Exh. PDE-1T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. U-17_____

DIRECT TESTIMONY OF

PATRICK D. EHRBAR

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, business address and present position with Avista Corporation?

A. My name is Patrick D. Ehrbar and my business address is 1411 East Mission Avenue, Spokane, Washington. I am presently assigned to the State and Federal Regulation Department as Director of Rates.

Q. Would you briefly describe your educational background and professional experience?

A. Yes. I am a 1995 graduate of Gonzaga University with a Bachelors degree in Business Administration. In 1997 I graduated from Gonzaga University with a Masters degree in Business Administration. I started with Avista in April 1997 as a Resource Management Analyst in the Company's Demand Side Management (DSM) department. Later, I became a Program Manager, responsible for energy efficiency program offerings for the Company's educational and governmental customers. In 2000, I was selected to be one of the Company's key Account Executives. In this role I was responsible for, among other things, being the primary point of contact for numerous commercial and industrial customers, including delivery of the Company's site specific energy efficiency programs.

I joined the State and Federal Regulation Department as a Senior Regulatory Analyst in 2007. Responsibilities in that role included being the discovery coordinator for the Company's rate cases, line extension policy tariffs, as well as miscellaneous regulatory issues. In November 2009, I was promoted to Manager of Rates and Tariffs, and later promoted to be Senior Manager of Rates and Tariffs. In my current role my responsibilities include revenue requirements, electric and natural gas rate design, decoupling, power cost and natural gas rate adjustments, customer usage and revenue analysis, and Rates administration.

Q. What is the scope of your testimony in this proceeding?

A. My testimony will explain certain commitments offered by Avista and Hydro One (hereafter jointly referred to as "Joint Applicants") as part of our request for approval of the Proposed Transaction. Among the commitments is a proposed Rate Credit to customers beginning following the closing of the transaction, which will provide immediate net benefits to customers. I will explain how Joint Applicants are proposing to allocate this benefit to Avista's electric and natural gas customers. I will also explain other regulatory commitments offered by the companies.

In addition, my testimony will explain the proposed accounting protocol for any affiliate transactions between Avista and Hydro One following the closing of the transaction. Finally, I will explain why Joint Applicants believe this filing for approval of the Proposed Transaction should be processed separately from the pending electric and natural gas general rate cases, and should not be consolidated.

Q. Are you sponsoring any exhibits that accompany your testimony?

A. Yes. I am sponsoring Exh. PDE-2 which provides the derivation of the Company's standard cost allocators, which are used to spread the proposed Rate Credit among the Company's electric and natural gas customers in Washington, Idaho, and Oregon. Exh. PDE-3 shows the allocation of the proposed Rate Credit to Avista's Washington electric and natural gas customers. Next, I am sponsoring Exh. PDE-4, which is a memorandum summarizing the proposed accounting protocol for any affiliate transactions between Avista and Hydro One following the closing of the transaction. Finally, Exh. PDE-5 includes proforma electric and natural gas tariffs that provide the terms and conditions of the proposed Rate Credit. These exhibits were prepared under my supervision. A table of contents for my testimony is as follows:

II. RATE COMMITMENT NO. 18

Q. Please explain the annual Rate Credit (Commitment No. 18) proposed by Joint Applicants.

A. As explained by Mr. Morris, the proposed annual Rate Credit is $2.65 million per year for the first five years following the closing of the transaction, and the Rate Credit increases to $3.65 million per year for the last five years - for a total of $31.5 million over the 10-year period. These annual rate credits are <u>system amounts</u>, and would be <u>allocated by service and state jurisdiction</u> as described later in my testimony.

Joint Applicants are proposing that the Rate Credit applicable to Washington customers be passed through to customers through separate tariffs: Schedule 73 for electric customers and Schedule 173 for natural gas customers.

Q. Is any portion of the proposed Rate Credit offsetable?

A. Yes. A portion of the proposed Rate Credit for the 10-year period is offsetable. That is, when cost savings or net benefits directly related to the transaction are already reflected in base retail rates for customers, the separate Rate Credit on Schedules 73 and 173 will be reduced by an amount up to the offsetable portion of the Rate Credit. As Mr. Thies explains, $1.7 million of the $2.65 million annual Rate Credit for the first five years is offsetable. For the last five years, $2.7 million of the $3.65 million is offsetable. To the extent that Avista demonstrates there are net cost savings, or net benefits, directly associated with the transaction that are already reflected in base retail rates, the Rate Credit for the first five years would be reduced by up to $1.7 million, and the Rate Credit for the last five years would be reduced by up to $2.7 million.

