommendations. Of note, in both his direct and rebuttal testimony, Mr. McKenzie cites anticipated changes in long-term interest rates over the next few years, pointing, in particular, to continued anticipation that rates for Aa utilities, Aaa

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[95] We note here the discussion below regarding our decision to reject Mr. McKenzie's proposal to increase his ROE recommendation by 10 basis points (from 9.8 percent to 9.9 percent) as a potential means to allow Avista to recover flotation costs issuing new equity. Our rejection of his proposal narrows the range of reasonable ROE results to 9.0 percent to 9.8 percent, resulting in a mid-point of 9.4 percent.

corporations, and 10- and 30-year treasury rates will increase substantially over the next five years due to actions by the Federal Reserve and by general capital market uncertainty.[96] Not surprisingly, the remaining expert witnesses reject Mr. McKenzie's assessment of capital market conditions, contending that recent actions by the Federal Reserve and other relevant data do not suggest that interest rates can be expected to trend higher over the foreseeable future.[97]

70 We recognize there is considerable uncertainty in capital markets and accept, for now, Mr. McKenzie's contention that conditions are such that increases to long-term interest rates are likely over the immediate and near term horizon. The record shows the Federal Reserve has articulated continuation of measured increases to key U.S. interest rates. As Mr. McKenzie notes:

> On June 14, 2017 the Federal Reserve increased the target range for the Federal Funds rate by another 25 basis points to 1.00% to 1.25%. This is in addition to similar increases in March 2017, December 2016, and December 2015. More rate hikes by the Federal Reserve are anticipated.[98]

71 We agree that current Federal Reserve sentiment and policy will maintain the trajectory of gradual increases in U.S. interest rates in 2018 and 2019, a trend which, on balance, weighs against a decrease to Avista's ROE at this time.[99]

72 We also note the TCJA will increase stress on the Company's balance sheet and credit metrics as short-term cash flows are impacted by customer refunds.

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[96] McKenzie, Exh No. AMM-14T at 15.

[97] Parcell, Exh. DCP-1T at 7-16 and Gorman, Exh. MPG-1T at 3:15-18.

[98] McKenzie, Exh AMM-14T at 19:6-9.

[99] In other proceedings over the past few years we have reduced the authorized ROE for several Washington utilities, including Avista, based on the record in each proceeding. Heretofore, our decisions reflect a trend of modest downward adjustments that reflect, to some degree, the effect of the Federal Reserve's stimulus policies on U.S. interest rates and the corresponding effect that these policies have had on the inputs and methods the cost of capital witnesses employed in such proceedings.

73 Accordingly, we maintain Avista's authorized ROE at the current rate of 9.5 percent as consistent with the public interest.

74 As a final matter, we note that Mr. McKenzie proposed an adjustment to Avista's authorized ROE to account for flotation costs incurred from the sale of common stock. He claims a flotation cost adjustment is necessary to enable Avista to recover all of the costs incurred for the use of investors' funds.

75 Both Mr. Garrett for Public Counsel and Mr. Gorman for ICNU oppose the adjustment. Mr. Garrett asserts that flotation costs are not actual expenses incurred by a utility because it does not actually pay for these costs.[100] He also contends that investors are well aware of underwriter's fees, which do not go directly to the company, but instead compensate the underwriter for its services.[101] Similarly, Mr. Gorman opposes an adjustment for flotation costs, pointing out that Mr. McKenzie's proposal is not based on the recovery of prudent and verifiable actual flotation costs incurred by Avista, but rather, on generic cost information of other utility companies.[102]

76 We agree with Mr. Garrett and Mr. Gorman and reject Mr. McKenzie's proposed adjustment for flotation costs as a component of our determination of Avista's authorized ROE. While these costs may be legitimate adjustments made during the underwriting process, we are not persuaded they should be included as a component of Avista's authorized ROE. We agree with Mr. Garrett that flotation costs are recognized in the underwriting process as part of the monies retained by underwriters at the time of issuance. We also agree with Mr. Gorman that Mr. McKenzie has failed to demonstrate the level of costs, if any, that Avista actually incurred during the test year, and developed his proposed flotation cost adjustment on information derived from other utilities.

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[100] Garrett, Exh No. DJG-1T at 58:7-13. Mr. McKenzie points out that underwriters used to facilitate equity issuances are typically compensated through an "underwriting spread" which is the difference between the price at which the underwriter purchases the shares from the firm and the price at which the underwriter sells the shares to investors.

[101] D. Garrett, Exh No. DJG-1T at 58:14-17.

[102] Gorman, Exh No. MPG -1T at 64:16-21.

2. Cost of Debt

77 ***Avista.*** Mr. Thies presents Avista's proposed cost of debt and the Company's interest rate risk mitigation program. He recommends an overall cost of debt of 5.62 percent based on anticipated long-term debt issuances, capital expenditures, and the need to renew a substantial revolving credit facility. Mr. Thies notes that the Company's proposed cost of debt calculation embeds an average of $100 million in short-term debt at 3.26 percent within his calculation, although short-term debt is excluded from his proposed capital structure.[103]

78 Avista has $654.5 million of long-term debt maturing between 2018 and 2022, which, according to Mr. Thies, represents over one-third of long-term debt outstanding at the end of 2016. He offers Exhibit No. MTT-5C to show the forecasted debt issuance over the next five years with a proportionately large amount planned for 2018. Additionally, the Company's $400 million revolving credit facility is used to cover variations in cash flows and interim capital expenditure funding. It is also used for letters of credit required for contractual obligations that expire in the second quarter of 2021 (the last month of Avista's proposed three-year rate plan).

79 Mr. Thies provides brief testimony about Avista's *Interest Rate Risk Management Plan* (the Plan). Avista used the Plan to mitigate interest rates for a portion of the forecasted debt issuances with the use of financial hedging "ramp ups" several years prior to the anticipated issuance. He argues the Plan reduces cash flow volatility and does not involve speculation.

80 ***Staff.*** Staff's witness Mr. Christopher McGuire recommends the Commission remove $54 million in hedging losses from Avista's cost of debt, asserting the losses are associated with the 2016 First Mortgage Bond debt issuance of $175 million.[104] By doing so, the Company's proposed cost of debt is reduced from 5.62 percent to 5.41 percent. Mr. McGuire argues for this disallowance on the basis that the *Interest Rate Risk Management Plan* is not risk responsive and only executed for managing company cash flow volatility with no benefit to

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[103] Thies, Exh. MTT-1T at 13, n. 5.

[104] Staff notes it did not pursue a disallowance during the Avista 2016 GRC, in Dockets UE-1602285 and UG-160229, because the Company only updated the cost of debt on rebuttal and did not request the associated higher revenue requirement. In its Post-Hearing Brief, Staff indicated it would review this issue in the Company's next general rate proceeding. Mr. McGuire also references Bench Request No.5 in which the Commission requested additional information regarding the impact of the 2016 debt issuance on Avista's cost of debt. *See* McGuire, Exh. CRM-2.

the ratepayer. He notes that the Commission has identified as the appropriate risk model in the natural gas hedging practices policy statement issued in March 2017.[105]

81 Additionally, Mr. McGuire provides an historical analysis of Avista's embedded cost of debt versus market spot rates[106] and presents a table illustrating interest rate volatility during the time period the 2016 debt instrument hedges were executed to demonstrate the programmatic nature of the Company's interest rate hedging plan.[107] He argues Avista's hedging activities do not respond to changing market conditions. Instead, he states the "goal of the Company's hedging practices is to increase the certainty of future costs"[108] and that the Company "causes the rate impact by purchasing cash flow stability with excessive hedge losses."[109]

82 On behalf of Staff, Mr. Parcell incorporates Mr. McGuire's recommendation into his testimony and cost of debt calculations. However, instead of providing an overall cost of debt as the Company presents, Mr. Parcell distinguishes the cost of short-term versus long-term debt. Staff does not contest the cost of short-term debt and utilizes the rate cited in Mr. Thies' testimony.[110]

83 ***Public Counsel.*** Mr. Garrett does not contest Avista's proposed cost of debt.

84 ***ICNU.*** Mr. Gorman contests Avista's cost of debt due to the securities maturing in 2018 that currently have embedded rates in excess of the current market cost of debt. He adjusts the Company's proposed long-term debt to reflect estimated refinancing at 4.5 percent (based on BBB rated debt of approximately 4.27 percent) from the current bond rates of 7.35, 7.45,

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[105] *In the Matter of the Commission Inquiry Into Local Distribution Companies' Natural Gas Hedging Practices*, Docket UG-132019, Policy and Interpretive Statement on Local Distribution Companies' Natural Gas Hedging Practices (Mar. 13, 2017). Mr. McGuire acknowledges the policy statement was issued after the debt issuance, in December 2016, but does not believe this precludes the Commission from making this disallowance. He testifies the "companies could have … identified the problem themselves prior to that date…the Commission should not have to tell risk managers that their job is to manage risk." McGuire, Exh. CRM-1T at 22:11-16.

[106] McGuire, Exh. CRM-1T at 7, Figure 1.

[107] *Id.* at 15, Figure 2.

[108] *Id.* at 18:23-24.

[109] *Id.* at 19:8-9.

[110] Parcell, Exh. DCP-1T at 22:18-23:6.

and 5.95 percent. This reduces Avista's embedded cost of debt from 5.62 percent to 5.31 percent. Mr. Gorman does not contest the Company's cost of short-term debt.[111]

85 ***Avista's Rebuttal.*** Responding to Staff, Mr. Thies argues the Company's *Interest Rate Risk Management Plan* activities directly benefit the ratepayers by mitigating interest rate volatility, as the cost of debt is a contributing component of the overall ROR used to determine a portion of the revenue requirement related to rate base. He argues that because Avista only issues long-term debt once a year, utilizing interest rate swaps over time reduces the concentration risk, and therefore mitigates interest rate volatility rate impacts for ratepayer benefit.[112] If the 2016 interest rate hedges are excluded from the cost of capital, Mr. Thies reports the impact would be a decrease in long-term cost of debt from 5.62 percent to 5.54 percent with a corresponding write-off of $33.6 million in 2018.[113]

86 Additionally, Mr. Thies responds to Mr. McGuire's claim that the Plan is not risk responsive by maintaining that the Plan allows for discretion in determining whether to hedge, take partial action, or no action. He also refutes Staff's claim based on its hindsight review of interest rates. Mr. Thies provides details of specific monitoring in place prior to the first hedge for the 2016 issuance. He reports the Company monitors Thomson Reuters on a daily basis and watches economic forecasts and Federal Reserve activities. Specifically, in March 2013, Mr. Thies testifies the interest rates at the time were 3.1 percent and forecasted 30-year Treasury bonds were expected to rise as high as 5 percent.[114] Therefore, he finds Mr. McGuire's historical analysis is inappropriate.

87 Mr. Thies asserts the Company adhered to its operational guidelines as outlined in the Plan and provides the internal audit report findings to that end in Exhibit No. MTT-8. He argues the Plan was finalized in 2013 after consultation with Staff and has been included as an appendix to his testimony in each general rate case since that time, with hedging settlements being included as part of the cost of capital calculations.[115] Mr. Thies does not believe it is appropriate to apply the natural gas policy statement *ex post facto* when the policy statement

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[111] Gorman, Exh. MPG-1T at 30:8-22.

[112] Thies, Exh. MTT-6T at 17:14-18:6.

[113] *Id.* at 25:1-3.

[114] *Id.* at 20:16-21:2.

[115] *Id.* at 18:12-19:8.

provides the Company until the 2020 Purchased Gas Adjustment (PGA) filing to have a comprehensive risk responsive strategy in effect.[116] While Mr. Thies testifies the Company "is open to discussing new options for mitigating customer interest rate risk," he argues that "excluding the 2016 interest rate hedges from cost of debt is punitive and unjustified." [117]

88 In response to ICNU, Mr. Thies recommends the Commission reject Mr. Gorman's proposed cost of debt as it includes forecasted debt issuances. He argues the -use of "pro-forma debt" to finance capital additions beyond those included by the parties in this proceeding is inappropriate.[118]

89 ***Discussion and Decision.*** The expert witnesses dispute the cost of short- and long-term debt to be used for purposes of establishing Avista's authorized ROR. Avista proposes to use its weighted cost of long-term debt of 5.62 percent, which inherently includes consideration of a short-term cost of debt of 3.26 percent, even though the Company excluded short-term debt as a specific component of the Company's proposed capital structure.

90 As discussed above, Mr. McGuire proposes to adjust Avista's cost of debt to eliminate certain hedging losses associated with the 2016 First Mortgage Bond debt issuance of $175 million.

91 We adopt Avista's proposed cost of debt of 5.62 percent, which reflects a short-term debt cost of 3.26 and long-term debt cost of 5.76 percent. We accept Mr. Thies' assertions that the Company adhered to its *Interest Rate Risk Management Plan* operational guidelines. Mr. Thies appropriately notes the Plan was finalized in 2013 after consultation with Staff and has been included as an appendix to his testimony in each GRC since that time, with hedging settlements being included as part of the cost of capital calculations.

92 We agree with Mr. Thies that Mr. McGuire's attempt to apply the Commission's natural gas policy statement after the fact is inappropriate. Notwithstanding our decision here, we agree with Mr. McGuire that, on a going forward basis, the Company is expected to apply to its interest rate hedges the risk mitigation approach as provided in the March 2016 policy statement. We also agree with Mr. Thies that Mr. Gorman's proposed adjustment for a securities maturation in 2018 is inapposite as an attempted pro forma adjustment based on

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[116] *Id.* at 22:17-23:3.

[117] *Id.* at 26:15-18.

[118] *Id.* at 15:12-18.

estimates that may or may not materialize. The rates for the 2018 security issuances will not be ascertained until after the effective date of this Order and therefore do not comport with the known and measureable standard. Based on this discussion, we agree and accept the Company's proposed cost of debt.

3. Capital Structure

93 ***Avista.*** Avista witnesses Mr. Thies and Mr. McKenzie both provide testimony in support of the Company's proposed hypothetical capital structure of 50 percent debt, and 50 percent equity, and 0 percent short-term debt. Mr. Thies argues the use of a hypothetical capital structure is a rate making tool the Commission has applied to allow the Company an opportunity to earn its proposed ROR.[119] Further, he testifies maintaining a 50/50 ratio provides customer benefits in the form of lower cost to access capital markets given a solid financial profile and credit rating.[120] Mr. McKenzie furthers this argument providing "[o]ther things being equal, a higher debt ratio, or lower common equity ratio, translates into increased financial risk for all investors."[121]

94 Mr. McKenzie asserts the 50/50 ratio is a reasonable capital structure for Avista in comparison to his proxy group common equity ratios on both an historical and forecasted average basis. He testifies that, as of December 31, 2016, the average common equity ratio for the proxy group was 48.3 percent. Using *Value Line* data projected during the next three to five years, the proxy has an expected average common equity ratio of 50.1 percent.[122] Finally, he argues the proposed capital structure reflects the Company's financial status and needs to support continued system improvements, as well as debt repayment obligations.[123]

95 ***Staff.*** Mr. Parcell discusses the importance of determining a proper capital structure within the rate base/rate of return regulatory framework recognizing the assets employed in providing utility services and determining the associated return on those assets by

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[119] Thies, Exh. MTT-1T at 13:14-16.

[120] *Id.* at 14:4-15.

[121] McKenzie, Exh. AMM-1T at 24:13-14.

[122] *Id.* at 26:2-12. Mr. McKenzie also references the PSE 2004 GRC Order (Dockets UE-040641 and UG-040642) in which the Commission observed the appropriateness of affording more weight to forward-looking equity ratio data to determine the proper equity ratio to embed in prospective rates.

[123] *Id.* at 29:20-23.

identifying the liabilities and common equity used to finance them.[124] Based on his analysis, he testifies Avista's equity ratios have been stable over the past five years at approximately 48 percent (including short-term debt).[125] During this same time period, Mr. Parcell's proxy group shows an average of 51.2 percent (excluding short-term debt) with U.S. state regulatory averages of 49.7 percent.[126]

96 In selecting his recommended capital structure, Mr. Parcell offers his understanding of the Commission's policy on determining the proper capital structure as "[balancing] safety (the preservation of investment quality credit ratings and access to capital) against economy (the lowest overall cost to attract and maintain capital) [using either] the Company's historical capital structure, the projected capital structure, or a hypothetical capital structure."[127] He argues his proposed capital structure complies with this policy in maintaining the 51.5 percent debt and 48.5 percent equity stipulated to by the parties in the 2015 Avista GRC.[128] Further, he reasons this structure is appropriate as it: (1) exceeds the Company's actual capital structure of 48.0 equity as of December 31, 2016, (2) is similar to other electric and combination electric utilities, and (3) reflects that Avista's actual equity ratios have not increased in recent years.[129]

97 ***Public Counsel.*** On behalf of Public Counsel, Mr. Garrett disagrees with the Company's proposal to use a hypothetical capital structure in this proceeding. He instead proposes a capital structure based on Avista's test year consisting of 51.5 percent debt and 48.5 percent equity.[130]

98 Mr. Garrett performs an analysis to determine the effects of various debt ratios with the ROE proposed by the Company. His calculations indicate that an ROE of 9.9 percent has a corresponding debt ratio of 70 percent. While Mr. Garrett does not propose the Commission

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[124] Parcell, Exh DCP-1T at 27:22-18:2.

[125] *Id.* at 18:15-16. We note that excluding short-term debt the average is 49.9 percent for comparison purposes with his later testimony.

[126] *Id.* at 19:8-15.

[127] *Id.* at 21:20-22:4.

[128] *Id.* at 20:16-19.

[129] *Id.* at 21:3-16.

[130] D. Garrett, Exh. DJG-1T at 74:13-14.

apply a capital structure with 70 percent debt, he uses the calculation to illustrate the mismatch between Avista's request for a hypothetical capital structure containing a 50/50 ratio combined with an ROE of 9.9 percent.[131]

99 Additionally, Mr. Garrett argues regulated utilities do not have the same incentive to maximize their value by minimizing their weighted average cost of capital because of the nature of rate base/rate of return ratemaking.[132] In support of using the Company's test-year structure, he argues that utilities can afford to have higher debt ratios due to their relative low-risk, large amount of fixed assets, and stable earnings.[133] Further, Mr. Garrett says he does not believe it appropriate to utilize the capital structures of a regulated utility proxy group to assess the appropriate structure for Avista for two reasons. First, he argues the capital structure must be based on the unique financial metrics of the target utility. Second, Mr. Garrett testifies the capital structures of the proxy group companies may not have been approved by their regulatory commissions.[134]

100 Mr. M. Garrett also discusses Avista's proposed merger in the context of Hydro One Limited's capital structure and cost of debt, which he says is "more in line with the downward trend in utility capital costs…across the country."[135]

101 ***ICNU.*** Mr. Gorman recommends the Commission authorize a capital structure based on the Company's actual mix at year-end 2016, including short-term debt of $100 million, resulting in a structure consisting of short-term debt of 2.9 percent, long-term debt of 48.7 percent and common equity of 48.4 percent.[136] He argues that Mr. Thies' proposal to eliminate short-term debt and increase common equity to the projected level at May 1, 2018, "unnecessarily increases Avista's revenue deficiency as common equity is the most expensive form of capital…"[137]

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[131] *Id.* at 71:4-72:3.

