

**Exh. DCG-3
Docket UE-210402
Witness: David C. Gomez**

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**PACIFICORP d/b/a PACIFIC POWER
& LIGHT COMPANY,**

Respondent.

DOCKET UE-210402

EXHIBIT TO TESTIMONY OF

DAVID C. GOMEZ

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Docket UE-170485, Gomez Exh. DCG-1CT, Excerpt of Response Testimony
Pro Forma Power Costs, Pages 4:5–8:6 (October 27, 2017)*

December 13, 2021

1 baseline until a) Avista’s next general rate case or b) the total credit balance owed to
2 ratepayers, currently at \$21.9 million,⁵ falls below \$10 million, whichever occurs
3 sooner.

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5 **III. BACKGROUND AND PURPOSE OF THE ERM**

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7 **Q. Can you briefly describe Avista’s ERM?**

8 A. The ERM is a power cost recovery mechanism designed to equitably allocate
9 between the Company and its customers the risk of ordinary variations in power
10 costs that may occur between rate cases. The Commission established the ERM by
11 its order approving a settlement among all parties in Docket No. UE-011595.⁶ The
12 ERM tracks Avista’s actual monthly net power supply expenses and compares these
13 amounts against “base” levels embedded in the Company’s rates.

14 The Company and its customers share deviations in actual power costs from
15 the baseline costs. After actual power costs exceed a dead band, the deviations are
16 shared in two levels of “sharing bands.” The current dead and sharing bands for the
17 ERM are provided in Table 1 below. In the current version of the ERM, annual
18 variations beyond the \$4 million dead band fall into the sharing bands and, as their
19 name implies, any resulting annual variation in power costs beyond \$4 million is
20 allocated between ratepayers and the Company accordingly.

⁵ UE-011595, Per Avista’s Cover Letter of October 16, 2017, for the September 2017 monthly report.

⁶ *Wash. Utils. & Transp. Comm’n v. Avista Corporation*, Docket No. UE-011595, Fifth Supplemental Order (June 18, 2002) (2002 ERM Order).

Annual Power supply Cost Variability	Deferred for Future Surcharge or Rebate to Customers	Expense or Benefit to the Company
+/- \$0 - \$4 million	0%	100%
+ between \$4 million - \$10 million	50%	50%
- between \$4 million - \$10 million	75%	25%
+/- excess over \$10 million	90%	10%

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Table 1: Current Avista ERM Bands

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10 **Q. What is the purpose of the ERM?**

11 A. The ERM has two core purposes: (1) to equitably allocate between Avista and its
12 customers the risk of ordinary power cost variability; and (2) to incentivize Avista to
13 effectively manage or even reduce its power costs.⁷ The Commission sets rates that
14 reflect an appropriate level of normalized net power supply costs and at a level that
15 provides the Company with an opportunity to recover its power costs over time.
16 However, the potential exists that the Company may experience power costs in the
17 rate year that are significantly and materially above or below those embedded in
18 rates. The ERM's purpose, therefore, is to mitigate the impacts of year-to-year
19 variability in power costs fairly and equitably for both the Company and its

⁷ *In the Matter of the Petition of Avista Corp. for Continuation of the Company's Energy Recovery Mechanism, with Certain Modifications*, Docket UE-060181, Order 03, ¶ 23, Finding of Fact 3 (June 16, 2006).

1 customers while providing an economic incentive for the Company to reduce its
2 power costs.

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4 **Q. What was the context behind the creation of Avista's ERM?**

5 A. The ERM came about as a result of the Western U.S. Energy Crisis of 2000 and
6 2001, which contributed significantly to a decline of Avista's financial condition
7 during that period.⁸ During the crisis, the Company managed to accrue over \$200
8 million in deferred power costs attributed to a perfect storm of poor hydro conditions
9 in the Pacific Northwest coupled with high wholesale electric market prices. To help
10 ameliorate Avista's dire financial situation, the Commission took action by allowing
11 deferral of certain power costs for potential later recovery through a combination of a
12 surcharge on rates and general rate increases. The impact of the Commission's
13 actions during that crisis were described in the testimony of Mr. Jon Eliassen,
14 Avista's then Chief Financial Officer:

15 The regulatory action and support received to date from this Commission has
16 been a critical part of that progress [toward financial stability]. In particular,
17 the surcharge implemented last fall was a key action that provided cash flows
18 necessary to allow the Company to reduce the amount of money being
19 borrowed to pay for power purchases. The deferral accounting order,
20 prudence settlement and interim rate increase orders granted earlier this year
21 have all been recognized by the financial community as positive steps by this
22 Commission that show its commitment to the financial health of regulated
23 utilities in Washington.⁹

24 In addition to the provisional actions described above, the Commission also
25 implemented the ERM as a long-term solution to address the limits of traditional rate

⁸ 2002 ERM Order at ¶ 28.

⁹ 2002 ERM Order at ¶ 6.

1 making to anticipate, in a general rate case, Avista’s actual level of rate year power
2 costs. Together, these actions helped restore investor confidence in Avista and stave
3 off a bankruptcy of the utility.¹⁰

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5 **Q. Why are the ERM’s bands so important?**

6 A. As opposed to a dollar-for-dollar recovery mechanism, the ERM includes sharing
7 bands which are designed to allow the equitable sharing of the inherent risk of
8 variation in power costs between ratepayers and the Company. The existence of the
9 dead band is designed to provide Avista with a strong incentive to not only improve
10 the accuracy of its estimated rate year power costs, but to develop cost control
11 strategies to mitigate its exposure to commodity price and weather risk.

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13 **Q. Why is the power cost baseline so important?**

14 A. The ERM’s power cost baseline reflects the amount of power costs that are included
15 in rates. Therefore, the standard for changing the power cost baseline is the same
16 standard that applies to rate increases generally—the Company bears the burden of
17 proof to show that any increase it proposes is fair, just, and reasonable.¹¹

18 Moreover, the proper functioning of the ERM bands requires a well-forecast
19 baseline, especially if the baseline is adjusted annually. For example, if the baseline

¹⁰ Many of Washington State’s electric utilities were experiencing financial difficulties as a result of the Western U.S. Energy Crisis. In the case of Puget Sound Energy (PSE), the Commission implemented the Power Cost Adjustment Mechanism (PCA) which is designed to “achieve an appropriate balance between risks to customers and risks to utility shareholders” and “result in a sharing of costs and benefits between PSE and its customers if power costs deviate significantly from those embedded in PSE’s rates.” *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy*, Docket No. UE-011571, Twelfth Supplemental Order (June 20, 2002).

¹¹ RCW 80.04.130; *Wash. Utils. & Transp. Comm’n v. Avista Corporation*, Docket Nos. UE-160228 and UG-160229, Order 06, 57, ¶ 110 (Dec. 15, 2016).

1 is consistently set too low it will cause the Company to absorb yearly revenue
2 shortfalls pursuant to the bands that deny its opportunity to recover its costs.
3 Conversely, if the baseline is consistently set too high, customers will overpay for
4 power costs and the Company will receive an undeserved windfall. Therefore, for
5 the ERM to function properly, the baseline must be set at a level that provides an
6 equal likelihood of power costs coming in above or below the baseline.

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8 **Q. Why do you feel it is necessary to revisit the ERM's history and purpose?**

9 A. The ERM is not functioning as intended because Avista does not accurately model
10 its power costs. Since 2011, despite almost annual revisions to its ERM baseline,
11 Avista has over-collected its power costs from its customers by \$64.6 million—an
12 average of \$10.8 million per year.¹²

13 Avista's failure to accurately forecast its power costs has produced a windfall
14 for its shareholders and has harmed customers. The Company has profited in five of
15 the last six years from the ERM bands. Since 2011, it retained a net total of \$24.7
16 million—an average of \$4.1 million per year—of the over-collected power costs
17 before depositing the remaining \$39.8 million in the deferral account.¹³ Importantly,
18 customers never received a rebate for the over-collected power costs because the
19 ERM deferral balance has repeatedly been used to offset rate increases that were
20 driven, in part, by Avista's inaccurate power forecasts.

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¹² Gomez, Exh. DCG-2, Column H, Row "Totals".

¹³ Gomez, Exh. DCG-2, Column I & J, Row "Totals".