The proposed $31.5 million benefit for the 10-year period represents the "floor" of benefits customers will receive; as additional merger savings occur, those would be reflected as part of the cost of service captured in subsequent general rate cases. The $31.5 million will be received by customers either through the separate Rate Credit on tariff Schedules 73 and 173, or by the benefits being reflected in base retail rates.

Q. Please explain how the Rate Credit is proposed to be allocated among Avista's electric and natural gas customers.

A. The cost savings related to the transaction, described by Mr. Thies, generally fall into the category of costs referred to as "common costs." For ratemaking purposes, these common costs are allocated between electric and natural gas customers, and by state jurisdiction (Washington, Idaho, and Oregon) using standard allocation factors that have been used for many years to allocate common costs, and have been reviewed periodically in general rate cases.[1]

[1] The allocation methodologies used for purposes of allocating "common costs" have been reviewed and approved by the utility commissions in Washington, Idaho, and Oregon. In addition, these methodologies are employed in each general rate case filed by the Company in each jurisdiction.

Joint Applicants are proposing to allocate the Rate Credit to Avista's electric and natural gas customers, and by state jurisdiction, using these same allocation factors.[2]

Q. Using these existing allocation methods, how would the Rate Credit be allocated first between Avista's services, i.e., <u>between electric and natural gas operations</u>?

A. To allocate the Rate Credit to electric and natural gas operations, the Company uses what is referred to as a "Factor 7" allocator. This factor is developed using the following four components:

(1) Direct Operations & Maintenance ("O&M") and Administrative and General (A&G) costs, excluding labor and resource costs, that are assigned to electric service, natural gas North (Washington and Idaho) service and Oregon natural gas service.

(2) Direct O&M and A&G labor costs that are assigned to electric service, natural gas North (Washington and Idaho) service and Oregon natural gas service.

(3) Number of customers for electric service, natural gas North (Washington and Idaho) service and Oregon natural gas service.

(4) Net direct plant that is assigned to electric service, natural gas North (Washington and Idaho) service and Oregon natural gas service.

The calculations to develop the Factor 7 allocator are provided in Exh. PDE-2.

---

[2] The AEL&P operations in the City and Borough of Juneau, Alaska, operate substantially independent of Avista Utilities, and the costs from which the merger-related cost savings are derived, are currently not being charged to AEL&P. Therefore, there are no financial cost savings to flow through to AEL&P customers. For Avista's retail operations in Montana, Avista has approximately 30 retail customers and total retail revenue of approximately $74,000. Due to the very limited retail operations by Avista in Montana, for administrative efficiency the past practice by the Montana Public Service Commission has been to review the final rates recently filed and approved in the State of Idaho, and approve those for Avista's Montana customers, when a request is made by Avista. The date of the last approved retail rates in Montana for Avista was April 27, 2011. Since that time electric retail rates have increased in the State of Idaho, but Avista has not proposed similar increases for its Montana customers. Because Avista's current retail rates for its Montana customers are already below its cost of service, and for the sake of administrative efficiency, Avista and Hydro One are not proposing to flow through a financial benefit to Avista's Montana customers related to the Proposed Transaction. (If a proportionate benefit to Montana customers were to be calculated based on the level of retail revenue, the total annual Rate Credit for all customers combined would be approximately $190.)

Q. Once the Rate Credit is allocated between electric and natural gas operations, how is the credit split <u>between the state jurisdictions</u>?

A. For Avista's <u>electric</u> operations, the Company uses what is referred to as a "Factor 4" allocator for purposes of allocating common costs to Washington and Idaho. This factor is developed using the following four factors:

(1) Direct O&M and A&G costs, excluding labor and resource costs that are assigned to Washington and Idaho electric service.

(2) Direct O&M and A&G labor costs that are assigned to Washington and Idaho electric.

(3) Number of customers for Washington and Idaho electric.

(4) Net direct plant that is assigned to Washington and Idaho electric service.

For Avista's <u>natural gas</u> operations, the Company uses a similar natural gas "Factor 4" allocator for purposes of allocating natural gas service costs common to Washington and Idaho.[3] This factor is developed using the following four factors:

(1) Direct O&M and A&G costs, excluding labor and resource costs that are assigned to Washington and Idaho natural gas service.

(2) Direct O&M and A&G labor costs that are assigned to Washington and Idaho natural gas service.