[132] *Id.* at 65:4-6.

[133] *Id.* at 13-15.

[134] *Id.* at 66:8-67:17.

[135] M. Garrett, Exh. MEG-1T at 15:2-3.

[136] Gorman, Exh. MPG-1T at 26, Table 6.

[137] *Id.* at 27:3-5.

102 In further support of his proposed capital structure, Mr. Gorman emphasizes that both rating agencies have rated Avista's outlook as "Stable" with S&P recently improving the outlook to "Positive" based on the potential acquisition by Hydro One Limited.[138] Additionally, he argues the year-end mix is similar to the structure previously awarded in the 2015 Avista GRC.[139] Finally, Mr. Gorman believes his proposal is "more reasonable as it achieves the objective of maintaining Avista's financial integrity and credit standing at a lower cost to retail customers."[140]

103 ***Avista's Rebuttal.*** Mr. Thies states that the primary difference between Avista's proposed capital structure and the other parties' is their inclusion of short-term debt in the calculation.[141] He explains the Company excluded short-term debt through a hypothetical capital structure based on the traditional pro forma analysis of Ms. Andrews that illustrates inadequate rate relief. Mr. Thies testifies that utilization of this regulatory tool provides the Company an opportunity to earn the proposed rate of return.[142] Therefore, Avista maintains its proposed hypothetical capital structure of 50 percent equity on rebuttal.[143]

104 Relying on Mr. McKenzie's utility trend analysis, Mr. Thies does not agree with Mr. Garrett's recommendation to move Avista toward Hydro One Limited's authorized capital structure or his argument that Hydro One Limited's structure is more in line with other jurisdictions across the country.[144]

105 ***Discussion and Decision.*** As discussed previously, Avista's currently authorized capital structure reflects 48.5 percent equity and 51.5 percent long- and short-term debt. Here, Avista proposes a hypothetical capital structure of 50 percent equity and 50 percent debt, derived in part by excluding short-term debt from the overall capital structure.

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[138] *Id.* at 24:6-8.

[139] *Id.* at 28:10-12.

[140] *Id.* at 26:11-13.

[141] Thies, Exh. MTT-6T at 13:10-12. Mr. Thies also notes that although Mr. Garrett indicates he did not include short-term debt, his testimony includes short-term debt within the long-term debt line item.

[142] *Id.* at 13:17-14:1.

[143] *Id.* at 16:5-9.

[144] *Id.* at 15:19-16:4.

106 The expert witnesses for Staff, Public Counsel, and ICNU oppose the Company's proposed hypothetical capital structure for a number of reasons, including, but not limited to, the Company's exclusion of short-term debt in its capital structure presentation, consistency of Avista's actual capital structure over the past few years, and little to no change in the Company's ratings agency outlook, among other factors.

107 We agree with Mr. Parcell that the evidence shows the actual equity component that Avista has maintained over the past few years, is in line with its currently authorized equity share of 48.5 percent, and is consistent with the capital structure of other utilities included in the proxy groups of the expert witnesses.

108 Mr. Parcell, Mr. Garrett, and Mr. Gorman each suggest the Company has failed to justify the need to increase the equity share of its capital structure. They argue that doing so would needlessly serve to raise the Company's authorized ROR, which, with its corresponding effect on the utility's rates, will unreasonably burden the Company's ratepayers.

109 As Mr. Parcell correctly points out, in setting a company's authorized capital structure, the Commission must balance safety (the preservation of investment quality credit ratings and access to capital) against economy (the lower overall cost to attract and maintain capital) using either the Company's historical capital structure, the projected capital structure, or a hypothetical capital structure. Here we find the Company has failed to justify a material change to its currently authorized capital structure consistent with this principle. While we understand that an increase to the equity component of the Company's authorized capital structure could potentially lower costs to access capital and solidify further Avista's existing credit ratings, we are not persuaded that an increase in the equity level as proposed by the Company is currently necessary.

110 A hypothetical capital structure should also be reserved for circumstances including, but not limited to, financial hardship or tight capital market conditions. In this case, we do not find either of these circumstances present to justify a hypothetical capital structure.

111 Accordingly, we reject Avista's proposed hypothetical capital structure and adopt the following structure for purposes of determining Avista's authorized ROR:

Table 2
Avista's Authorized Capital Structure

Component	Share

Equity	48.50%
LT Debt	48.60%
ST Debt	2.90%
Total	**100.00%**

112 As set forth in Table 3 below, applying the share of each component of the Company's capital structure to the costs of debt and ROE we adopt above, we derive an overall ROR of 7.5 percent to be utilized in the development of Avista's authorized revenue requirement for purposes of establishing rates in this proceeding.

Table 3
Determination of Avista's Authorized Rate of Return

Share	Cost	Weighted Cost
2.9%	3.26%	0.09%
48.6%	5.76%[145]	2.80%
48.5%	9.50%	4.61%
	7.50%	

[145] Derived using Thies, Exh. MTT-2C, columns j-k, excluding line 29.

C. Power Costs

113 ***Avista.*** During the 2016 test year, Avista was authorized to spend $98.8 million on power costs, but only spent $88.4 million.[146] The Company is requesting authorized power costs of $114.8 million in this case, an increase of $16 million (16.2 percent) over authorized rates and $26.3 million (29.8 percent) over test year expenditures.

114 In his overview, Mr. William Johnson explains that the primary driver of the Company's requested power cost increase is the expiration of a capacity sales contract with Portland General Electric (PGE), which provided $8 million in annual benefits to Washington customers that are currently reflected in rates but are no longer being received by the Company.[147]

115 Mr. Johnson also argues that if the Company is granted the Rate Plan as requested, it should be allowed to update its power cost baseline each year because customer rates should reflect the costs that the Company is experiencing as closely as possible.[148] He further argues that such treatment would be consistent with Puget Sound Energy's (PSE) power cost only rate case mechanism and the annual purchased gas cost adjustments for natural gas companies.[149]

116 In his initial testimony, Mr. Clint Kalich describes the Aurora software that the Company uses to model its power costs. Generally, the tool models load, generation, and transmission constraints across the Western Interconnect and calculates hourly market prices at each market hub in the West.[150] Using those market prices as inputs, Aurora then optimizes Avista's system each hour by seeking the lowest-cost mix of Company generation, market sales, and market purchases.

117 Mr. Kalich also testifies that Aurora's forecasted market prices track closely with available market forwards, which demonstrates the model's accuracy.[151] Finally, he briefly describes

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[146] Johnson, Exh. WGJ-1T at 3:12-18.

[147] *Id.* at 5:17-21.

[148] *Id.* at 11:9-13. The Company abandons this position on rebuttal.

[149] *Id.* at 11:13-16.

[150] Kalich, Exh. CGK-1T at 3:8-18.

[151] *Id.* at 5:1-22.

the modifications that Avista makes to the Aurora database, which he says are consistent with how the Company has used Aurora in previous cases.[152]

118 At the request of Staff, Mr. Kalich filed supplemental testimony that explains in greater detail the modifications that the Company makes to the Aurora model to ensure that its modeled market prices align with forward market prices, and compares the changes made in this case with the changes made in the Company's 2015 GRC.[153] He also provides an overview of the Energy Recovery Mechanism (ERM) since it was instituted in 2003, which indicates that in the first seven years, the mechanism under-collected by an average of $14.6 million per year, while in the last six years, it over-collected by an average of $10.8 million per year.[154]

119 Mr. Kalich concludes that the largest driver of the differences in power costs between the 2015 GRC and the current proceeding is the expiration of the PGE contract, which accounts for 80 percent of the Company's requested power cost increase.[155]

120 Avista's witness, Mr. Jeff Schlect, identifies a need for a $1.2 million[156] increase to the ERM baseline to offset a decrease in Avista's transmission revenues.[157] The primary drivers are the expiration of large transmission sales contracts to the Bonneville Power Administration, Morgan Stanley, and First Wind Energy Marketing.[158] Two factors offset the increased costs to some degree: increased revenue from higher Open Access

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[152] *Id.* at 7:8-10:2.

[153] Mr. Kalich explains why the Company goes through the exercise of adjusting the Aurora model to align with forward market prices in Exh. CGK-3T at 7:13-8:12.

[154] Kalich, Exh. CGK-3T at 28:9-20.

[155] *Id.* at 4:12-20.

[156] Schlect, Exh. JAS-1T at 9:17. The $1.9 million figure provided there, multiplied by the Washington allocation factor of .6574, yields $1.2 million.

[157] The transmission revenues that Mr. Schlect addresses are tracked through the ERM. The transmission expenses that he discusses, related to various regional body memberships, are not tracked through the ERM, but are included in adjustment 3.01. See Andrews, Exh. EMA-2 at 25:7-22 and 44:11-20.

[158] Schlect, Exh. JAS-1T at 15:1-10; 15:19-16:12.

Transmission Tariff (OATT) rates that FERC recently authorized the Company to charge,[159] and an increased revenue forecast for short-term transmission sales.[160]

121 Mr. Schlect also provides an update on Avista's consideration of joining the Energy Imbalance Market (EIM). He indicates that the Company is still considering the EIM and is not requesting recovery of any EIM costs in this proceeding.[161] For Avista, a primary driver in its analysis of joining the EIM is reduced daily market liquidity resulting from fewer available bilateral trading partners, as a growing number of regional utilities are now relying on the EIM for short-term power needs.[162]

122 ***Staff.*** Testifying on behalf of Staff, Mr. David Gomez argues that Avista has not met its burden of proof for its requested increase. Based on the Company's recent history of consistently over-forecasting its power costs, he recommends that the Commission deny Avista's request and make no changes to the baseline until the next rate case or until the ERM deferral balance, $21.6 million in ratepayers' favor as of November 2017, falls below $10 million.[163]

123 Mr. Gomez briefly recounts the history and purpose of Avista's ERM, which uses dead bands and sharing bands to: (1) equitably allocate between Avista and its Washington customers the risk of ordinary power cost variability, and (2) incentivize Avista to effectively manage or even reduce its power costs.[164] Table 4 summarizes Avista's current ERM structure:

Table 4
<u>Avista ERM Structure</u>

If collected revenue is, relative to authorized baseline:	Customer responsibility is:	Company responsibility is:
+/- $0 to $4 million	0%	100%

[159] *Id.* at 9:20-10:8.

[160] *Id.* at 12:22-14:2.

[161] *Id.* at 17:20-21.

[162] Kinney, Exh. SJK-1T at 27: 21-24.

[163] Gomez, Exh. DCG-1CT at 3:20-4:3.

[164] *Id.* at 5:11-13 (citing Order 03 in Docket UE-060181).

+ $4 million to $10 million	50%	50%
- $4 million to $10 million	75%	25%
+/- $10 million and up	90%	10%

124 Mr. Gomez concludes that, because of the way dead bands and sharing bands are structured, an appropriately set baseline is a necessary component of the ERM. If it is consistently set too low, the Company will absorb much of that difference between the authorized baseline and higher actual costs, and not recover its costs. If the authorized baseline is consistently set too high, the Company will receive a windfall at customers' expense. Mr. Gomez concludes that an appropriate ERM baseline should balance those risks by having an equal likelihood of costs coming in higher or lower.[165]

125 However, Mr. Gomez argues, Avista's power cost model is biased toward consistently over-estimating its power cost needs, which works to the Company's favor in two ways: generating excess revenue that the Company can keep through the dead and sharing bands and padding the ERM deferral account, which the Company then uses as an offsetting tool to facilitate its rate requests.[166]

126 As evidence for his claims, Mr. Gomez testifies that since 2011, Avista has over-collected its power costs by $64.6 million and, because of the dead and sharing bands, has kept $24.1 million – an average of $4.1 million per year.[167] He also briefly recounts the Company's recent history of annual rate case filings and concludes that the practice of allowing the Company to use ERM deferral balances to offset rate increases should cease, as it creates a strong incentive for the Company to over-forecast its power costs.[168] Mr. Gomez concludes that Avista's chronic over-forecasting of its power costs has prevented the ERM from working properly and raises questions regarding the Company's requested power cost increase.[169]

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[165] *Id.* at 7:18-8:6.

[166] *Id.* at 9:2; 11:8-21.

[167] *Id.* at 8:8-17.

[168] *Id.* at 10:1-11-21.

[169] *Id.* at 9:7-11.

127 Mr. Gomez contests the Company's claim that the expiration of the PGE sales contract necessitates a change in the power cost baseline. Avista made this same argument in the 2016 rate case, arguing that rates in 2017 had to be reset to account for the contract's expiration at the end of 2016. When the Commission rejected that case and left the baseline unchanged, rates continued to reflect the revenue that Avista received from the contract.[170] Despite that, Mr. Gomez testifies that Avista still over-collected on its power costs by $3.6 million through September 2017, suggesting that Avista overstated the impact of the PGE contract expiration and that granting the Company's request in the 2016 case would have only resulted in additional deferrals in 2017.[171]

128 Mr. Gomez also compares Avista's power cost modeling from 2011 to 2016 to that of PSE over the same period, and finds that PSE, on average, over-forecasted its power costs by 0.6 percent per year, while Avista, on average, over-forecasted its power costs by 7.4 percent per year over the same period.[172] He concludes that Avista's forecast inaccuracies are the result of its flawed usage of the Aurora model and spends the bulk of his testimony providing a detailed explanation of the specific flaws he identified.[173] Mr. Gomez argues that the problems he identifies demonstrate that Avista is manipulating the model to overestimate its power costs.[174] He identifies eight specific issues with the Company's usage of Aurora and presents Staff's alternative for how the issues should have been handled. In brief, Mr. Gomez identifies the following issues:

1. Rate year loads: Avista's modeled load in the rate year is 4 percent higher than weather-normalized test year load. Using projected load growth rates from Avista's 2015 Integrated Resource Plan, rate year loads should only be 0.5 percent higher than the test year.[175]

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[170] *Id.* at 12:6-8. See also *WUTC vs. Avista Corporation,* Dockets UE-160228 and UG-160229, Exh. WGJ-1T at 5:9-6:3.

[171] *Id.* at 12:8-17. Through November, Avista over-collected by $3 million.

[172] *Id.* at 13:1-5.

[173] *Id.* at 13:13:6-14:2.

[174] *Id.* at 14:13-15.

[175] *Id.* at 15:1-12.

2. Hourly load shape: Avista does not normalize its hourly load shape, resulting in larger hourly variations during costly peak hours.[176]

3. Forced outage rates: Avista does not provide documentation for its forced outage rate assumptions for some plants and does not reflect recent reliability investments that the Company represented as reducing forced outage rates at certain plants.[177]

4. Variable O&M costs: Avista could not provide documentation for the variable O&M costs that it input into Aurora.[178]

5. Marginal cost adders: Avista applies marginal cost adders to certain resources to make the modeled dispatch more reflective of actual dispatch, but it does not document how those adders are determined.[179]

6. Resource dispatch margin: Avista uses this input to align Aurora's modeled power prices with current market forward prices, but it results in further model distortions and has failed to deliver accurate price forecasts.[180]

7. General model settings: Avista acknowledges that it made general changes to Aurora's dispatch settings but did not explain the purpose for these modifications. Changes of this nature require significant discovery to understand and effectively shift the burden of proof onto Staff and other intervenors.[181]

8. Out-of-model adjustments: Avista's process for incorporating its power and natural gas contracts into the Aurora model is unclear and inconsistent.[182]

129 Mr. Gomez concludes that Avista's power cost request should be rejected because its modeling has been consistently inaccurate and its manipulations of the Aurora model are undocumented and result in power costs that other parties cannot validate.[183] He further

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[176] *Id.* at 16:16-18:6.

[177] *Id.* at 18:8:22:2.

[178] *Id.* at 22:6-23:11.

[179] *Id.* at 23:14-27:12.

[180] *Id.* at 27:14-32:5.

[181] *Id.* at 32:32:7-33:12.

[182] *Id.* at 33:14-34:17.

[183] *Id.* at 35:3-19.

argues that the structure of the ERM and the current deferral balance of $21.3 million provide both the Company and ratepayers with sufficient protections during the Rate Plan.[184] He recommends that Avista undertake a complete overhaul of its power cost forecasting and begin investigating the sources of its forecast errors.[185]

130 ***Public Counsel.*** Rachel S. Wilson of Synapse Energy Economics responds to Avista's requested power cost increase on behalf of Public Counsel. She concludes that Avista's frequent overearning through the ERM mechanism is driven by the Company's efforts to match the Aurora output to Mid-C forward prices and the many distorting adjustments it makes to the model to reach that target.[186] She recommends that the Commission reject the Company's requested power costs, that the ERM be allowed to function as designed and balance over time, and that Avista fully explore participation in the EIM.[187]

131 Ms. Wilson argues that the ERM was designed to manage power cost variability from year-to-year, but Avista's requests to reset the baseline every year since 2011 have prevented it from operating in this manner.[188] She also argues that recent years have been relatively stable both in terms of natural gas prices and hydropower production, and that Avista's persistent over-collection of actual power costs – which the Company has not explained – must therefore be the result of modeling flaws.[189]

132 Avista's use of Mid-C forward prices as its modeling target is inappropriate, Ms. Wilson argues, because market forwards and dispatch modeling serve different purposes. Market futures are financial instruments used for regional trading, while the purpose of dispatch modeling is to determine the least-cost solution for meeting demand in a given area, based on known factors such as resource costs and expected load.[190]

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[184] *Id.* at 35:17-19.

[185] *Id.* at 36:2-14.

[186] Wilson, Exh. RSW-1CT at 4:7-17.

[187] *Id.* at 4:18-5:2.

[188] *Id.* at 8:1-8.

[189] *Id.* at 8:9-12.

[190] *Id.* at 9:4-10:9.

133 Ms. Wilson argues that Aurora should be used to forecast expected costs under average conditions, which is why Avista and other utilities use 80 years of hydro data. By contrast, Mid-C futures are based on what market participants expect to happen given current conditions.[191] Furthermore, Mid-C prices represent profit-maximizing behavior by market participants to get the most value for their generation, whereas a dispatch model is seeking a least-cost balance of load and resources.[192]

134 Ms. Wilson argues that while a dispatch model has to solve for 24 hours every day, Mid-C contract prices are only divided into peak and non-peak offerings, which does not provide sufficient granularity for an hourly dispatch solution.[193]

135 To match its modeled prices to Mid-C forwards, Avista modifies inputs like resource costs and expected loads. Ms. Wilson argues that Aurora is not equipped to respond appropriately to those kinds of changes, and the output is distorted as a result.[194] In general, she argues, Avista's practice of increasing load to get the model to match Mid-C forwards results in it over-forecasting Avista's need to dispatch or purchase energy from high-cost peaking units, which, in turn increases Avista's power costs.[195]

136 Ms. Wilson concludes that the Commission should reject the Company's request and require Avista to explain the reason for its over-earnings from 2011 to 2016.[196] She testifies:

> At a minimum, the Commission can require Avista to provide the reasoning behind its overearning in the relevant historical years from 2011 through 2016. This may include backward-looking validation of the Aurora$_{XMP}$ model, where Avista compares modeled results from Aurora$_{XMP}$ to actual prices at Mid-C, and/or using evidence from its own purchases and sales, to discern the causes behind deviations in actuals from forecasts. Avista may want them to calibrate the model, making adjustments based on historical data (rather than the current iterative process used by

[191] *Id.* at 10:10-19.

[192] *Id.* at 11:1-7.

[193] *Id.* at 11:13-12:8.

[194] *Id.* at 13:1-14:14.

[195] *Id.* at 15:1-16:11.

[196] *Id.* at 18:7-9.

the Company) with the goal of more accurately matching forecasted net power supply expenses to actuals.[197]

137 She also recommends that Avista return to a fundamentals-based approach to forecasting power costs, which makes minimal model adjustments.[198] Finally, she suggests that the Commission consider requiring Avista to conduct a backward-looking validation of its power cost forecasts from 2011 through 2016, to identify the causes of its forecast error and better calibrate the model.[199]

138 ***ICNU.*** ICNU witness, Mr. Bradley G. Mullins recommends that the Commission deny the Company's request, based on Staff's discovery that "Avista's power cost modeling is based on a number of arbitrary assumptions which are intentionally designed to inflate the level of power costs in setting the ERM."[200] Mr. Mullins states, while in previous cases he has raised many of the power cost modeling issues that Staff identified in this case, Staff's investigation in this case has demonstrated that the impact of the Company's "arbitrary assumptions" is greater than he had understood.[201] He concludes that the authorized power costs should remain at the current level as the Company's current ERM deferral balance provides a sufficient hedge in the event that the Company's projected power cost increases are realized.[202]

139 ***Avista's Rebuttal.*** Mr. Johnson testifies that if Avista's power cost baseline is not increased, the ERM's dead band structure will force the Company to absorb a majority of its projected power cost increase as unrecovered costs.[203] He argues that Staff and the other parties have failed to provide any evidence to support their recommendations, and instead "assume that, because Avista didn't perfectly forecast costs during a period of rapidly falling expense,

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[197] *Id.* at 18:7-15.

[198] *Id.* at 18:16-21.

[199] *Id.* at 18:7-13.

[200] Mullins, Exh. BGM-1T at 31:17-19.

[201] *Id.* at 31:19-23.

[202] *Id.* at 31:1-8.

[203] Johnson, Exh. WGJ-6T at 2:18-3:2.

there must be something inherently or intentionally biased in its power cost modelling and that bias somehow magically offsets other undisputed power cost increases."[204]

140 However, in light of the parties' recommendations, Mr. Johnson suggests that Avista would be willing to forego its proposed annual power cost adjustments in years two and three of the Rate Plan, if the Commission approves the Company's requested first-year increase, to allow the parties to "reach a common understanding of what the ERM is designed to do."

141 He argues that the ERM should be evaluated in terms of its overall history since 2003, to recognize that the Company has absorbed significant losses as well, and to appreciate the decline in power costs since 2011, which has been a positive development for all parties and resulted in significant benefits to customers.[205] He also argues that attacks on the Company's modeling practices are unfair, as the Commission has approved the modeling approach on many occasions.[206]

142 Mr. Johnson testifies that since 2003, the net position of the ERM mechanism is $37.3 million in under-forecast power costs, of which the Company has absorbed $16.8 million and customers have paid $20.6 million.[207] He argues that the recommendations of Staff and the other parties ignore the first seven years of the ERM.[208]

143 Mr. Johnson asserts that the recent trend of lower-than-forecast power costs is the result of rapidly falling power cost prices. Since 2011, he states, Washington's allocated power costs have fallen by $133.1 million, and customers have captured $108.5 million of those reductions through reduced rates and ERM rebates.[209] Prices for natural gas and power have simply fallen faster than the ERM mechanism could adjust, and Avista has had good water conditions and good luck with plant availability, which have further reduced power prices.[210] According to Mr. Johnson, Avista has been successfully responding to the ERM's

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[204] *Id.* at 3:5-12.

[205] *Id.* at 4:1-13.

[206] *Id.* at 14-21.

[207] *Id.* at 8:1-17.

[208] *Id.* at 9:4-6.

[209] *Id.* at 10:20-11:4.

[210] *Id.* at 12:1-8.

incentives to manage its power costs, not manipulating the model as the parties allege.[211] Similarly, he argues that the Company's over-collection of power costs in 2017, despite the rejection of its 2016 GRC, is the result of good luck related to favorable hydro conditions and the continued decline in natural gas prices, not modeling deficiencies.[212]

144 Mr. Johnson argues that the loss of the PGE sales contract accounts for $10.6 million, or 66 percent of the Company's requested power cost increase, and that known contract terms for purchased power account for another $3.3 million.[213] He also asserts that Avista is entitled to recover known, legitimate increases such as these, and that allowing them to flow through the ERM, as the intervenors suggest, is contrary to the mechanism's purpose.[214]

145 Mr. Kalich argues that none of the other parties presented alternate power cost calculations, and that their scattershot criticisms do not produce any tangible alternatives.[215] He maintains that Staff had all of the tools and information necessary to conduct alternative Aurora model runs but did not do so.[216] ICNU and Public Counsel were provided with similar opportunities to conduct their own Aurora runs, but each also declined to do so.[217]

146 Mr. Kalich testifies that Avista conducted 23 alternative Aurora runs in response to data requests from the parties, and additional runs to evaluate the recommendations of Mr. Gomez.[218] He implies that the parties ignored these analyses because the analyses resulted in higher power costs.[219]

147 Mr. Kalich argues that Avista's power cost modeling methodology has been developed over many years with significant input from Staff and other parties. Modeling changes have only been adopted after significant vetting and Commission approval, and should not be changed

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[211] *Id.* at 12:13-22.

[212] *Id.* at 13:8-23.

[213] *Id.* at 14:1-21.

[214] *Id.* at 15:5-14.

[215] Kalich, Exh. CGK-4T at 2:21-25.

[216] *Id.* at 3:1-23.

[217] *Id.* at 6:13-7:5.

[218] *Id.* at 4:3-5; *Id.* at 6:5-12.

[219] *Id.* at 7:16-20.

based on how current conditions benefit one party or another, particularly in the absence of alternative model recommendations.[220]

148 In response to intervenors' comparisons of actual power costs to authorized power costs in historical years, Mr. Kalich contends that power cost modeling is based on normalized conditions, not forecasts, and it is therefore unreasonable to expect that the forecast will match actual costs in a given year.[221]

149 Mr. Kalich responds to the criticisms of each party directly. He takes exception to Mr. Gomez's assertion that the Company's filing lacks transparency, stating that parties had full access to the model and all of the Company's assumptions. No other party has made that accusation, he points out.[222]

150 Mr. Kalich then undertakes a point-by-point response to the eight issues that Mr. Gomez identified. He generally argues that the Company's practices in these areas are based on previous precedent and that Mr. Gomez does not provide a strong rationale for changing the practice. Many of the changes that Mr. Gomez recommends are related to ensuring the proper dispatch order, and do not have a material impact on power costs. When the Company conducted a model run that incorporated all of Mr. Gomez's recommendations, it actually increased system power supply costs by $2.7 million, Mr. Kalich states.[223]

151 Mr. Kalich also provides a response to the critiques of Public Counsel witness Ms. Wilson. He argues that her position rests on a flawed assertion that water levels and natural gas prices have been "relatively stable" since 2011.[224] He also dismisses her argument that matching Aurora's output to market forwards is distortionary, stating that matching the model to market forwards is consistent with Commission-approved practice and results in a more realistic model outcome. Not matching the model to market forwards would distort the results and reduce the accuracy of power cost forecasts, he concludes.[225] When Ms.

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[220] *Id.* at 8:14-9:10.

[221] *Id.* at 11:3-10.

[222] *Id.* at 12:21-13:9.

[223] *Id.* at 20:3-7.

[224] *Id.* at 22:2-10.

[225] *Id.* at 24:1-20.

Wilson's recommendations are included in the model, Mr. Kalich testifies that power costs increase by $5.6 million.[226]

152 In response to ICNU, Mr. Kalich simply states that Mr. Mullins relied wholly on the testimony of Staff for his recommendation, and in the absence of any evidence or analysis to support it, that recommendation should be rejected.[227]

153 ***Discussion and Decision.*** As Avista witness Mr. Kalich indicates in his rebuttal testimony, the contention over power costs in this case has risen to a level that we have not seen in some time.[228] That said, the issues raised by intervening parties suggest that this debate was long overdue. Regardless of whether changes in Avista's modeling practices have been made incrementally and with the support of the Commission and parties, as Mr. Kalich argues,[229] it is clear that those changes have collectively pushed the modeling to a tipping point and injected controversy into a topic that has historically been marked by general agreement among the parties.

154 The power cost debate in this case revolves around two central points: Avista's power cost modeling practices and the appropriateness of changing the ERM baseline. We take each of these in turn.

155 Mr. Kalich correctly identifies the Commission's previous endorsement of the bidding factor approach to aligning the power cost model. However, his own testimony also makes it clear that the Company has added a number of modeling modifications in addition to bidding factors, such as "adjusting congestion and costs to transmission from the Northwest to California, adjusting Northwest hydro shaping factors, and modifying Northwest electricity loads."[230]

156 It is not clear in the record whether the parties and the Commission have reviewed and accepted these additional modifications. What is clear in the record is that Avista's power cost forecasts have been consistently unbalanced in the Company's favor over recent years.

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[226] *Id.* at 27:11-18.

[227] *Id.* at 28:1-12.

[228] *Id.* at 9:1-2.

[229] *Id.* at 9:4-10.

[230] Kalich, Exh. CGK-3T at 10:1-5.

Avista has not supplied a backcast or other analysis to isolate the effect of lower natural gas prices and power prices on the directionally biased results observed over the last six years. The modeling concerns Mr. Gomez and Ms. Wilson raise are a first effort to remedy the repeated, unbalanced outcomes and may offer some explanation as to the cause of the observed inaccuracies.

157 The second point relates to the justification for increasing Avista's ERM baseline. Most of this discussion centered on the expired PGE contract, which Avista represents as a $10.6 million annual net loss.[231] Mr. Gomez argues that the Company should not be granted an increase based on the expiration of the PGE contract because it has already gone one year since the expiration of the contract without an adjustment and still over-recovered its power costs, which indicates that the Company overstated the loss and did not need an adjustment.[232] Mr. Johnson counters that low gas costs and favorable hydro conditions allowed the Company to absorb the lost PGE revenue in the test year.[233]

158 We agree with Mr. Johnson. Power costs are set based on known and forecast costs during a normalized year, and decisions should not be made solely based on how the forecast performed during the specific circumstances of a single test year. The expiration of the PGE contract is a finite, known event with a measurable impact, and adjusting the ERM baseline based on how that event would impact power costs during a normalized year is appropriate.

159 We authorize an increase of $14.5 million to the ERM baseline. This increase accounts for the increase in Washington's allocated share of power costs and the increased transmission costs identified by Mr. Schlect, which were both uncontested. It also accounts for the lost revenue from the PGE contract, which we find to be a significant change that justifies a baseline adjustment.

160 While we are authorizing an increase to the baseline in the instant case, the Commission believes the number of recent baseline adjustments is excessive. As Staff has pointed out, setting a proper baseline is necessary for the ERM to function as intended. Moving the baseline upward or downward in each general rate case results in distorted results. Going forward, the Commission will consider carefully any adjustments to the power cost baseline

[231] Johnson, Exh. WGJ-6T at 14:1-21.

[232] Gomez, Exh. DCG-1CT at 12:8-17.

[233] Johnson, Exh. WGJ-6T at 13:8-23.

and change it only in extraordinary circumstances, which would include more closely matching the baseline to actual collections.

161 Further, we order the Company to engage Staff, Public Counsel, ICNU, and other interested stakeholders in a discussion about how power cost modeling may be simplified and improved. While we do not think that a technical topic like power cost modeling lends itself to a formal collaborative or Commission proceeding at this time, we direct Avista to consult with its peer utilities, independent experts in the power cost modeling industry, Staff, and the other parties in this case on ways in which the Company may document the functionality and rationale of its power cost modeling and make changes to eliminate its directional bias. We order the Company to report back on this process and identify any resulting changes in its methodology in its next general rate case filing.

162 We recognize the apparent incongruity in questioning the Company's power cost model, but accepting that model's representation of how the PGE contract expiration affected the Company's revenue requirement. However, we find that the end of the PGE contract is a significant change to Avista's power costs that justifies a change in the baseline, and Avista's representation of how the revenue loss impacts the baseline is the only representation we have in the record. We therefore accept that representation for the purposes of this case only, and take this opportunity to remind intervening parties that they should endeavor to prepare and propose their own adjustments to power cost models and, where practical, to support their arguments with power cost modeling.

D. Capital Additions

163 ***Avista.*** In its initial filing, Avista proposes two separate pro forma capital adjustments each for electric and natural gas operations, resulting in four total adjustments. The first series of adjustments are based on a traditional pro forma study, while the second are based on the Company's proposed EOP study.

164 For the traditional pro forma adjustments, Avista proposes to use a cutoff date of December 31, 2017, and a threshold of 0.5 percent of rate base, which translates to a threshold of $6.9 million for electric projects and $1.3 million for natural gas projects.[234] Using this approach,

[234] Schuh, Exh. KKS-1T at 9:8-18.

Avista identifies five electric projects and six natural gas projects that the Company states are eligible for pro forma treatment.[235] Table 5 summarizes these projects:

Table 5

Summary of Avista's proposed pro forma capital investments

***Electric*[236]**

Substation rebuilds	$10.4 million
Information technology refresh program	$10.3 million
Distribution grid modernization	$9.8 million
Wood pole management	$7.0 million
Little Falls plant upgrade	$6.9 million
Electric Total:	***$44.4 million***

***Natural Gas*[237]**

Aldyl-A pipe replacement	$11.3 million
Information technology refresh program	$3.0 million
Information technology expansion program	$2.0 million
Central Office Facility restructuring	$1.9 million
Gas distribution non-revenue blanket	$1.7 million
Gas replacement for street/highway projects	$1.5 million
Natural Gas Total:	***$21.4 million***

165 Accounting for the impact of accumulated depreciation and amortization, the pro forma capital additions would increase rate base by $34.9 million for Avista's electric operations and $17.8 million for its natural gas operations.[238]

[235] *Id.* at 9:14-15. Through subsequent discovery, Avista acknowledged that the downtown network facility had been inadvertently included in the narrative (but not the math) of the electric adjustment and in both the narrative and the math for the natural gas adjustment. The correct number of projects in the Company's proposed traditional pro forma adjustment is five for electric and six for natural gas.

[236] Scanlan, Exh. KBS-1T at 20:16-20.

[237] *Id.* at 21:1-5.

[238] Andrews, Exh. EMA-2 at 8:42. This figure includes the net plant impact of the downtown network building, which was subsequently removed. Avista did not update this figure, as the Company takes a different approach to pro forma adjustments on rebuttal.

166 In calculating its proposed EOP pro forma capital adjustment, Avista essentially removes the cost threshold and proposes the inclusion of all projected capital expenditures in calendar year 2017.[239] Ms. Schuh argues that such treatment is necessary to reflect the level of rate base that will be required to serve customers during the rate year.[240]

167 The resulting proposed adjustments include 82 additional, discrete projects[241] totaling $249.4 million in capital investment on the electric side[242] and $38.5 million on the natural gas side.[243] Accounting for accumulated depreciation and amortization, the proposed adjustments would increase rate base by $119.9 million on the electric side[244] and $13.6 million on the natural gas side.[245]

168 Mr. Kinney describes 22 generation projects that the Company proposes to include in its pro forma adjustments, ranging from a few hundred dollars to $6.9 million which, collectively, total $43.5 million.[246] Only one project actually meets Avista's stated threshold and entered service in 2017 – the $6.9 million upgrade of the 32 megawatt Little Falls hydroelectric plant reflecting plant improvements to replace two turbines, all four generators, and general electric infrastructure at the plant. The equipment being replaced ranges from 60 to 100 years old.[247]

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[239] Schuh, Exh. KKS-1T at 10:11-14.

[240] *Id.* at 12:17-19.

[241] The Company does not consistently present the number of projects included in its pro forma adjustments. Exh. KKS-2 lists 11 traditional pro forma projects and 82 EOP pro forma projects, for a total of 93. In rebuttal testimony, the Company lists 121 total projects included in its proposed pro forma adjustments.

[242] Andrews, Exh. EMA-3 at 10:37.

[243] Andrews, Exh. EMA-7 at 8:35.

[244] *Id.* at 10:49.

[245] *Id.* at 8:42.

[246] See Kinney, Exh. SJK-1T at 13:1-21. Multiplying the total $66.1 million in investment by the Washington allocation factor of .6573 yields a total of $43.5 million.

[247] *Id.* at 14:12-30.