(3) Number of customers for Washington and Idaho natural gas service.

(4) Net direct plant that is assigned to Washington and Idaho natural gas service.

The calculations to develop the Factor 4 allocators are provided in Exh. PDE-2.

Q. And finally, how are Joint Applicants proposing to spread the Rate Credit among the electric and natural gas service schedules within each state?

[3] The allocation of the Rate Credit to Oregon natural gas customers will have already been determined using the Factor 7 allocator explained earlier.

A. For Avista's electric service schedules, the Joint Applicants are proposing to spread the Washington electric Rate Credit on a uniform percent of base revenue basis. The Joint Applicants chose this method of rate spread because it generally matches how the common costs discussed earlier are presently being recovered from customers. For the spread of the Rate Credit within each service schedule (i.e., rate design), the Joint Applicants applied the Rate Credit to the volumetric energy blocks on a uniform cents per kWh basis. Page 2 of Exh. PDE-3 provides the proposed rate spread and rate design of the electric Rate Credit.

For Avista's natural gas service schedules, the Joint Applicants are proposing to spread the Washington natural gas Rate Credit on a uniform percent of margin basis. As with the electric rate spread, the Joint Applicants chose this method of rate spread because it generally matches how the common costs discussed earlier are presently being recovered from customers. For the spread of the Rate Credit within each service schedule (i.e., rate design), the Joint Applicants applied the Rate Credit to the volumetric energy blocks on a uniform cents per therm basis. Page 2 of Exh. PDE-3 provides the proposed rate spread and rate design of the natural gas Rate Credit.

Q. When would those credits be reflected in customers' billing rates?

A. Joint Applicants propose to have the Rate Credit go into effect on the first day of the month following the month in which the transaction closes. For example, if the transaction closes on October 1, 2018, the Rate Credit would go into effect on November 1, 2018. This timing will allow time for Avista to file conforming tariffs with the Commission, and give the Commission adequate time for review.

Q. Have the Joint Applicants filed tariffs that would implement the proposed Rate Credit?

A. Yes. The Joint Applicants have developed electric and natural gas proforma tariffs outlining the terms and conditions of proposed Rate Credit, and they are included in Exh. PDE-5. Joint Applicants would file conforming tariffs prior to the Rate Credit effective date to implement the credit, if the Commission approves the Proposed Transaction.

Q. Will the per kWh or per therm Rate Credit be static over the 10-year period?

A. No. Joint Applicants are proposing that the allocation factors used to spread the Rate Credit by service and by state be updated over time, such that the most current allocation factors used in the most recent general rate case are used for purposes of allocating the Rate Credit. By updating these factors at the conclusion of a general rate case, they will be consistent with the allocation factors used in establishing base retail rates for customers at the time.

In addition, as explained earlier, as the annual benefits to customers are rolled into base retail rates over time, the separate Rate Credit on Schedules 73 and 173 will change.

III. REGULATORY COMMITMENT NOS. 20, 23, 26-28, 31-32

Q. What are the regulatory commitments offered by Avista and Hydro One as part of Joint Applicants' request for approval of the Proposed Transaction that you are addressing in your testimony?

A. Joint Applicants are offering the following regulatory commitments that I am supporting:

- Compliance with Existing Commission Orders – Commitment No. 20
- Cost Allocations Related to Corporate Structure and Affiliate Interests –

Commitment No. 23

- FERC Reporting Requirements – Commitment No. 26
- Participation in National and Regional Forums – Commitment No. 27
- Treatment of Confidential Information – Commitment No. 28
- Annual Report on Commitments – Commitment No. 31
- Commitments Binding – Commitment No. 32

Q. What is Joint Applicants' commitment related to compliance with existing Commission Orders (Commitment No. 20)?

A. Under this commitment, Olympus Holding Corp. and its subsidiaries, including Avista, acknowledge that all of the existing orders issued by the Commission with respect to Avista (or its predecessor, Washington Water Power Co.) remain in effect, and are not modified or otherwise affected by the Proposed Transaction.

Q. Please explain the commitment associated with Cost Allocations Related to Corporate Structure and Affiliated Interests (Commitment No. 23).

A. In Commitment No. 23, Avista makes specific commitments related to Cost allocations related to corporate structure and affiliated interests. Avista agrees to provide cost allocation methodologies used to allocate to Avista any costs related to Olympus Holding Corp. or its other subsidiaries, and commits that there will be no cross-subsidization by Avista customers of unregulated activities.