169 With regard to planned capital expenditures through 2021, Mr. Kinney identifies another $347.5 million that the Company proposes to spend on generation projects.[248] The largest planned investments over the period are $44.7 million to implement the Clark Fork Settlement Agreement,[249] $42.9 million to redevelop the Post Falls hydroelectric facility,[250] $23.8 million on various, unidentified upgrades for Colstrip Units 3 and 4,[251] $27.9 million for rehabilitation of the Nine Mile hydroelectric plant,[252] and $21.9 million for upgrades at the Long Lake hydroelectric plant.[253]

170 Ms. Rosentrater states that the Company "must continuously invest in its transmission infrastructure to maintain safe and reliable service for our customers and to meet mandatory federal reliability standards."[254] The Company's investments:

- replace equipment that has reached the end of its useful life,
- meet customer requests for interconnection or service enhancement,
- repair or replace infrastructure that fails,
- meet the Company's regulatory compliance requirements,
- ensure the availability of critical equipment when needed, and
- enhance the capacity or performance of the system to meet Company standards or serve additional load. [255]

171 Ms. Rosentrater states that "the Company's Transmission System Asset Management Plan recommends a 30-year replacement period for transmission assets."[256] She asserts Avista's

[248] *Id.* at 13:1-22.

[249] *Id.* at 25:22-38.

[250] *Id.* at 20:31-22:2.

[251] *Id.* at 25:3-20.

[252] *Id.* at 19:31-45.

[253] *Id.* at 19:4-29.

[254] Rosentrater, Exh. HLR-1T at 25:8-9.

[255] *Id.* at 25:10-14.

[256] *Id.* at 25:21-26:3.

current spending on replacement of transmission facilities reflected in its rate proposal "will require some transmission assets to operate reliably at an age beyond 60 years."[257]

172 Ms. Rosentrater states that North American Electric Reliability Corporation standards are the primary driver of regulatory compliance costs, especially the new standards that became mandatory under federal law in 2007 and require the transmission system to continue to operate normally with two major component outages.[258]

173 To meet its Performance and Capacity standards, Ms. Rosentrater states "the Company must plan for sufficient capacity in the system to accommodate a planned or forced outage to any one system component without customers having to experience an extensive outage."[259] The Company also invests in such assets as its Supervisory Control and Data Acquisition (SCADA) systems "to effectively monitor and control the system to ensure proper system performance."[260]

174 Ms. Rosentrater describes the newly established "engineering round table" that reviews the need for proposed transmission investment.[261] Consisting of 10 Company employees from Avista's major business units, the roundtable's purpose "is to provide added structure and increased transparency of the review process for both internal and external stakeholders, for development of all proposed transmission projects whether large specific projects or smaller, program-related proposals."[262]

175 Ms. Rosentrater describes general historical industry trends and lists three broad projects and one specific project: Distribution Grid Modernization, Distribution Wood Pole Management, Underground Cable Replacement, and PCB Transformer Replacement.[263] She states, however, that the planned investment level of the Distribution Grid Modernization Program requested in rates will result in an 80-year replacement cycle instead of the optimal 60-year

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[257] *Id.* at 25:21-26:6.

[258] *Id.* at 26:20-27:10.

[259] *Id.* at 29:6-11.

[260] *Id.* at 29:15-17.

[261] *Id.* at 30:6-31:11.

[262] *Id.* at 30:7-16. See *Id.* at 32 for a categorized transmission project investment list.

[263] *Id.* at 13:19-16:27.

schedule, resulting in the loss of a portion of the added customer value that could be delivered by the Grid Modernization Program.[264]

176 With regard to the Company's natural gas operations, Ms. Rosentrater testifies that Avista's primary drivers for investment in the distribution system are to ensure sufficient capacity to meet design-day heating needs, to replace equipment that has reached the end of its useful life, and to relocate natural gas lines in response to the infrastructure plans of local jurisdictions.[265]

177 Ms. Rosentrater identifies three natural gas distribution projects totaling $31.2 million that are eligible for traditional pro forma treatment: Aldyl A pipe replacement ($21.8 million), gas non-revenue program ($6.1 million) and gas replacement for street and highway projects ($3.3 million).[266] She also identifies 13 additional projects totaling $37.3 million that are associated with the Company's proposed EOP pro forma adjustment.[267] The largest drivers in this category are projected load growth-driven system expansion ($23.1 million), the high pressure pipeline remediation program ($5.3 million), and the isolated steel pipe replacement program ($2.1 million).[268]

178 According to Mr. Kensok, the technology refresh project is intended to keep up with the useful life of information technology components and supports technology replacement across six technology domains by balancing failure rates with useful life.[269] He explains that each "domain is governed by a Program Steering Committee that guides annual project priority in response to Avista's overall approach to technology and technology roadmaps, while balancing the risk of reliability and functionality."[270]

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[264] *Id.* at 16:29-17:6.

[265] *Id.* at 40:9-23.

[266] *Id.* at 43:1-38.

[267] *Id.* at 42:13-34.

[268] *Id.* at 44:1-49:6.

[269] Kensok, Exh. JMK-1T at 16:34-37. The six domains include: Distributed Systems, Central Systems, Communication Systems, Network Systems, Environmental Systems, and Business Applications.

[270] *Id.* at 16:37-17:1.

179 Turning to the Technology Expansion Program, Mr. Kensok states that the need for investment in recent years has primarily been driven by the need for new or expanded applications and networks systems.[271] He presents a projection indicating steady investment levels through 2020 of approximately $14 million with an increase to $19 million in 2021.

180 Finally, Mr. Kensok describes how the Company prioritizes information technology investments. Avista's technology initiatives are established by senior executives who are members of the Executive Technology Steering Committee (ETSC).[272] The demand for a proposed investment project and a five year roadmap are presented to the ETSC and the Technology Planning Group (TPG) along with the factors driving the current and expected need and timing for the investment.[273] Mr. Kensok clarifies that it is the TPG that "sets the priority across the technology investment portfolio, balancing business value and customer benefits, based on the ETSC's guidance."[274]

181 Turning to technology O&M costs, Mr. Kensok states that the Company's Traditional Pro Forma Study presented in its direct testimony includes both incremental labor costs and non-labor costs for information services that will be in place during the rate period beginning May 1, 2018.[275] He explains that "[t]hese incremental expenditures are necessary to support Company cyber and general security, emergency operations readiness, electric and natural gas facilities and operations support, and customer services."[276]

182 Mr. Kensok provides examples of how the Company "has successfully managed its O&M expenses."[277] For instance, the Company renegotiated a telecommunications contract two years prior to the end of its term, saving approximately $215,000 annually on the new five year contract.[278]

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[271] *Id.* at 19:14-15.

[272] *Id.* at 22:26-27.

[273] *Id.* at 22:22-26.

[274] *Id.* at 22:27-23:1.

[275] *Id.* at 24:1-5.

[276] *Id.* at 24:5-8.

[277] *Id.* at 31:12-13.

[278] *Id.* at 31:12-15.

183 ***Staff.*** Testifying on behalf of Commission Staff, Ms. Kathi Scanlan presents Staff's five criteria for supporting a pro forma plant adjustment:

- the plant addition must be major,
- it must be used and useful to Washington customers,
- its costs must be known and measurable,
- its costs must reflect any offsetting factors, and
- it must have been a prudent addition.[279]

184 For purposes of determining whether a resource qualifies as a major addition, Staff interprets WAC 480-140-040 and the Commission's order in Avista's 2015 GRC to establish a bright line threshold at 0.5 percent of net plant.[280] Ms. Scanlan argues that establishing materiality based on net plant is more appropriate than rate base, as the Company proposes, because rate base includes other factors that are not directly related to plant costs, such as deferred taxes and working capital.[281]

185 Staff's application of its criteria results in three key differences from the Company: Staff rejects the EOP pro forma adjustments outright, supports a higher cost threshold, and applies an earlier cutoff date for traditional pro forma adjustments.

186 Staff's pro forma cost threshold, based on the Company's net plant in service as of December 31, 2016, is \$8.6 million, about \$1.7 million higher than the Company's proposed threshold.[282] Staff also argues that costs incurred after August 31, 2017, should not be eligible for pro forma treatment, because they are based on forecasts and expenses for projects scheduled to be in service beyond this date and were too late in the rate case process for Staff to audit.[283] Ms. Scanlan argues that Staff's approach is more appropriate, because Avista's proposed threshold dilutes the meaning of major plant, distorts test year revenues and expenses, and relies on forecasted plant balances.[284]

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[279] Scanlan, Exh. KBS-1T at 15:1-12.

[280] *Id.* at 18:10-19, citing *WUTC vs. Avista,* Dockets UE-150204 and UG-150205, Order 05, ¶ 40.

[281] *Id.* at 18:20-19:12.

[282] *Id.* at 19:22.

[283] *Id.* at 23:1-9.

[284] *Id.* at 29:16-30:5.

Table 6
Summary of Staff Proposed Pro Forma Projects

Electric

Project	Avista Proposed	Staff Proposed
Substation Rebuilds	$10.4 million	$0.9 million
Information Technology Refresh Program	$10.3 million	$3.1 million
Distribution Grid Modernization	$9.8 million	$7.2 million
Wood Pole Management	$7.0 million	Excluded
Little Falls Powerhouse Redevelopment	$6.9 million	Excluded
Electric Rate Base Total	***$44.4 million***	***$11.2 million***

Natural Gas

Project	Avista Proposed	Staff Proposed
Aldyl-A Pipe Replacement	$11.3 million	$6.5 million
Information Technology Refresh Program	$3.0 million	$0.9 million
Information Technology Expansion Program	$2.0 million	$0.4 million
Central Office Facility Restructuring	$1.9 million	$0.2 million
Gas Distribution Non-Revenue Blanket	$1.7 million	$1.8 million
Gas Replacement for Road Projects	$1.5 million	Excluded
Natural Gas Rate Base Total	***$22.7 million***	***$9.9 million***

187 Ms. Scanlan argues that it would be inappropriate to set rates based on Avista's forecast of capital expenditures, because the forecast the Company included in its initial filing was already inaccurate by August, with actual electric transfers $6 million lower than forecast and natural gas transfers $3 million lower than forecast.[285]

188 Ms. Scanlan also identifies potential issues with projects planned in 2018 that the Commission should keep in mind as it considers granting a rate plan proposal, i.e., Colstrip upgrades and a new corporate jet and hangar.[286] She argues that the Company's testimony and evidence does not appear to have supported the recovery in rates of recent investments in Smart Burn technology at Colstrip, and that Mr. Kinney's testimony on planned

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[285] *Id.* at 30:7-17.

[286] *Id.* at 31:17-32:5.

expenditures at Colstrip is "sparse, vague and lacking sufficient detail."[287] Since the Smart Burn technology did not meet Avista or Staff's pro forma threshold, Ms. Scanlan recommends that the Commission revisit the issue and explicitly consider whether Avista should recover the costs of Smart Burn in a future rate case.[288]

189 Similarly, Ms. Scanlan argues that Avista did not provide sufficient documentation for its planned investments in a new corporate jet and hangar in 2018, and that the issue should be addressed in the next rate case.[289]

190 ***ICNU.*** Testifying on behalf of ICNU, Mr. Mullins declines to adopt a bright-line threshold for major plant additions, instead relying on professional judgment and his understanding of previous Commission decisions on pro forma adjustments.[290] He also argues that routine replacements of existing property should not be granted pro forma treatment.[291]

191 Applying these standards, Mr. Mullins only supports two of the Company's proposed pro forma projects: the Little Falls Plant Upgrade and the Aldyl-A Pipe Replacement.[292] He recommends that all remaining pro forma projects be rejected because they are either too small or because they constitute a routine replacement of existing property.[293]

192 ***Avista's Rebuttal.*** On rebuttal, Ms. Schuh argues that Staff's pro forma threshold is fundamentally unfair, as it excludes 114 out of 121 capital projects that the Company proposed for pro forma treatment[294] and fails to reflect the level of plant that will be in service during the rate year.[295] She argues that in previous cases, Staff proposed an attrition

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[287] *Id.* at 32:9-33:22.

[288] *Id.* at 34:1-13.

[289] *Id.* at 34:17-35:5.

[290] Mullins, Exh. BGM-1T at 25:9-17.

[291] *Id.* at 25:18-21.

[292] *Id.* at 25:1-8.

[293] *Id.* at 25:9-27:9.

[294] Schuh, Exh. KKS-3T at 4:1-2. Exhibit KKS-5, provided on rebuttal, identifies 121 projects as Ms. Schuh stated. The exhibit KKS-2, provided in the initial filing, only identified 82.

[295] Schuh, Exh. KKS-3T at 5:3-7:12.

adjustment when pro forma adjustments didn't allow the Company a reasonable opportunity to earn its allowed rate of return, but has not done so in this case.[296]

193 However, recognizing Staff's concerns, Avista proposes a different approach to pro forma adjustments on rebuttal, based on Staff's approach in the recent PSE GRC. Avista accepts Staff's EOP adjustment as a starting point, and then takes a functionalized approach, in which the Company independently calculates cost thresholds for generation, transmission, distribution, general plant, underground storage, and gas distribution projects, based on the rate base associated with each function.[297] Avista proposes to include expenditures through October 31, 2017, in its pro forma adjustment.

194 This approach reduces the number of pro forma projects to 36, but preserves the majority of the Company's total requested pro forma dollar amounts.[298] Avista's proposed pro forma capital adjustments on rebuttal increase electric rate base by $132.2 million (85.4 percent of its initial request for $154.8 million) and gas rate base by $30.6 million (96.8 percent of its initial request for $31.5 million).[299] Ms. Schuh states that Avista believes thresholds are inappropriate for pro forma adjustments, but calculated the functionalized thresholds as a compromise with Staff.[300] Further, Ms. Andrews argues that Staff, in adjusting its 2016 AMA balances to an EOP basis, has failed to "include the annualized level of depreciation expense on that same level of rate base, prevent[ing] the Company from recovering its investment or 'return of' that same investment."[301]

195 Ms. Schuh also rebuts the testimony of Mr. Mullins, arguing that his use of an arbitrary cost threshold and argument that routine equipment replacements do not qualify for pro forma treatment are inconsistent with Commission precedent.[302]

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[296] *Id.* at 13:1-11.

[297] *Id.* at 15:10-17:15. Avista also sub-functionalized the generation function into thermal, hydro, and other generation categories. See *Id.* at 16, n. 28.

[298] For a list of the 36 projects included in the Company's proposed adjustment, see Exh. KKS-5.

[299] Schuh, Exh. KKS-3T at 17:16-19 and 18:14-17.

[300] *Id.* at 19:13-15.

[301] Avista's Post-Hearing Brief, ¶ 13 (citing Andrews, Exh. EMA-10T at 20:6-10) (Emphasis in original).

[302] Schuh, Exh. KKS-3T at 24:15-27:6.

196 ***Discussion and Decision.*** In our Final Order in Pacific Power & Light Company's (Pacific Power) 2014 GRC, we clearly stated that we do not employ bright-line policies in considering post-test year capital additions.[303] We did, however, provide several points of policy guidance that are relevant to the instant case:

- These types of adjustments are evaluated on a case-by-case basis, following the used and useful and known and measurable standards while exercising considerable discretion.[304]
- There is no bright-line cutoff date, but granting pro forma adjustments beyond a few months after the end of the test year is "exceptional."[305]
- The later in time that a plant addition takes place, the more rigorous and concrete the support for it must be.[306]
- Pro forma adjustments must be supported by significant, auditable data.[307]
- While the Commission does not support a bright-line definition of major investment, proposed projects should meet some reasonable definition of major.[308]
- Pro forma adjustments must reflect offsetting factors.[309]

197 Additionally, we noted the number of projects in Pacific Power's proposed pro forma capital additions adjustment, which was 30, and the fact that Pacific Power's initial data in support of some adjustments proved to be inaccurate.[310] Ultimately, the Commission rejected 25 of Pacific Power's proposed 30 projects.

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[303] *WUTC vs. Pacific Power & Light Company*, Docket UE-140762, Order 08, ¶ 165 (March 25, 2015).

[304] *WUTC vs. Pacific Power & Light Company*, Docket UE-140762, Order 08 (March 25, 2015), ¶165 (March 25, 2015).

[305] *Id.*, n. 57.

[306] *Id.*, ¶169.

[307] *Id.*

[308] *Id.*, ¶170.

[309] *Id.*

[310] *Id.*, ¶169.

198 We find the sheer number of projects in the Company's initial filing – 121 of them – present the same issues we identified in the Pacific Power case. It creates a significant, and nearly prohibitive burden for Staff and the intervening parties to conduct any practical review and audit of such a large number of projects. Though Avista lowers this number to 36 projects on rebuttal, no intervening party may engage in a review and audit at this point in the proceeding. Further, Avista's proposal had only a small effect on the monetary impact of the Company's proposed pro forma adjustments.

199 The Company, which bears the burden of proof in this matter, did not provide any documentation of its proposal on rebuttal to functionalize its adjustments, which prevents the Commission or any party from properly evaluating it. When we authorized PSE's functionalized approach, we did so as part of our approval of a settlement agreement and did not reach the issue on its merits. Avista's use of functionalization in this case demonstrates that the approach is ripe for abuse, as the Company has divided and subdivided its functions until they are small enough to support even the barest pro forma adjustments. We reject the functionalized approach Avista proposes in the instant case not only because the Company did not support its request, but because it results in a bright-line test and can easily be leveraged to support otherwise minor projects, as we see in this case.

200 Staff accurately identified many of the factors that the Commission considers in establishing a pro forma adjustment, but carries its interpretation too far in advocating for a bright-line cost threshold, which we have clearly and repeatedly rejected. That said, given the sheer number of projects that Avista identified in its initial case, we appreciate Staff's position. As none of the other parties proposes a viable alternative, we accept, for purposes of this case, a more flexible version of Staff's "major" cost threshold proposal, which allows recovery of three additional projects that are significant. The Little Falls Powerhouse Redevelopment (Little Falls) and the Wood Pole Management (WPM) projects were both excluded by Staff as having been below the minimum threshold of $8.6 million for major capital additions, with Little Falls and WPM totaling $6.9 million and $7 million, respectively.

201 As for the Company's natural gas operations, we find that the Gas Replacement for Roads Projects (GRRP) should also be included despite the amount for this adjustment falling just below Staff's $1.7 million natural gas major projects threshold. GRRP expenses, for which Avista has requested recovery of $1.5 million, arise when the Company is forced by a local jurisdiction to relocate its natural gas facilities and Avista would be "in violation of its franchise agreements" if it refused or delayed action.[311] We find that these projects provide tangible value to ratepayers. In exercising our considerable discretion and examining each pro forma adjustment, we adopt Staff's recommendations on major plant adjustments with the exception of these three projects, which should also be allowed.

202 Further, we have cautioned that it would take exceptional circumstances for us to allow pro forma adjustments beyond the end of the test year. Staff provides a reasonable proposal to bridge the gap between an end-of-the-test year cutoff and the Company's much more permissive proposal. We find Staff's proposal of an August 31, 2017, cutoff deadline, eight months after the end of the test period, eminently reasonable.

203 We accept Avista's argument on rebuttal that the depreciation expense should be included to match the rate base balances Staff modified from 2016 AMA balances to EOP balances. Staff's exclusion of the annualized depreciation expense within its adjustment deprives Avista of a return of its investment. We find that the Company should also receive its annualized depreciation expense for this adjustment.

204 On a final note, we concur with Staff's assessment that Avista has provided insufficient information related to its investments at Colstrip Units 3 and 4. The Company presents an argument for the Smart Burn investment on rebuttal, but it does not dispel Staff's primary concern: that the investment does not appear to have been required by any state or federal laws.[312] Any future compliance obligations that the Smart Burn investment might have helped mitigate are purely speculative, and it is unclear whether the decision by the Colstrip owners to proactively take on future assumed compliance obligations reflected that retirements of other coal units in the region might reduce any compliance obligations for Colstrip Units 3 and 4.[313]

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[311] Rosentrater, Exh. HLR-1T at 43:30-38.

[312] Scanlan, Exh. KBS-1T at 32:12-14. As part of its testimony supporting the Rate Plan, Avista provided projected capital spending for Colstrip Units 3 and 4 from 2017 through 2021 of approximately $36 million on a Washington basis. Staff provided the combined owners' projected capital spending for Colstrip Unit 3 and 4 of approximately $314 million for the same period.

[313] Kinney, Exh. SJK-5T at 11:15-17. Mr. Kinney references the interaction between coal plant retirements and future obligations on Colstrip Units 3 and 4, but it is not clear whether recent retirements and announcements of future retirements were reflected in the Smart Burn decision.

205 Furthermore, Avista provides no details for its substantial planned investments in Colstrip Units 3 and 4 during the period 2018 through 2021. Given the weak economic conditions for coal plants, the age of Colstrip Units 3 and 4, as well as the unidentified upward bounds of potential environmental liabilities, the Commission agrees with Staff's recommendation that Avista must provide a more detailed examination of its justification for its investments at Colstrip in its next GRC.[314]

E. Operations and Maintenance Offsets

206 ***Avista.*** Avista witness Ms. Schuh proposes O&M offsets associated with the proposed capital additions adjustment included in the Company's EOP study.[315] She states that Avista reviewed maintenance records:

> to determine whether any specific maintenance costs were incurred in the test year that would be reduced or eliminated by the investment. Those costs were quantified and included as a reduction to O&M costs in the Pro Forma O&M Savings adjustment…[316]

She also states that increased or preserved generation resulting from generation plant additions is reflected in the results of the AURORA model.[317]

207 ***Staff.*** Ms. Scanlan does not include any O&M offsets, stating that none of the pro forma plant additions Staff supports have identifiable O&M offsets and the five plant additions with O&M offsets proposed by the Company associated with pro forma adjustments either do not qualify as major plant additions or the Company has withdrawn any O&M offsets associated with the pro forma plant addition.[318]

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[314] If and when the Company requests recovery of a portion of Colstrip capital expense in a GRC, the request must be accompanied by a comprehensive, up-to-date analysis of the economics and environmental liabilities and risks of Colstrip Units 3 and 4 over their expected life.

[315] Schuh, Exh. KKS-1T at 10:13-14, n 5.

[316] *Id.*

[317] *Id.* These benefits would be in the power cost results of the model and included in the proposed authorized power costs.

[318] Scanlan, Exh. KBS-1T at 24:9-13; 23:20-23; 24:3-7.

208 Ms. Scanlan states the Company includes three electric O&M offsets and two natural gas O&M offsets in its direct testimony.[319] She asserts that, in discovery, the Company removed one of the electric O&M offsets that it had inadvertently included.[320] Ms. Scanlan excludes Avista's other two electric offsets because they are associated with proposed pro forma plant additions that do not qualify as major plant additions.[321]

209 For natural gas O&M offsets, Ms. Scanlan states that, in response to discovery, the Company removes one of its O&M offsets to correct its adjustment and that she removes the other Company-proposed O&M offset because it is associated with a pro forma plant addition that, according to her criteria, is not a major project.[322]

210 ***Avista's Rebuttal.*** The Company substantially changes the pro forma plant additions it proposes to include in Rate Year 1. As a result, Ms. Andrews revises the Company's Pro Forma O&M offsets adjustments, as proposed on direct, to reflect offsets related to the pro forma plant additions it proposes on rebuttal.[323] Ms. Schuh presents the O&M offsets associated with five proposed pro forma plant additions as shown in Table 7 reproduced below.[324]

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[319] *Id.* at 23:19-20; 24:3-4.

[320] *Id.* at 23:20-23.

[321] *Id.* at 23:23-24:2.

[322] *Id.* at 24:3-7.

[323] Andrews, Exh. EMA-10T at 34:5-7.

[324] Schuh, Exh. KKS-3T at 22:15-21.

Table 7
Electric and Natural Gas O&M Offsets

ER	Business Case Name	Electric	Natural Gas
2423	System Transmission Rebuild Condition	$ 21,691	$ -
2457	Benton-Othello 115kv Reconductor	6,573	-
2060	Wood Pole Management	44,959	-
2584	Street Light Conversion to LED Fixtures	800,038	-
5005	Information Technology Refresh	18,017	5,190
7139	Downtown Network New Warehouse/Operations Building	210,000	-
Total		**$ 1,101,278**	**$ 5,190**

211 She states that the O&M offset for Street Light Conversion to LED Fixtures is included "even though the capital costs for this street light conversion project did not make the Company's functionalized threshold, and therefore has been excluded from the revenue requirement."[325] Ms. Schuh states that including this offset "provides a 10 [percent] reduction in the electric revenue requirement amount included related to the 2017 capital additions."[326]

212 ***Discussion and Decision.*** We approve the Company's O&M offsets that correspond directly to the capital additions adjustments we approve in this Order. Avista provided O&M offset amounts for two capital projects that we approve: Wood Pole Management, with an offset of $44,959, is included in this adjustment on the Company's electric side of operations, and Information Technology Refresh, with an offset of $18,017 and $5,190 for its electric and natural gas operations, respectively, is included. The Commission finds these O&M offsets in the public interest.

F. Multi-Party Partial Settlement Stipulation

213 On November 1, 2017, Avista, Staff, NWIGU, and the Energy Project (Settling Parties) filed a Multiparty Partial Settlement Stipulation (Partial Settlement) resolving cost-of-service, rate spread, and rate design for electric and natural gas services. ICNU opposes the Partial

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[325] *Id.* at 23:5-10.

[326] *Id.* at 23:10-12.

Settlement, and Public Counsel chose not to sign the Settlement. The Settling Parties agree that Avista's electric and natural gas cost-of-service studies (COSS) are directionally accurate but do not agree on specific cost-of-service methodologies and reserve the right to take any position on cost-of-service issues in the pending generic cost-of-service proceeding.[327] The Settling Parties adopt Avista's initial rate spread proposal, and agree to a mixture of basic and demand charge increases.

214 ***ICNU's Opposition.*** ICNU recommends the Commission reject Avista's electric COSS and adopt its own. It argues that the inter-class cross-subsidization revealed in its own COSS is too extreme for the Commission to wait for the completion of the generic cost-of-service proceeding. The organization recommends the Commission adopt a method that relatively assigns more production and transmission costs to a customer class's demand rather than its energy use. ICNU also proposes that the Commission allow large commercial and industrial customers to opt out of paying into Avista's demand-side management (DSM) program, and create a large customer demand response program.

215 The Settling Parties testify that the Partial Settlement is in the public interest for five reasons.[328]

1. The Partial Settlement defers arguments on the appropriate cost-of-service methodology to the generic cost-of-service collaborative.
2. Each of the parties agree that Avista's electric and natural gas COSS's are directionally accurate and that the Partial Settlement 'begins the process' of reducing cross-class subsidization.
3. The Partial Settlement avoids litigation expense, especially on the issue of cost-of-service, which will be explored in greater detail in the collaborative.
4. The Partial Settlement incrementally moves residential electric customers closer to parity without causing rate shock.
5. The Partial Settlement creates two new natural gas rate schedules expanding customer options.

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[327] For further information regarding the generic cost-of-service proceeding, see Dockets UE-170002 and UG-170003.

[328] Joint Memo in Support of the Partial Settlement, ¶¶ 22-26.

1. Electric and Natural Gas Cost-of-service

216 The Settling Parties do not agree on specific cost-of-service methodologies but reserve all issues and argument for the Commission's generic cost-of-service proceeding. However, they do agree that Avista's COSSs produce results that are directionally accurate, and at present, customer classes are not at unity.

217 The Settling Parties adopt Avista's proposed electric and natural gas rate spread proposals.[329]

- If electric rates are increased, all customer classes will receive an equal percentage rate increase, except Residential Schedules 1/2, which will receive a relative 106 percent increase, and General Service Schedules 11/12 will receive an 80 percent relative increase.
- If electric rates are decreased, all customer classes will receive an equal percentage rate decrease, except Residential Schedules 1/2, which will receive a relative 94 percent decrease, and General Service Schedules 11/12 will receive a 125 percent relative decrease.
- Each natural gas customer class except Special Contracts Schedule 148 will receive a percentage increase or decrease to margin rates dictated by the percentage increase or decrease in base margin revenue approved by the Commission in the 2018 rate year and in each year of any approved rate plan.[330]

2. Electric and Natural Gas Rate Design

218 For electric and natural gas rates, the Settling Parties propose several basic and demand charge increases to the customer classes. If the Commission approves a three-year rate plan, basic and demand charges would not change in the second and third years. For electric operations, the Partial Settlement proposes to administer the class's allocated revenue requirement through a uniform percentage basis to the class's variable energy rates using Schedules 96 and 93. For gas operations, the Partial Settlement proposes to administer the class's allocated revenue requirement through a uniform percentage basis.

219 The Settling Parties also propose that remaining revenue requirement be spread on a uniform basis to each block of each schedule's volumetric energy rates.

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[329] *Id.*, ¶8

[330] *Id.*, ¶11

Table 8
Partial Settlement Electric Basic and Demand Charge Increases

Type of Service	Present Charge	Proposed Charge	Increase
Residential Service Schedules 1/2			
Basic Charge	$8.50	$9.00	$0.50
General Service Schedules 11/12			
Basic Charge	$18.00	$20.00	$2.00
Demand Charge less than 20 kW	$0.00	No change	No change
Demand Charge over 20kW	$6.00/kW	$6.50/kW	$0.50
Single Phase Service Minimum	$15.00	$15.00	No change
Three Phase Service Minimum	$25.35	$25.35	No change
Large General Service Schedules 21/22			
Demand Charge under 50kW	$500.00	$500.00	No change
Demand Charge over 50 kW	$6.00/kW	$6.50/kW	$0.50
Extra Large General Service Schedule 25			
Demand Charge under 3,000 kva	$21,000	$24,000	$3,000
Demand Charge over 3,000 kva	$6.00/kva	$6.50/kva	$0.50
Annual Minimum	$829,950	$829,950	No change
Pumping Schedules 31/32			
Basic Charge	$18.00	$20.00	$2.00
Street and Area Lights 41-48			
Removal of High-Pressure Sodium Vapor			

Table 9
Partial Settlement Natural Gas Proposed Basic and Demand Charge Increase

Type of Service	Present Rates	Proposed Rates	Rate Increase
Residential General Service Schedules 101/102			
Basic Charge	$9.00	$9.50	$0.50
Large General Service Schedules 111/112			
Minimum monthly charge	$101.44	$101.44	No change
High Annual Load Factor Large General Service Schedules 121/122			
Minimum monthly charge	$252.28	$252.28	No change
Interruptible Service Schedule 132			

Annual minimum per therm	$0.27731	$0.27731	No change
Transportation Service Schedule 146			
Basic Charge	$500.00	$525.00	$25.00
Annual minimum per therm	$0.08905	$0.08905	No change

220 Finally, the Settlement creates two new natural gas transportation services, Schedules 116 and 126. Eligible customers include Large General Service Schedules 111 and 112 customers with a minimum annual average usage of 30,000 therms and all customers served under Schedules 121 and 122. Customers must take service for at least one year, pay base and adder schedule rates (such as DSM, decoupling, and low-income ratepayer assistance program) based on Schedules 111 and 112 if they elect to take service under Schedule 116, or pay based on Schedules 121 and 122 if they elect to take service under Schedule 126.

221 ***Testimony in Support of the Partial Settlement.*** Mr. Patrick Ehrbar testifies on behalf of the Company to support the Partial Settlement, and he asserts that it was a true “give-and-take” that attempted to arrive at a reasonable balance of differing interests.[331] He writes that the Settling Parties agree that a generic cost-of-service proceeding is the best venue to discuss specific methodologies, and cites to ICNU’s support of the generic proceeding in the previous rate case.[332]

222 In regard to the new natural gas transportation schedules, Mr. Ehrbar testifies that the Settling Parties did not amend existing natural gas transportation Schedule 146 for two reasons. First, the new Schedules 116 and 126 are designed to be revenue neutral for the Company.[333] The Settling Parties accomplished this by keeping base rates for Schedule 116 the same as Schedules 111 and 112, and the base rates for Schedule 126 the same as Schedules 121 and 122. The second reason is the cost-of-serving Schedule 116 and 126 customers will not be the same as Schedule 146, and a customer moving to Schedule 146 would shift costs onto other customers.

223 Mr. Ehrbar also writes that the minimum annual usage threshold was set at 30,000 therms for Schedule 116 to allow more customers access to transportation service, but not lead to a

[331] Ehrbar, Exh. PDE-8T at 2:10-18.

[332] *Id.* at 2:22-3:9.

[333] *Id.* at 9:8-19.

dramatic increase in the time and costs associated with scheduling customer-owned natural gas transport.[334]

224 Staff witness Ms. Elizabeth O'Connell filed testimony on behalf of Staff in support of the Partial Settlement. She testifies that Staff supports the Partial Settlement because:

- It reserves cost-of-service arguments for the generic proceeding and provides the Commission a "tenable basis" for making determinations in this case without the risk of creating additional precedent that interferes with the generic proceeding;[335]
- It moves each class towards parity yet avoids potential rate shock;[336]
- The proposed increase to basic and minimum charges increases the likelihood Avista can recover its fixed costs and minimizes rate shock;[337]
- The increase to demand charges can send an important price signal that encourages customers to reduce peak demand;[338]
- The phase-out of high-pressure sodium lights is consistent with Avista's biennial conservation plan;[339] and
- The new natural gas transportation services were a critical component to achieving a settlement, it will only apply up to 300 customers, and it may lead to achieving the Commission's policy goal of expanding the natural gas system.[340]

225 NWIGU witness Mr. Edward Finklea testifies in support of the Partial Settlement's natural gas terms as they spread the increasing costs on an equal percent of margin basis and

[334] *Id.* at 9:1-4.

[335] O'Connell, Exh. ECO-1T at 5:1-9.

[336] *Id.* at 8:2-6.

[337] *Id.* at 9:13-15.

[338] *Id.* at 9:15-17.

[339] *Id.* at 9:17-19.

[340] *Id.* at 10:2-10.

preserve the generic proceeding as a better forum for investigation of cost-of-service questions.[341]

226 Mr. Finklea is also supportive of the additional transportation service option for small commercial and industrial customers. He believes this option will give small customers a more cost-effective procurement option with greater flexibility.[342] He notes that PSE already has transportation schedules for smaller customers.[343]

227 The Energy Project supported the Partial Settlement because it moderates the impact of Avista's proposed customer charges and addressed parity concerns.[344]

228 Public Counsel did not sign the Partial Settlement but does not oppose it.

229 ***ICNU's Opposition.*** Testifying on behalf of ICNU, Mr. Robert Stephens urges the Commission not to wait for the completion of the generic cost-of-service proceeding and adopt his proposal in this rate case. He argues that there is a need to correct customer class inequities now, especially with the potential for a multi-year rate plan. The fact that a generic proceeding has begun, he writes, does not obviate the need for a COSS in this case.[345]

230 Mr. Stephens has two primary concerns with Avista's proposed electric COSS:

1. Avista's Peak Credit method is inappropriate because its classification of production and transmission plant leans too heavily on energy use and too little on the customer's contribution to peak demand for each month of the year.[346] Mr. Stephens recommends that production costs should be classified and allocated to customer classes according to each class' demand during Avista's system peak

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[341] Finklea, Exh. EAF-1T at 3:19-4:8.

[342] *Id.* at 4:16-19.

[343] *Id.* at 6:8-10.

[344] Collins, Exh. SMC-3T at 4:3-18.

[345] Stephens, Exh. RRS-1CT at 8:12-16.

[346] *Id.* at 9:7-12.

demand in the peak months. It is the demand for power, Mr. Stephens writes, not the energy flow itself that determines when additional capacity is needed. [347]

2. Avista's electric COSS improperly allocates the cost of transmission service using the same peak credit classification and allocation approach.[348]

a. Classifying Production Costs

231 Mr. Stephens asserts that production investment is primarily for meeting peak system demand, and therefore production should be assigned exclusively, or at least primarily, on each customer class' contribution to the coincidental peak (CP).[349] If energy usage is considered at all, Mr. Stephens testifies, it is more appropriate and typical to use the average and excess demand method that allocates production plants' costs to rate classes using factors that combine the classes' average demands and non-coincident peak demands.[350]

232 Nevertheless, if the Commission approves Avista's Peak Credit classification, Mr. Stephens recommends that the Commission adopt a Summer and Winter Allocation Method that assigns equal weight to the summer and winter seasons using an ICNU-modified 5-month CP allocation approach,[351] and limits peak demands to within 10 percent of the system peak.[352]

b. Allocation of Demand-Related Costs

233 For allocating demand-related costs, Mr. Stephens argues that the Company should not use its 12-month CP (12 CP) method.[353] Despite Avista's claim of being a winter-peaking

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[347] *Id.* at 9:13-10:6.

[348] *Id.* at 10:7-9.

[349] *Id.* at 24:16-18. Avista's method for classification of production and transmission results in 37.65 percent of costs allocated based on demand, and 62.35 percent of costs allocated based on energy usage.

[350] *Id.* at 25:3-6.

[351] A traditional 4 or 5 CP approach assigns equal weight to each month. Mr. Stephen's modified approach averages December and January and assigns 50 percent of the weight, and assigns the other 50 percent to the average of June, July, and August.

[352] Stephens, Exh. RRS-1CT at 25:2-6.