The cost-allocation methodology provided pursuant to this commitment will be a generic methodology that does not require Commission approval prior to it being proposed for specific application in a general rate case or other proceeding affecting rates. Avista will bear the burden of proof in any general rate case that any corporate and affiliate cost allocation methodology is reasonable for ratemaking purposes. Neither Avista nor Olympus Holding Corp. or its subsidiaries will contest the Commission's authority to disallow, for retail ratemaking purposes in a general rate case, unreasonable, or misallocated costs from or to Avista or Olympus Holding Corp. or its other subsidiaries.

With respect to the ratemaking treatment of affiliate transactions affecting Avista, the Joint Applicants will comply with the Commission's then-existing practice; provided, however, that nothing in this commitment limits Avista from also proposing a different ratemaking treatment for the Commission's consideration, or limit the positions any other party may take with respect to ratemaking treatment.

Avista will notify the Commission of any change in corporate structure that affects Avista's corporate and affiliate cost allocation methodologies. Avista will propose revisions to such cost allocation methodologies to accommodate such changes. Avista will not take the position that compliance with this provision constitutes approval by the Commission of a particular methodology for corporate and affiliate cost allocation.

Q. For Commitment No. 26, "FERC Reporting Requirements", what have Joint Applicants committed to as a part of the Proposed Transaction?

A. Avista will continue to meet all the applicable FERC reporting requirements with respect to annual and quarterly reports (e.g., FERC Form 1, 2, 3q) after closing of the Proposed Transaction.

Q. As it relates to Avista's "Participation in National and Regional Forums", what have Joint Applicants committed to as a part of this transaction (Commitment No. 27)?

A. Under this commitment Avista agrees that it will continue to participate, where appropriate, in national and regional forums regarding transmission issues, pricing policies, siting requirements, and interconnection and integration policies, when necessary to protect the interests of its customers.

Q. Please explain the commitment addressing the "Treatment of Confidential Information," (Commitment No. 28).

A. Commitment No. 28 states that, "Nothing in these commitments will be interpreted as a waiver of Hydro One's, its subsidiaries', or Avista's rights to request confidential treatment of information that is the subject of any of these commitments."

Q. Please describe Commitment No. 31, "Annual Report on Commitments".

A. By May 1, 2019 and each May 1 thereafter through May 1, 2023, Avista will file a report with the Commission regarding the implementation of the commitments as of December 31 of the preceding year. The report will, at a minimum, provide a description of the performance of each of the commitments. If any commitment is not being met, relative to the specific terms of the commitment, the report will provide proposed corrective measures and target dates for completion of such measures.

Q. Please describe Commitment No. 32, "Commitments Binding".

A. While there is more specific language contained within Commitment No. 32, in short, Hydro One and Avista acknowledge that the commitments being made by Hydro One and Avista are binding only upon them, their affiliates where noted, and their successors in interest. Further, the Joint Applicants are not requesting in this proceeding a determination of the prudence, just and reasonable character, rate or ratemaking treatment, or public interest of the investments, expenditures or actions referenced in the commitments, and that Parties in appropriate proceedings may take such positions related to those items as they deem appropriate.

IV. ACCOUNTING FOR MERGER-RELATED COSTS

Q. Please describe how Avista is accounting for the costs associated with the Proposed Transaction.

A. All costs associated with evaluating and executing on the Proposed Transaction are being separately tracked and recorded below-the-line to a nonoperating account. This includes internal labor, outside services, travel, and all other associated costs.

Attached as Exh. PDE-4 is Avista's "Direct Assignment Protocol," developed by Avista for the assignment of costs associated with the Proposed Transaction. The Protocol addresses the accounting for costs both prior to the closing of the transaction, as well as the accounting for costs following the closing.

Q. Following the closing of the transaction, how will Avista account for the costs associated with time and expenses incurred by Avista employees and Hydro One employees for any services or work between the two companies?

A. To the extent Avista employees dedicate time and incur costs related to the operations of Hydro One, those costs will be directly assigned and billed to Hydro One, and would not be borne by Avista's customers. Likewise, should Hydro One employees dedicate time and incur costs associated with Avista's operations, such costs would be directly assigned and billed to Avista. If a Hydro One employee's time and costs are related to Avista's regulated utility operations, the costs would be subject to review and approval by the Commission prior to being recovered in retail rates. The Company expects such assignment of costs, both to Hydro One and from Hydro One, to be relatively small, especially in the near-term, since Avista will continue to operate as a standalone utility.