[353] *Id.* at 11:14-22.

utility, Mr. Stephens contends that Avista has actually become a "bi-modal utility system" and is trending towards a summer-peaking utility.[354] Both Avista's system summer peaks and its winter peaks drive capacity demand, according to Mr. Stephens. Moreover, he writes, the NARUC Manual does not support the Company's use of 12 CP because that method is typically used when the monthly peaks lie within a narrow range, and Avista's load fluctuates too much.[355]

c. Classification of Transmission Costs

234 Mr. Stephens recommends that the Commission assign all of the transmission costs as demand-related using a 12 CP methodology. He states that he is unaware of any case in a state outside of Washington that classifies or allocates transmission costs as energy-related.[356] Unlike production costs, Mr. Stephens contends that there is no trade-off between fixed and variable costs to justify an energy component to reflect cost causation. Although he is uncertain that 12 CP is the best cost causation measure, FERC recommends using 12 CP for transmission service billing, and Avista uses it in its current OATT.[357]

d. Rate Spread

235 Mr. Stephens writes that the Company's proposed rate spread is acceptable if Avista receives its full revenue request. However, if the Commission approves something less than proposed, Schedules 1 and 2 should not be reduced, and the 'savings' should go to the other classes.[358] For 2019 and 2020 rates, he recommends Schedules 1 and 2 rates are increased by at least 5 percent each year.[359]

236 Mr. Stephens does not think Avista's rate spread proposal moves residential customers enough towards parity. Although he does not believe full parity is feasible because it would

[354] *Id.*

[355] *Id.* at 13:10-16.

[356] *Id.* at 28:11-13.

[357] *Id.* at 30:3-9.

[358] *Id.* at 36:4-10.

[359] *Id.* at 36:11-37:2.

require a 29 to 36 percent increase in residential rates, he recommends the Commission adopt a rate spread that is more aggressive than the Company's proposal.[360]

e. Rate Design

237 Mr. Stephens makes two rate design recommendations. First, he recommends that the Commission eliminate the DSM rider for Schedule 25 customers, or in the alternative, create a self-direct option. Second, he recommends the Commission require Avista to develop a demand response program for a single customer.

238 Mr. Stephens argues that Schedule 25 customers receive direct DSM incentives far below their contribution levels relative to other schedules.[361] ICNU's efforts to address its concerns have not been favorably received in the Conservation Advisory Group and thus, ICNU is bringing them forward in this rate case. Mr. Stephens recommends the Commission allow Schedule 25 customers to opt-out because those customers already have adequate incentives to pursue cost-effective energy efficiency, and their complex systems do not readily conform to standard utility programs.[362]

239 Other stakeholders oppose the opt-out provision, according to Mr. Stephens, because other customers benefit from Schedule 25 customers subsidizing the program.[363] Mr. Stephens writes that energy intensive industries already have a strong incentive to pursue cost-effective energy efficiency and generally have done so, as evidenced by the small proportion of program incentives directed at these customers. He also questions the accuracy, certainty, and quantification of 'alleged savings.'[364]

240 If the Commission does not order an opt-out provision, Mr. Stephens recommends the Commission adopt a large customer self-directed DSM option that provides an additional

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[360] *Id.* at 35:8-20.

[361] *Id.* at 39:11-40:4.

[362] *Id.* at 40:14-41:2.

[363] *Id.* at 41:19-21.

[364] *Id.* at 42:11-20.

incentive to invest in energy efficiency, although "such an incentive arguably is not needed."[365]

241 Finally, Mr. Stephens recommends that the Commission direct Avista to initiate a pilot demand response program for Schedule 25 customers who are able to commit to load reduction of at least 25 megawatts.[366] He provides an initial proposal in Exhibit No. RRS-10, but he expects that other parties may have suggestions that could improve the proposal.

242 ***Parties' Rebuttal and Cross-Answering.*** Avista witness Mr. Ehrbar dismisses ICNU's criticism of its Peak Credit method as "missing the mark," arguing that the method balances how a system is designed to meet peak load with how the system is actually used day-to-day.[367] Moreover, he indicates that the Commission stated in the 2014 Pacific Power GRC that the Commission "has long preferred the Peak Credit methodology and consistently has approved its use in cost-of-service studies for Pacific Power, and for both PSE and Avista."[368] Significantly, Mr. Ehrbar also believes that Mr. Stephens's COSS is not materially different than the Company's, and in fact it confirms that, for the basis of setting rates, Avista's COSS is directionally accurate.[369]

243 Avista also opposes Mr. Stephens's DSM opt-out proposal for large customers. Avista argues that the Company's DSM program provides system benefits to all customers by deferring increased generation costs over time.[370] However, he notes the Company is willing to propose a self-directed option to its DSM Advisory Group in the second half of 2018.[371]

244 Staff witness Ms. O'Connell urges the Commission to reject ICNU's proposal, arguing that a COSS is a tool that informs but does not dictate rate spread, such that even if the Commission adopted ICNU's proposed COSS it would not change Staff's rate spread

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[365] *Id.* at 43:4-14.

[366] *Id.* at 46:23-47:5; Stephens, Exh. RRS-10 at 1.

[367] Ehrbar, Exh. PDE-9T at 4:8-11.

[368] *Id.* at 4:14-16 (citing *WUTC v. Pacific Power,* Docket UE-140762 et. al., Order 08, ¶190 (Mar. 25, 2015)).

[369] Ehrbar, Exh. PDE-9T 5:19-6:5.

[370] Christie, Exh. KJC-2T at 26:22-27:5.

[371] *Id.* at 27:8-13.

recommendation.[372] However, Ms. O'Connell disagrees with ICNU's assertion that there is a lack of support for Avista's COSS Peak Credit methodology, noting that the Commission has approved the Peak Credit method as far back as 1982. Furthermore, Ms. O'Connell contends that ICNU's view of COSS ignores the fact that a utility mostly operates under non-peak conditions and develops its resource stack accordingly.[373] Ultimately, Staff supports the Partial Settlement because Avista's COSS is directionally accurate, gradually moves customer classes toward parity, and allows the parties to dispute specific cost-of-service methodologies in the generic proceeding.[374]

245 Like Avista, Staff also opposes ICNU's proposal to allow large customers to opt-out of funding Avista's conservation programs. Ms. O'Connell states that ICNU's analysis fails to include indirect benefits to the entire system, such as deferred capacity, and asks the Commission to consider only direct incentive payments to Schedule 25 customers.[375] Staff also argues that a customer should not be able to opt out of paying for a specific resource, particularly one that the utility is legally obligated to pursue.[376]

246 The Energy Project opposes all of ICNU's proposals, writing that it does not see a useful purpose for litigating the breadth of cost-of-service arguments in this case because the Commission has already initiated a generic cost-of-service proceeding to examine these very arguments.[377] It also cites ICNU's proposed rate spread as unfair to the nearly 40 percent of the residential class that qualifies as 'low income.'[378] The Energy Project argues that allowing Schedule 25 customers to opt out of paying into Avista's conservation programs is poor public policy that ignores the benefits that all customers receive regardless of who directly participates in the program.[379]

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[372] O'Connell, Exh. ECO-6T at 3:6-10.

[373] *Id.* at 11:12-19.

[374] *Id.* at 3:11-17.

[375] Snyder, Exh. JES-12T at 2:11-3:8.

[376] *Id.* at 4:18-5:2.

[377] Collins, Exh. SMC-4T at 4:4-16.

[378] *Id.* at 5:15-6:15

[379] *Id.* at 6:16-8:13.

247 ***Discussion and Decision.*** Pursuant to WAC 480-07-750(1), the Commission will approve settlements when doing so is lawful, when the settlement terms are supported by an appropriate record, and when the result is consistent with the public interest in light of all the information available to it. In considering a settlement, we can accept the settlement, with or without conditions, or reject the agreement outright.[380]

248 The Settling Parties have presented us with a Partial Settlement that moves the rates of the customer classes closer to parity. ICNU argues for a quicker and more drastic move to parity than provided for in the Partial Settlement, but its proposal is contrary to the longstanding regulatory principle of gradualism. The Partial Settlement continues the process of reducing cross-class subsidization, and Avista's COSSs used by the Settling Parties, produces results that are directionally accurate. Further, by adopting the Partial Settlement, we leave the question of specific COSS methodologies to the generic cost-of-service proceedings.

249 We find that the Partial Settlement is lawful, the terms are supported by an appropriate record, and the result is consistent with the public interest in light of all the information before the Commission, and is approved.

250 We reject ICNU's recommendation to eliminate the DSM rider for Schedule 25 customers, or in the alternative, create a self-direct option. Although we are pleased that members of the Conservation Advisory Group are willing to discuss if the Company can better meet Schedule 25 customers' needs,[381] we state definitively that all customers benefit, even indirectly, when a utility invests in cost-effective conservation resources. We also agree with Staff that a customer should not have the option to choose to opt out of a resource the utility is legally obligated to pursue, particularly if that group of customers has already taken advantage of that program and now has fewer opportunities for direct benefits. Finally, we also decline to obligate the Company to create a demand response program for Schedule 25 customers at this time.

251 We observe that the parties in the instant and recent Avista general rate proceedings have used relative rates of return, or return ratios, to illustrate the disparity in the cost to serve each customer class from the revenues received from each class.[382] The Commission strives

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[380] WAC 480-07-750(2).

[381] Christie, Exh. KJC-2T at 27:8-13, and Snyder, Exh. JES-12T at 5:15-6:7.

[382] Ehrbar, Exh. PDE-1T at Table No. 5 (electric) and Table No. 8 (gas), O'Connell, Exh. ECO-1T at 7, Stephens, Exh. RRS-1CT at 37:15-17 and Table No. 4.

for setting cost-reflective rates and uses COSSs to inform its rate spread decisions. The parity ratio fulfills this purpose more accurately as a simple distillation of whether a customer class is paying the approximate amount needed to cover its share of costs. While we do not preclude the use of return ratios for parties in presenting their cases, we explicitly require that parties present the traditional parity ratio as well. If a party believes the return ratio is the appropriate measure, we expect corresponding testimony supporting this view.

252 Further, the dispute over cost-of-service study methodologies in this proceeding demonstrates that now is the time for Staff to move discussions forward, without further delay, in the generic cost-of-service proceeding and work with other parties to formulate recommendations for Commission consideration. While Staff and other parties have been distracted from devoting time to the generic proceeding due to the number and extent of litigated and other proceedings before the Commission, we note that this is the second consecutive general rate case in which the Commission has deferred cost-of-service issues to the generic proceeding. We expect Staff to schedule meetings as soon as possible to continue and make progress on these important discussions. We request Staff to report to the Commission its progress in the generic proceeding every three months from the effective date of this Order.

G. Line Extension and Fuel Conversion Programs

253 In its response testimony, Staff makes recommendations on the future of two of Avista's natural gas programs, the LEAP pilot and Fuel Conversion program.

254 ***LEAP.*** Approved in 2015 as a pilot, the LEAP program gives residential customers an allowance for installing natural gas facilities, and customers may use any excess allowance towards the purchase and installation of high efficiency space heating and water heating equipment.[383] The original purpose of LEAP was to "help expand natural gas distribution infrastructure to address environmental concerns associated with emissions, and further promote the efficient end-use of natural gas."[384]

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[383] Snyder, Exh. JES-1T at 3:17-4:2. Staff is not contesting Adjustment 3.13, Pro Forma LEAP Deferral. *See* Snyder, Exh. JES-1T at 4:3-6. The $2.9 million deferral balance incurred between March 1, 2016, and March 31, 2017, is amortized over a five-year period from May 1, 2018, to April 30, 2023. The resulting annual amortization is $580,000.

[384] *Id.* at 8:20-9:4.

255 Despite its design as an innovative program, Staff witness Ms. Snyder writes, LEAP does not adhere to best practices for a pilot program.[385] Avista has not considered or developed basic criteria to evaluate the success of the pilot at the end of its three years.[386] The recent uptick in residential natural gas hook-ups appears to correlate with the inception of the LEAP program. However, Avista does not have sufficient evidence, or the appropriate metrics, for the Company or other parties to determine whether the LEAP program is driving the demand.[387] Ms. Snyder theorizes that it is possible that other factors could be driving conversions, such as new construction in Avista's service territory, low gas prices, or the Company's Fuel Conversion program.[388]

256 Ms. Snyder recommends that the Commission impose upon the Company the following reporting and evaluation conditions:[389]

- Avista must work with Staff to identify appropriate measures for evaluating the success of LEAP;
- Avista shall appropriately modify the metrics reported in the semi-annual reports;
- Avista must update tariff sheets to reflect programmatic changes; and
- Avista's electric-to-natural gas Fuel Conversion program should be discontinued starting with the 2018-2019 biennium.

257 Staff also requests that the Company be required to notify Staff no later than November 30, 2018, if it intends to make the LEAP program permanent, modify it, extend it as a pilot, or discontinue it.

258 Measures of success should go beyond the number of new customers hooked-up, writes Ms. Snyder. She recommends that the Company incorporate additional measures of success that,

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[385] *Id.* at 4:20-5:4.

[386] *Id.* at 5:8-7:1. Ms. Snyder writes that prior to the first semi-annual report, Avista asked Staff what content it would like to see in the reports and complied with all of Staff's requests. The information includes hook-ups per year, hook-ups since inception of the pilot, and average amount of estimated line extension, among others.

[387] *Id.* at 7:4-8.

[388] *Id.* at 7:4-8:11.

[389] *Id.* at 3:1-7.

at a minimum, include cost-effectiveness,[390] long-term emissions comparisons,[391] and customer survey data.[392]

259 ***Fuel Conversion.*** Staff argues that the Company's Fuel Conversion program, funded through its electric conservation rider, is duplicative with other DSM, rebate incentives, providing 'generous' rebates to the same customer and for the same actions.[393] Ms. Snyder recognizes the benefits of increasing access to natural gas, but argues that those programs are more properly funded through natural gas rates as is done in the LEAP program.[394]

260 Ms. Snyder considers it unfair for electric ratepayers to pay other customers to switch to natural gas.[395] First, it burdens them with paying the costs of conversion,[396] and second, electric customers do not receive the same type of avoided costs benefit from fuel conversion as from traditional conservation measures. Ms. Snyder also argues that counting loss of load as a benefit is as inappropriate as counting customers who leave the system, such as through retail wheeling, as a benefit.

261 Ms. Snyder argues that fuel conversions are not electric conservation, and should not be funded through the electric conservation rider.[397] Ms. Snyder asserts that converting electric load to gas does not meet the definition of conservation in WAC 480-109-060(6) or in the Northwest Power Act.[398] Nor has the Northwest Power and Conservation Council included

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[390] *Id.* at 9:6-10:2.

[391] *Id.* at 10:4-11:8.

[392] *Id.* at 11:11-11:17.

[393] *Id.* at 13:11-21.

[394] *Id.* at 12:22-13:7; *Id.* at 19:6-8.

[395] *Id.* at 15:8-16:2.

[396] Ms. Snyder estimates that the total available rebate for an average customer who switches to natural gas using a mix of LEAP, Fuel Conversion, and natural gas DSM rebates is $5,555, and can reach up to $7,582. One effect of the duplicative rebate programs, according to Ms. Snyder, is it makes it difficult for Staff to determine the effect of the LEAP program. Snyder, Exh. JES-1T at 14:2, Table 2.

[397] Snyder, Exh. JES-1T at 16:8-18:6.

[398] The Pacific Northwest Electric Power Planning and Conservation Act, better known as the Northwest Power Act, defines conservation as, "any reduction in electric power consumption as a

fuel conversion as a form of electric conservation in the regional power plan. Avista's Fuel Conversion program, argues Ms. Snyder, does nothing to promote the efficient *use* of electricity.

262 Despite allowing the Company to recover the costs of the program through the electric conservation rider, Ms. Snyder argues, historically the Commission has not treated Fuel Conversion savings as conservation. Moreover, the savings from the program have been held outside of the Company's conservation target, and the program is not required by the state's Energy Independence Act.[399] When the Commission has approved non-conservation program costs recovered through the conservation rider,[400] she argues, the projects were small, had minimal impact on the rate of the rider, were recognized to provide public benefit, and were unlikely to be supported by the utility if not for this type of recovery.[401] Ms. Snyder asserts that these themes no longer exist in Avista's Fuel Conversion program.

263 The cumulative impact of the LEAP program, the rebates for energy efficient appliances, and the Fuel Conversion rebate "puts more than just a thumb on the scale in favor of gas" and distorts the inter-fuel competition both inside and outside Avista's electric service territory.[402] Staff finds this bias unnecessary and undesirable.

264 Ms. Snyder is also uncertain how the LEAP program impacts the cost-effectiveness of the DSM programs because Avista has not provided analysis or information for Staff to perform the analysis.[403] This is problematic, according to Ms. Snyder, because cost-effectiveness tests are used to measure the value of conservation programs. Ms. Snyder is also concerned that the Company is planning to increase the budget for the Fuel Conversion program up to

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result of increases in the efficiency of energy use, production, or distribution." Pub. L. No 96-501, §3(3), 94 Stat 2697, 2698 (1980) (codified at 16 U.S.C. § 839a(3)).

[399] Snyder, Exh. JES-1T at 16:19-17:5.

[400] Such as electric vehicle pilots, net metering costs, and demand response programs.

[401] Snyder, Exh. JES-1T at 18:10-17.

[402] Snyder, Exh. JES-1T at 19:15-19.

[403] *Id.* at 20:2-18.

42 percent of the total electric DSM budget, which is four times greater than in 2017.[404] Ms. Snyder writes that the proposed incentive expenditures "dwarf" the proposed incentives for all other residential programs.[405]

265 Finally, Staff recommends that the Commission continue to allow Avista to provide funding to its seven Community Action Partner (CAP) agencies for the purposes of funding low-income fuel conversions.[406]

266 ***Avista's Rebuttal.*** Avista witness, Mr. Kevin Christie, asks the Commission not to impose Staff's proposed conditions upon the LEAP program during its pilot stage. He notes that Staff evaluated and supported the Company's proposal and the Commission approved it on a temporary basis for a three-year period.[407] Moreover, during the development of the first semi-annual report, Staff was consulted on the appropriate metrics to include in the required semi-annual reporting, which the Company intends to use to evaluate the success of the program.[408] Mr. Christie states that it would be premature to terminate or modify the program at this time.[409]

267 On rebuttal, the Company agrees to Staff's condition to notify the Commission of its intent to modify, extend, or discontinue the program by November 30, 2018.[410] However, Mr. Christie disagrees that the program fails to adhere to the best practices for pilot programs.[411] He argues that the Company is collecting the relevant data to determine the success of the program, is willing to make modifications to the semi-annual report, and is open to improving the metrics of the program. Mr. Christie writes that the Company has not shifted

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[404] *Id.* at 21:1-14. According to Ms. Snyder, Avista is budgeting $4,563,322 for fuel conversions, including natural gas multifamily market transformation program increases that total up to $7,072,799 for electric-to-gas programs. The total DSM budget is $16,757,488.