At this point in time, there are no plans to combine any specific utility operations. In the future, however, if opportunities arise for the consolidation of certain Avista and Hydro One utility functions, where the utilities have an opportunity to benefit from specialized expertise or to achieve efficiencies, it may be appropriate to develop additional or different direct assignment or allocation protocols.

Q. Is Avista currently using the proposed Direct Assignment Protocol with other existing affiliate companies of Avista?

A. Yes. In 2014 Avista acquired Alaska Energy and Resources Company (AERC), including AEL&P, which provides electric service to customers in the City and Borough of Juneau, Alaska. We are using the same Protocol for these companies as we will use for the Avista/Hydro One Proposed Transaction.

To the extent Avista's general office employees spend time providing services and support to our existing subsidiaries, these costs are charged to suspense accounts (Deferred Debit Account No. 186), are loaded for benefits, and are then established as a receivable (FERC Account No. 146) when billed to the subsidiary. If other resources are expended during the course of this work, such as travel or consulting services, these costs are also charged to suspense accounts and billed to the subsidiary. All corporate services provided, and costs incurred, are direct billed to subsidiaries at cost. No additional margin or profit is included and no assets are allocated. This assignment of Avista costs, which are then billed back to the subsidiary at cost, serve to reduce the utility's expenses.

As indicated earlier, if Hydro One's employees were to provide support for Avista's utility operations, such costs would be directly assigned to Avista. Avista will use the same methodology for direct assignment of costs related to its relationship with Hydro One, as it is with AERC and AEL&P, as per the attached "Protocol for Direct Assignment" in Exh. PDE-4.

V. RELATIONSHIP TO PENDING GENERAL RATE CASES

Q. Should the Proposed Transaction be consolidated with Avista's pending electric and natural gas general rate cases (Dockets UE-170485 and UG-170486)?

A. No. As explained by Mr. Morris, following the close of this transaction, there will be little to no change in the operations of Avista, as compared to Avista's operations prior to the transaction.

There will be some cost savings immediately following the closing of the transaction, such as reduced expenses associated with Avista no longer having publicly traded common stock, fewer non-employee members of the Avista Board of Directors, and other cost savings explained by Mr. Thies. These savings, however, will be covered by the proposed Rate Credit. Avista and Hydro One are proposing to flow through to Avista's electric and natural gas retail customers a Rate Credit beginning at the time the Proposed Transaction closes (through the separate tariff Schedules 73 and 173). Therefore, the costs which are currently embedded in either existing retail rates or the current rate case, which will be reduced as a direct result of the Proposed Transaction, will be immediately credited back to customers beginning at the time the Proposed Transaction closes, through the Rate Credit.

Furthermore, the pending general rate cases are scheduled to be completed on or before April 26, 2018. A decision on this Proposed Transaction filing likely will not occur prior to this date. Thus, at the time a decision is due in the general rate cases, it will not be known whether the Proposed Transaction will be approved, and therefore whether there will, in fact, be any merger-related cost savings.

Q. Did the Commission consolidate the Puget Sound Energy ("PSE") acquisition docket in 2007 with its then-pending general rate case?

A. No. By way of background, PSE filed a general rate case on December 3, 2007 (Dockets UE-072300 and UG-072301). Just 14 days later, on December 17, 2007, PSE filed a Joint Application related to its purchase by an investment consortium ("Macquarie") (Docket U-072375). Shortly thereafter, the Commission denied a motion to consolidate the Macquarie purchase with the general rate case.[4] In that case, there was only a 14 day separation between the filings, and the Commission chose not to consolidate, whereas here Avista's general rate case is well underway.

Furthermore, the Avista transaction and the Puget transaction are very similar in the sense that the transactions were designed such that, following the closing there is very little change in the utility costs embedded in retail rates (and the rate case) as a direct result of the Proposed Transaction, i.e., there is little to no change in utility operations following the closing of the transaction.

In this instance, Avista filed its electric and natural gas general rate cases more than 3.5 months prior to the filing of the Joint Application in this case, and discovery is well underway along with an established procedural schedule. To consolidate the general rate cases with this merger case would unnecessarily delay the rate effective date of the general

[4] See Prehearing Conference Transcript, Docket U-072375, p. 0027, ll. 17-20 (January 14, 2008).

rate cases, and would lead to incremental regulatory lag in the recovery of costs that, in the end, will essentially not be affected by the proposed transaction. The Rate Credit is designed to capture any savings.

Q. Does this conclude your pre-filed, direct testimony?

A. Yes it does.