[405] *Id.*, Table 3.

[406] *Id.* at 24:4-9.

[407] Christie, Exh. KJC-2T at 3:25-27.

[408] *Id.* at 4:1-5.

[409] *Id.* at 6:5-7.

[410] *Id.* at 4:17-5:9.

[411] *Id.* at 5:12-6:7.

course from the original purpose of the program and is not trying to "maximize the number of new natural gas customers."[412]

268 Avista plans to evaluate the success of the program using the metrics already included in the semi-annual report.[413] However, based on the number of new residential hook-ups and reported positive feedback from customers, Mr. Christie considers the LEAP program to be successful to-date.[414] Although new residential construction does account for a portion of new hook-ups, Mr. Christie credits the LEAP program with natural gas hook-up growth outpacing population growth rates.[415]

269 Specifically regarding Staff's three identified metrics for evaluating success of the program, Mr. Christie is unpersuaded that they are necessary. He argues that cost-effectiveness tests such as the Total Resource Cost (TRC) test are not applicable to the program because the Commission already approved the Company's use of the Perpetual Net Present Value (PNPV) methodology for calculating available line extension amounts for new natural gas customers.[416] The Company proposed the PNPV because the result is economical for a prospective customer to use the full amount available to them for a line extension, writes Mr. Christie. The result is the same if a customer has excess funds to apply to a new appliance.

270 If the LEAP pilot becomes a full-fledged program, the Company agrees it would be appropriate to perform an analysis of its effect on future emissions.[417] Avista is also open to discussing additional survey instruments that it can use to gauge both participant and non-participant feedback but cautions surveying non-participants may not be feasible.[418]

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[412] *Id.* at 6:12-7:2.

[413] *Id.* at 7:4-8.

[414] *Id.* at 7:10-13.

[415] *Id.* at 7:17-8:6. According to Mr. Christie, prior to LEAP, residential natural gas growth outpaced population growth by 0.3 percent. Current population growth is 1.6 percent but residential natural gas customer growth is 2.3 percent. Therefore, Avista credits LEAP with an additional 0.4 percent customer growth.

[416] *Id.* at 8:12-9:17.

[417] *Id.* at 9:19-10:18.

[418] *Id.* at 11:6-12.

271 The Company has had an electric-to-natural-gas Fuel Conversion program since at least 1990, according to Mr. Christie, and, as an individual measure, it has a TRC and Utility Cost Test score above 1.0.[419] Contrary to Staff's contention that fuel conversions are not conservation, Avista believes it is a cost-effective method to achieve electric savings because the direct use of natural gas is more efficient than generating electricity from natural gas.[420] In fact, Mr. Christie argues, fuel conversions meet the definition of conservation within WAC 480-109-060(6) because fuel conversion is a reduction of electric power consumption and the reduction is the result of the increase in the efficiency of energy use.

272 Avista does not see a correlation between not meeting its natural gas conservation target in previous years and its Fuel Conversion program.[421] Nor does Avista agree that the Fuel Conversion program unfairly burdens electric customers.[422] Mr. Christie writes that Ms. Snyder failed to mention that all electric customers benefit from the deferral of future resource acquisitions. In addition, ending the program would harm electric customers who are unable to afford converting to natural gas without the availability of the Fuel Conversion program.[423]

273 Mr. Christie also disagrees with Staff's characterization that expenditures for the Fuel Conversion program dwarf all other residential program expenditures.[424] According to Mr. Christie, incentives for fuel conversion make up only 29 percent of the overall DSM budget, not 42 percent as Ms. Snyder claims.[425] Mr. Christie also argues that the Fuel Conversion program is large because it has a significant amount of cost-effective savings, which the Company must pursue.

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[419] *Id.* at 12:11-19.

[420] *Id.* at 13:10-14:7.

[421] *Id.* at 15:10-11.

[422] *Id.* at 15:20-16:11.

[423] *Id.* at 16:14-17:2.

[424] *Id.* at 17:17-19:3.

[425] *Id.* at 17:17-20. According to Mr. Christie, Ms. Snyder's 42 percent takes into consideration indirect, non-incentive utility costs that are allocated to each program for planning purposes and excluded its Northwest Energy Efficiency Alliance contributions for the Simple Steps LED program.

274 Responding to Staff criticism that the Company would not run a cost-effectiveness test that combined the LEAP and Fuel Conversion programs, Mr. Christie writes that Staff's request for cost-effectiveness results was denied because the programs are separate and distinct, according to Mr. Christie.[426] The Company did not provide the results because customer incremental costs vary, LEAP merely provides access to natural gas, there are no identifiable efficiency savings, and combining measures into a single test has not been Avista's practice.[427]

275 Finally, Mr. Christie notes that Staff had not shared its positon on the program until October 23, 2017, and some members of the Conservation Advisory Group oppose Staff's position.[428]

276 ***Public Counsel.*** Public Counsel is uncomfortable with Staff's recommendation for an immediate discontinuance of the Fuel Conversion program as a condition to the continuance of the LEAP program for two reasons.[429] First, Public Counsel believes it is inappropriate to terminate a DSM program in a GRC when the Conservation Advisory Group is an established venue for addressing these issues.[430] Since the inception of the Energy Independence Act, Public Counsel is unaware of a Commission order that contains the examination of a DSM program, except regarding the conditional requirement of excess conservation through the approval of a decoupling mechanism.[431] Public Counsel's witness, Ms. Carla Colamonici, notes that Staff argued as recently as Avista's 2016 GRC that a GRC was not the appropriate venue to consider an ICNU-proposed demand response program.[432]

277 Second, Public Counsel believes the Fuel Conversion program and the LEAP program are distinct programs, and therefore the possible termination of one program should not influence the continuation of the other.[433] Fuel Conversion is a DSM program under a

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[426] *Id.* at 19:6-20:4.

[427] *Id.* at 19:16-20:4.

[428] *Id.* at 21:10-22:4.

[429] Colamonici, Exh. CAC-1T at 8:19-9:12.

[430] *Id.* at 8:19-9:2.

[431] *Id.* at 8:15-21.

[432] *Id.* at 9:15-10:10.

[433] *Id.* at 9:3-12.

separate tariff that is best considered in the Biennial Conservation Plan proceeding, and the LEAP program should be reviewed in a GRC. Public Counsel supports Staff's other conditions to the LEAP pilot.[434]

278 If the Commission determines the instant proceeding is the appropriate venue to decide the fate of the Fuel Conversion program, Public Counsel recommends that the Commission allow the Company to continue offering the program.[435]

279 According to Ms. Colamonici, there continues to be a need in the residential sector for overcoming the economic barriers to switching from electricity to natural gas.[436] Natural gas is a more efficient and cost-effective method for heating, writes Ms. Colamonici.[437] She believes that Avista's particular climate and customer demographics may mean that the Fuel Conversion program is a cost-effective solution.[438] Moreover, because Avista's service territory primarily consists of moderate to low-income customers, Ms. Colamonici considers it inappropriate to allow only customers who qualify as low-income to continue to benefit from the Fuel Conversion program.[439]

280 Ms. Colamonici believes if the program were discontinued, Avista's electric and natural gas customers would lose direct and indirect benefits.[440] Electric customers directly benefit from shedding load, and natural gas customers would lose the benefit from infill opportunities on existing infrastructure. Ending the program may also result in higher electricity prices, earlier investments in generation, transmission, and distribution projects, infrastructure investments for capacity, and higher natural gas distribution prices.[441]

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[434] *Id.* at 10:19-11:4.

[435] *Id.* at 12:12-20.

[436] *Id.* at 14:11-15:5.

[437] *Id.* at 13:15-18.

[438] *Id.* at 14:24-15:1.

[439] *Id.* at 13:20-23.

[440] *Id.* at 14:2-9.

[441] *Id.* at 16:14-17:3.

281 Although it continues to support the Fuel Conversion program, Public Counsel is willing to consider a number of modifications, including reducing the Fuel Conversion budget, shifting the costs to the natural gas tariff, or merging the program with LEAP.[442]

282 ***The Energy Project.*** The Energy Project witness, Mr. Shawn Collins recommends that if the Commission discontinues the Fuel Conversion program, that the Commission retain the program for low-income weatherization.[443] He writes that the program is worth preserving because it is another option for reducing the energy burden of low-income households.[444] Mr. Collins does not share an opinion on the program as it applies to the general base of customers.

283 ***Discussion and Decision.*** With regard to the LEAP pilot, we agree with Avista that it is premature to impose Staff's proposed conditions, as the pilot is only in its second year of a three-year trial. We are satisfied with the Company's agreement to notify Staff and the Commission by November 30, 2018, whether it intends to modify, extend, or discontinue the LEAP program. We find that the public interest is not served by premature termination of the three-year LEAP program.

284 While we recognize Staff's concerns regarding the metrics the Company will apply in its semi-annual reports, Avista consulted Staff when developing the metrics the Company plans to use to evaluate the success of the program. However, as the Company indicated in rebuttal that it is willing to make modifications to the semi-annual report, and is open to improving the metrics of the program, we encourage the Company, Staff, Public Counsel and the other stakeholders to discuss whether any additional metrics or reporting are appropriate as the Company evaluates the success of the pilot and as the Company considers the continuation of the LEAP pilot.

285 As to the Fuel Conversion program, we agree with Staff that it is not appropriate for electric ratepayers to subsidize their fellow electric customers' conversion to natural gas. As Staff correctly points out, when large industrial or commercial electric customers depart a utility's system, these fleeing customers must pay a transition fee so that the remaining electric customers are not left with costs resulting from load loss. In the case of natural gas fuel

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[442] *Id.* at 17:16-18:5.

[443] Collins, Exh. SMC-4T at 10:1-6.

[444] *Id.*

conversion, electric customers are asked to subsidize the conversion of their fellow ratepayers and must also incur any potential expenses relating to the Company's lost load. Based on this inequity, the Commission finds that the Company may continue the natural gas Fuel Conversion program, but that the program should not be funded through the electric conservation rider but instead should be funded by the Company's natural gas conservation rider.

286 As several parties noted, the Conservation Advisory Group is the appropriate forum to discuss and form such a plan. We agree and direct the Company and Staff to work with the Conservation Advisory Group on a plan that gradually transfers the funding obligation for the Fuel Conversion program from the electric conservation rider to the natural gas conservation rider by December 31, 2019. In developing this plan, the parties also should assess the effectiveness and sustainability of the Fuel Conversion program under a new funding structure going forward. The Company must submit this plan within six months from the effective date of this Order.

H. Working Capital

287 Working capital is a measure of the amount of funding needed to satisfy both the level of daily operating expenditures and a variety of non-plant investments that are necessary to sustain ongoing operations of the utility. It is a component of rate base and, in general, incorporates the following elements: (1) fuel inventory; (2) materials and supplies; (3) prepayments; and (4) cash working capital. The final element of cash working capital is typically the most controversial item in a rate case.

288 There are three generally accepted methodologies for calculating working capital consisting of the Lead-Lag Study, Formula Method, and Balance Sheet Method. In numerous cases before the Commission, Staff has proposed a variation of the Balance Sheet approach known as the Investor Supplied Working Capital (ISWC) methodology.

289 The ISWC methodology attempts to overcome the shortcoming in the Balance Sheet Method related to the inclusion of non-utility and non-jurisdictional entries by performing an extensive account analysis and appropriate categorization of those entries. As ratepayers and non-investors may contribute working capital through various regulatory ratemaking components, this method also attempts to capture those occurrences such as deferred income taxes, unamortized investment tax credits, customer deposits, or trade creditors in the final cash working capital calculation.

290 ***Staff.*** Staff witness Ms. Betty Erdahl makes two recommendations regarding the working capital included by Avista in its per books results of operations. These recommendations result in working capital allowance decreases of $7 million for electric and $4 million for gas.[445]

291 Avista and Staff both utilize the ISWC approach but with different allocation methodologies. Generally, using the ISWC approach, a party analyzes the Company's balance sheet as of a specific date. In analyzing the balance sheet accounts, the party classifies each line item as an operating or non-operating investment.[446] The total operating investments are then allocated between electric or gas operations using a party's preferred methodology.

292 First, Staff recommends re-categorizing several types of accounts as non-operating. These accounts include: accounts that accrue interest, accounts that are not allowed for ratemaking (e.g., charity and donations), and accounts related to non-utility activities.[447] Specifically, Ms. Erdahl re-categorizes two asset accounts to non-operating because they earn interest and therefore should not generate a second return for investors. Additionally, two Idaho jurisdiction liability accounts are re-classified as non-operating for consistency with Washington ratemaking treatment of similar accounts.[448]

293 Second, Ms. Erdahl revises the allocation methodology between electric and gas basing the split on investment[449] rather than the Company's methodology that determines the allocation factors by assigning each current asset and liability account to the jurisdiction and service

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[445] Erdahl, Exh. BAE-1T at 7:16-23. Per Data Request 244, provided as Exh. BAE-7, the Company agreed to some of the re-categorizations recommended by Staff significantly reducing the difference between the two parties' working capital proposals. The Company's rebuttal filing confirms the data in Exh. BAE-7, which is the starting point for Staff's contested calculations.

[446] In this case both Staff and the Company allocate between operating and non-operating segments using the percent of investment attributed to each of those categories. Staff uses 86.87 percent and 13.13 percent for operating and non-operating, respectively. Erdahl, Exh. BAE-1T at 10:1-3. Avista uses 87 percent and 13 percent for operating and non-operating, respectively. Andrews, Exh. EMA-16 at 2.

[447] Erdahl, Exh. BAE-1T at 12:13-19.

[448] *Id.* at 13:3-17.

[449] Percentage of total Company rate base used in electric versus natural gas operations.

directly impacted by the underlying account.[450] Mr. Erdahl believes Avista's approach, which uses two methodologies, is confusing.[451] Staff argues its single allocation methodology applied to both operating and non-operating, and electric and gas operations is consistent with the Commission-accepted approach to ISWC for Pacific Power, PSE, and Cascade Natural Gas Corporation.[452]

294 ***Avista's Rebuttal.*** On behalf of Avista, Ms. Andrews responds to Staff's recommended ISWC adjustments. Ms. Andrews' rebuttal testimony and corresponding exhibit confirms it made certain adjustments and corrections as portrayed by Staff's response testimony, thereby reducing the discrepancy of working capital included in rate base between the Company and Staff to approximately $1.5 million.[453] However, Avista continues to disagree with Staff's two remaining contested issues including four accounts that Staff re-categorizes and the allocation methodology across the Company's five operating divisions for all accounts.[454]

295 The parties disagree about account categorization for two types of accounts. First, Staff excludes from working capital accounts that earn interest. Ms. Andrews argues these accounts earn a low interest rate, 1.0 percent or less, and are treated in a manner consistent with prior Avista cases.[455] The second account type contains two accounts for earnings tests in the Company's Idaho jurisdiction. Staff reclassifies these accounts to include them in working capital. The Company opposes this reclassification for two reasons: (1) the accounts do not earn interest, and (2) the Company's allocation method assigns 100 percent of the liability to the Idaho jurisdiction thereby having no effect on the working capital for the Washington jurisdiction.[456]

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[450] Erdahl, Exh. BAE-1T at 8:8-10.

[451] *Id.* at 11:13-16.

[452] *Id.* at 11:1-5.

[453] Ms. Andrews provides Exh. EMA-16 containing her calculations for all contested adjustments. The working capital supporting documents may be found in pages 1 through 4 of that exhibit.

[454] Avista's five operating divisions are: Washington electric, Washington natural gas, Idaho electric, Idaho natural gas, and Oregon natural gas.

[455] Andrews, Exh. EMA-10T at 53:7-13.

[456] *Id.* at 53:14-54:4.

296 Turning to the allocation methodology, Avista makes two primary arguments in support of its position. First, Ms. Andrews testifies the account-by-account analysis to assign working capital to the jurisdiction and service it directly impacts avoids inappropriately allocating working capital between operating divisions.[457] Ms. Andrews highlights the difference produced by the parties' methodologies whereas assets serving solely electric or gas are so assigned using the Company's methodology but spread across electric, gas, and non-served jurisdictions under Staff's methodology.[458]

297 Second, Ms. Andrews testifies that Avista has utilized the ISWC method for determining cash working capital in each of its GRCs since 2010. Additionally, she argues the Company revised its methodology due to Staff opposition during each of Avista's 2010 through 2012 GRCs. The allocation previously used by Avista is the same methodology that Staff now proposes in this proceeding. Further, Ms. Andrews notes Staff supported the Company's revised methodology in the 2014 GRC and did not contest working capital in the 2015 GRC.[459] Finally, Ms. Andrews disagrees with Staff's argument to move all regulated utilities to conform to the same ISWC allocation methodology. She argues it is more important to retain consistency across individual utility operating divisions than between peer utilities with different jurisdictions and business structures.[460]

298 ***Discussion and Decision.*** The interest-bearing accounts that Avista includes in cash working capital, and Staff contests, contain relatively very small amounts. We find that, on a very limited basis, these amounts should be included in the working capital adjustment. That said, we caution the Company that, in the future, any accounts that accrue interest, no matter how small or inconsequential, must be classified as non-operating and removed from working capital. In addition, we appreciate Staff's attempt at standardization of our allocation of working capital. However, it is not necessary or appropriate to do so in every case, for every company. Once again, the Commission does not always favor bright-line tests, such as here where Staff would have us approve a standard allocation methodology, as

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[457] *Id.* at 54:17-55:2.

[458] *Id.* at 55:3-56:4.

[459] *Id.* at 57:8-18; *Id.* at 4-11.

[460] *Id.* at 56:8-20.

they remove the Commission's flexibility and considerable discretion. Thus, we decline to adopt Staff's recommended ISWC allocation method.

I. Low Income Assistance

299 ***Staff.*** Mr. Hancock testifies that Staff has continued to monitor Avista's implementation of its Low-Income Rate Assistance Program (LIRAP) and believes the Company is in compliance with the Commission's 2015 GRC Order.[461] However, Staff recommends that the Commission require Avista to articulate how it will implement the goals of the program in the compliance filing of the instant rate case. Staff also recommends that the Commission extend the LIRAP plan one additional year, through 2020, with the same percentage increase established in the 2015 GRC.

300 ***The Energy Project.*** The Energy Project argues that there remains a need for energy assistance in the Company's Washington service territory, including within Avista's energy efficiency programs.[462] The Company provides energy assistance and efficiency programs for low-income ratepayers, working with six CAP agencies and one tribal weatherization organization.[463] The Energy Project asserts that Avista's current annual budget for electric and natural gas low-income weatherization is approximately $2 million.[464] Mr. Collins states that this only reaches a minority of eligible households, with a majority of those qualifying households going unserved by the weatherization program.[465] As a result, The Energy Project recommends that any increase in Avista's residential rates be paired with an increase in funding for the low-income weatherization program.[466] Specifically, Mr. Collins recommends an increase of $350,000 for each year of an approved rate plan, and a shareholder 'flexible fund' contribution of $150,000 in the first year, and a subsequent $75,000 for each additional rate year plan.[467] According to The Energy Project, increasing

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[461] Hancock, Exh. CSH-1T at 23:5-13.

[462] Collins, Exh. SMC-1T at 3:1-2 and 5:4-6.

[463] *Id.* at 5:4-6.

[464] *Id.* at 7:12-13.

[465] *Id.* at 7:14-15.

[466] *Id.* at 8:4-10.

[467] *Id.* at 8:22-9:8.

the annual budget for low-income weatherization would "allow for more households to mitigate the increase in their rates as a result of this GRC."[468]

301 The Energy Project does not propose an increase for LIRAP as it is in the midst of a five-year plan.[469]

302 ***Avista's Rebuttal.*** In response to Staff's testimony, Mr. Christie does not agree that it is necessary to explain how the Company's delivery of the LIRAP program is meeting the Commission's approved goals in the compliance filing of this GRC. Rather, the Company prefers to address the achievements of the program in its annual LIRAP report or alternatively in its next status update prior to August 31, 2018.[470] However, Avista supports Staff's proposal to extend the LIRAP plan by an additional year through 2020.[471]

303 Responding to The Energy Project's recommendation, Avista suggests a relatively lower increase to low-income weatherization funding. Mr. Christie argues that The Energy Project's recommendation would increase low-income weatherization from $2 million to $3 million over the course of a three-year rate plan, far exceeding LIRAP funding increases.[472] He recommends aligning the annual increases to the funding increase for LIRAP, which are 7 percent annual increases. He also writes that Avista is willing to discuss increasing shareholder contributions with its Conservation Advisory Group but does not recommend the Commission order additional contributions in this rate case.[473]

304 ***Discussion and Decision.*** We agree with Avista that it is unnecessary at this time to require a compliance filing from the Company in this GRC detailing how its delivery of the LIRAP program is meeting our approved goals. Instead, Avista should follow through with its proposal to address any concerns by Staff or other stakeholders in the Company's annual LIRAP report. Further, we agree with The Energy Project that there is merit to increasing annual funding of low-income weatherization on the electric side of operations. We find an increase in electric low-income weatherization funding in the amount of $350,000 to be in

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[468] *Id.* at 7:20-8:1.

[469] *Id.* at 9:11-14.

[470] Christie, Exh. KJC-2T at 25: 9-13.

[471] *Id.* at 23:13-18.

[472] *Id.* at 25:16-23.

[473] *Id.* at 26:8-10.

the public interest. At the same time, we reject The Energy Project's recommendation that the Commission require Avista's shareholders to contribute $150,000 to the program for the first year of any approved multi-year rate plan and an additional $75,000 every year after. We do not have the authority to order the Company's shareholders to donate monies into any Avista low-income program. That said, we encourage Avista to do as it offered and discuss the matter of increasing shareholder contributions with the Conservation Advisory Group.

J. Pro Forma Non-Executive Labor

305 Several parties dispute whether to adjust 2016 test year union and non-union non-executive wages and salaries to reflect 2017 increases and subsequent increases set for March of 2018. ICNU and NWIGU propose excluding the union and non-union labor expense increases set to occur in March of 2018.[474] Public Counsel proposes removing half of the dollar amount of the combined 2017 and 2018 union and non-union labor adjustment.[475] Staff does not contest the Company's adjustment.

306 ***Avista.*** Ms. Andrews proposes three adjustments to non-executive labor costs. The first is a 3 percent increase beginning March 2017 for non-union employees that represents actual increases already in effect.[476] Second, she proposes an adjustment increasing by 3 percent non-union employee wages beginning March 2018 that was approved by the Board of Directors in May 2017.[477] Third, Ms. Andrews adjusts the Company's rate request to reflect the current contract with the International Brotherhood of Electric Workers Union that runs through March 25, 2019.[478] Without further explanation, Ms. Andrews states her adjustment is consistent with Dockets UE-150204 and UG-150205.[479]

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[474] Mullins, Exh. BGM-1T at 31:4-6.

[475] M. Garrett, Exh. MEG-1T at 24:3-4.

[476] Andrews, Exh. EMA-2 at 27:5-7.

[477] *Id.* at 27:6-7; Andrews, Exh. EMA-10T at 60:6-7.

[478] Andrews, Exh. EMA-2 at 27:7-9.

[479] *Id.* at 27:9-10.

307 ***ICNU/NWIGU.*** Mr. Bradley Mullins supports the inclusion of 2017 actual wages but contests the inclusion of union and non-union wage increases beginning March 2018.[480] Conceding that Avista may have approved a 2018 wage increase, Mr. Mullins postulates that the Company may implement a smaller wage increase, or otherwise reduce labor expenses.[481] As an example, Mr. Mullins states that programs such as Avista's voluntary severance incentive programs implemented around 2012, "would have the effect of reducing labor expenses relative to the escalation Avista has proposed."[482] Considering the uncertainty of offsetting actions that may occur, Mr. Mullins concludes the 2018 union and non-union wage adjustment is not known and measurable.[483]

308 ***Public Counsel.*** Mr. Mark Garrett proposes to remove one-half of Avista's total 2017 and 2018 union and non-union wage adjustment, reasoning that doing so effectively allows into rates the requested increase for 2017 but not the increase projected for 2018.[484] Mr. Garrett states that projected costs two years beyond the test year do not qualify under "[a] modified test year approach that allows adjustments for known and measurable changes occurring during the test year or shortly thereafter."[485] He also claims that his adjustment "helps synchronize payroll costs with plant additions" which the Company's Average-of-Monthly-Averages (AMA) pro forma study includes through 2017.[486]

309 ***Avista's Rebuttal.*** Ms. Andrews opposes ICNU and NWIGU's and Public Counsel's adjustments. She testifies that all wage increases are known and measureable based on either a union contract or approval by the Compensation Committee of the Company's Board of Directors.[487]

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480 Mullins, Exh. BGM-1T at 30:11-17.

481 *Id.* at 30:20-31:1.

482 *Id.* at 31:1-4.

483 *Id.* at 30:20-22; 31:4-6.

484 M. Garrett, Exh. MEG-1T at 24:3-5.

485 *Id.* at 23:22-24:3. (Emphasis in original).

486 *Id.* at 24:5-8.

487 Andrews, Exh. EMA-10T at 60:4-7. Ms. Andrews testifies "Non-union wage increases for 2018 were approved in May of 2017 by the Compensation and Organization Committee, as reflected in its Board minutes." *Id.* at 60:6-7.

310 Ms. Andrews also asserts that "[t]he Commission has previously held that board-approved union and non-union wage increases fulfill the 'known and measurable' standard in [Commission] rules."[488] To support her assertion she provides a quote from Order 10 in Dockets UE-090134 and UG-090135:[489]

> Staff and Public Counsel generally agree that known and measurable company obligations, such as union wage increases resulting from collective bargaining agreements or non-union wage increases approved by the board of directors, are proper adjustments.[490]

311 In addition, Ms. Andrews quotes a Staff witness from the same proceeding stating that "…the non-union increases that were approved by the board" are obligations the Company has incurred.[491]

312 Finally, Ms. Andrews points out that Public Counsel's proposed adjustment to remove half of the Company's adjustment is "arbitrary and was not supported by analysis and actual data provided through discovery."[492]

313 ***Discussion and Decision.*** The changes to union wages agreed to by contract for 2017 and 2018 are known and measurable, and they represent an obligation that cannot be modified by the Company. In contrast, Avista has more control over the non-union wage increases for 2018 and could, theoretically, offset or even reverse those wage adjustments.

314 While the Commission has historically not approved labor expenses one full year after the end of the test year, the union wages for 2018 are fixed by contract that runs through 2019. For the above reasons, the Commission accepts the Company's 2017 and 2018 union wage increases as well as 2017 non-union wage increases, but we reject the proposed 2018 non-union wage increases.

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[488] *Id.* at 60:7-9.

[489] *Id.* at 60:9-14. *Washington Utilities & Transportation Comm'n v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-090134 and UG-090135 (consolidated), Order 10, ¶105 (December 22, 2009).

[490] Andrews, Exh. EMA-10T at 60:11-14.

[491] *Id.* at 60:16-25. *Washington Utilities & Transportation Comm'n v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-090134 and UG-090135 (consolidated), TR 685:5-11.

[492] Andrews, Exh. EMA-10T at 60:2-4.

FINDINGS OF FACT

315 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

316 (1) The Washington Utilities and Transportation Commission (Commission) is an agency of the State of Washington vested by statute with the authority to regulate rates, regulations, practices, accounts, securities, transfers of property and affiliated interests of public service companies, including electric and natural gas companies.

317 (2) Avista Corporation, d/b/a Avista Utilities (Avista or Company) is a "public service company," an "electrical company," and "gas company" as those terms are defined in RCW 80.04.010 and used in Title 80 RCW. Avista provides electric and natural gas utility service to customers in Washington.

318 (3) On May 26, 2017, Avista filed with the Commission revisions to its currently effective Tariffs WN U-28, Electric Service, and WN U-29, Natural Gas Service, including a proposed multi-year rate plan (Rate Plan) and an initial increase in rates of $61.4 million and $8.3 million for its electric and natural gas operations, respectively.

319 (4) On December 22, 2017, the Tax Cuts and Jobs Act of 2017 became effective and, among other things, reduced the federal corporate income tax rate from 35 percent to 21 percent. Avista holds plant and non-plant related excess deferred income tax for the calendar year ending December 31, 2017, and plant and non-plant excess deferred income tax for the period January 1, 2018, through April 30, 2018. Additionally, Avista's corporate tax rate on a going-forward basis must be reset to the lower percentage.

320 (5) On March 19, 2018, Avista notified the Commission that the parties to Docket U-170970, the proceeding to adjudicate the Company's request to merge with Hydro One Limited, had reached a settlement-in-principle in which they agreed that the non-plant related excess deferred income tax as of December 31, 2017, and the deferred income tax from January 1, 2018, through April 30, 2018, would be applied

to pay down depreciation expense on Units 3 and 4 of the Colstrip generating facility.

321 (6) The Company's proposed Rate Plan, if approved, would have provided for increased revenues each year from May 1, 2018, through April 31, 2021.

322 (7) Avista employed four different revenue requirement studies, including a Traditional Pro Forma study, a Rate Year study, an End-of-Period (EOP) Rate Base study, and a K-Factor study.

323 (8) Neither Avista nor Staff argue that Avista is suffering from attrition.

324 (9) The final return on equity (ROE) recommendations offered by the expert witnesses ranged from 9.0 percent to 9.9 percent, resulting in a mid-point of 9.45, which is very close to Avista's current ROE of 9.5 percent.

325 (10) With regard to its interest rate hedging practices, the Company adhered to its *Interest Rate Risk* Management *Plan* operating guidelines.

326 (11) The Commission's natural gas hedging policy statement gives regulated companies until the 2020 Purchased Gas Adjustment filing to have a comprehensive risk responsive strategy in place.

327 (12) The interest rates for the 2018 security issuances will not be ascertained until after the entry of this Order and are not known and measurable.

328 (13) Avista has not demonstrated that an increase in the equity level of its capital structure is necessary at this time.

329 (14) While the Commission has previously endorsed the bidding approach to aligning the power cost model, the Company has added a number of modeling modifications in addition to bidding factors.

330 (15) It is unclear whether the parties and the Commission have reviewed and authorized these additional modifications to Avista's power cost model.

331 (16) The expiration of the Portland General Electric (PGE) contract was a finite, known event with a measurable impact on power costs.

332 (17) In the Order in Pacific Power & Light Company's 2014 general rate case, the Commission provided significant guidance to parties on its view of post-test year capital additions. Among other things, this guidance included, but was not limited to: (a) there is no bright-line cutoff date, but granting pro forma adjustments beyond a few months post-test year is exceptional; (b) the later in time that a plant addition takes place, the more rigorous and concrete the support for it must be; and (c) proposed projects should meet some reasonable definition of "major".

333 (18) Avista did not provide any documentation of its proposal to functionalize its capital addition adjustment on rebuttal.

334 (19) The sheer number of projects the Company included in its capital additions adjustment was unrealistic for any party or the Commission to review in the time period allotted in a general rate case.

335 (20) Three projects, the Little Falls Powerhouse Redevelopment, the Wood Pole Maintenance project, and the Gas Replacement for Roads project, are proximate to Staff's threshold for major capital projects and provide tangible value to ratepayers.

336 (21) Staff failed to adjust the depreciation expense to match the rate base balances it modified from 2016 annual-of-monthly-averages balances to EOP balances.

337 (22) The Partial Settlement moves rate classes closer to parity while also subscribing to the regulatory principle of gradualism.

338 (23) The Line Extension Allowance Program is only in its second year of a three year pilot.

339 (24) Electric ratepayers are unnecessarily subsidizing conversions to natural gas in the Fuel Conversion program through the electric conservation rider.

340 (25) The interest-bearing accounts Avista includes in its working capital adjustment are fairly small.

341 (26) There is merit to increasing annual funding of low-income weatherization on Avista's electric side of operations.

342 (27) Avista requests recovery of its union and non-union non-executive wage increases for 2017 and 2018, one and two full years beyond the test year, respectively.

CONCLUSIONS OF LAW

343 Having discussed above all matters material to this decision, and having stated the following summary conclusions of law, incorporating by reference pertinent portions of the preceding detailed conclusions:

344 (1) The Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

345 (2) The Commission will address the non-protected non-plant related excess deferred income taxes the Company collected during the calendar year 2017 in Avista's pending merger proceeding, Docket U-170970.

346 (3) Avista shall, in accordance with the Tax Cuts and Jobs Act of 2017 and this Order, reduce the federal corporate income tax rate it passes on to ratepayers from 35 percent to 21 percent.

347 (4) Further, it is reasonable to reduce any revenue requirement increase approved for Avista in this Order by the plant-related excess deferred income taxes collected from customers during the calendar year 2017.

348 (5) Given the significant impact that Avista's merger proceeding and its recently-filed depreciation studies will have on the Company and its ratepayers, the requested Rate Plan's three year commitment would not be in the public interest.

349 (6) Avista's current return on equity of 9.5 percent is within the range of reasonableness and sufficient to attract investors.

350 (7) The flotation costs incurred by the Company's investors are not expenses the ratepayers shall bear.

351 (8) Avista's proposed 5.62 percent cost of debt is reasonable and lowering this level of debt, in this case, based on the natural gas hedging policy statement would be inappropriate.

352 (9) The Company failed to justify a hypothetical capital structure, which would result in a change to its currently authorized capital structure.

353 (10) An increase in the baseline of the Energy Recovery Mechanism by $14.5 million, based on the effect of the expiration of the PGE contract on power costs during a normalized year, is appropriate.

354 (11) With regard to the pro forma capital additions adjustment, Staff's proposal of an August 31, 2017, cutoff deadline, 8 months after the end of the test period, is eminently reasonable.

355 (12) Three of Avista's capital projects, though below Staff's "major" projects threshold, deserve recovery by the Company: Little Falls Powerhouse Redevelopment; the Wood Pole Management; and the Gas Replacement for Road projects.

356 (13) As a result of the matching principle, Avista's operations and maintenance (O&M) offsets that directly correspond to the capital projects approved in this Order, shall also be approved.

357 (14) The Company shall collect O&M offsets for Wood Pole Management on the electric side of operations and for the Information Technology Refresh on both its electric and natural gas side of operations.

358 (15) The Multi-Party Partial Settlement Stipulation is lawful, its terms are supported by an appropriate record, and the result is consistent with the public interest in light of all the information available to the Commission.

359 (16) Early termination of the Line Extension Allowance Program would be premature and not in the public interest.

360 (17) Continued subsidization of the natural gas Fuel Conversion program by Avista's electric conservation tariff rider is not reasonable.

361 (18) The Energy Project's request to increase low-income weatherization by $350,000 for electric customers is appropriate.

362 (19) The Commission is not authorized to order Avista's shareholders to contribute to the low-income weatherization program.

363 (20) While the 2017 and 2018 union and 2017 non-union wage increases are proper adjustments, the non-union wage increases for 2018 do not meet the Commission's known and measurable standard.

364 (21) Avista's rates resulting from the decisions made in this Order are fair, just, reasonable, and sufficient.

365 (22) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order.

ORDER

THE COMMISSION ORDERS THAT:

366 (1) The proposed tariff revisions Avista Corporation, d/b/a Avista Utilities (Avista), filed on May 26, 2017, and suspended by prior Commission order, are rejected.

367 (2) The Multi-Party Partial Settlement Stipulation filed by Avista, the Commission's regulatory staff, the Northwest Industrial Gas Users, and The Energy Project on November 1, 2017, which is attached to this Order as Appendix A, is accepted and adopted.

368 (3) Avista is directed to make a compliance filing containing revised tariff sheets as are necessary to implement the determinations in this Order. Summaries of both the electric and natural gas revenue requirements are attached hereto at Appendix B.

369 (4) After working with Staff and the Conservation Advisory Group and within six months after the entry of this Order, Avista will file a plan to gradually transfer the funding of the natural gas Fuel Conversation program from the electric conservation rider to the natural gas conservation rider by December 31, 2019, and assess the effectiveness and sustainability of the Fuel Conversion program under a new funding structure going forward.

370 (5) Avista is ordered to file a report in its next general rate case on the power cost modeling improvement process outlined in this Order and identify any resulting changes to its methodology.

371 (6) Staff is directed to schedule meetings in the generic cost-of-service proceeding in Dockets UE-170002 and UG-170003 as soon as possible. Staff shall report to the

Commission its progress in the generic proceeding every three months from the effective date of this Order.

372 (7) The Commission Secretary is authorized to accept by letter, with copies to all parties to this proceeding, such filings as Avista makes to comply with the terms of this Order.

373 (8) The Commission retains jurisdiction over the subject matters and parties to this proceeding to effectuate the terms of this Order.

DATED at Olympia, Washington, and effective April 26, 2018.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

JAY M. BALASBAS, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.