Exhibit No. ___ T (MPP-1T)
Docket UE-090134/UG-090135
and UG-060518 (consolidated)
Witness: Michael P. Parvinen

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **Respondent.** **. . . . .**	)	**DOCKETS UE-090134 and UG-090135** ***(consolidated)***
In the Matter of the Petition of **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **For an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism.** **. . . . .**	)	**DOCKET UG-060518 (*consolidated*)**

TESTIMONY

OF

MICHAEL P. PARVINEN

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

August 17, 2009

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Michael P. Parvinen. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Dr. S.W., P.O. Box 47250, Olympia, Washington 98504-7250. My e-mail address is mparvine@utc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission ("UTC") as the Assistant Director of Energy. In that capacity I supervise the members of the Energy Section that analyze electricity and natural gas filings and issues. Before my current position, I was a Regulatory Analyst and later the Deputy Assistant Director in the Energy Section.

Q. How long have you been with this agency?

A. I have been employed by the UTC since 1987.

Q. What are your educational and professional qualifications?

A. I graduated from Montana College of Mineral Science and Technology in May of 1986, and received a Bachelor of Science degree in business administration with a major in accounting. I have testified before the UTC in Dockets UE-080416/UG-080417 – Avista Corporation; Dockets UE-072300/UG-072301 – Puget Sound Energy, Inc.; Docket UG-060256 – Cascade Natural Gas Corporation; Dockets UE-

050482/UG-050483 – Avista Corporation; Docket UG-040640/UE-040641 – Puget Sound Energy, Inc.; Docket UG-021584 – Avista Corporation; Dockets UE-011570/UG-011571 – Puget Sound Energy, Inc.; Docket UE-010395 – Avista Corporation; Dockets UE-991606/UG-991607 – Avista Corporation; Docket UG-931405 - Washington Natural Gas Company; Docket UG-920840 - Washington Natural Gas Company; Docket UG-911246 - Cascade Natural Gas Corporation; Docket UE-900093 - The Washington Water Power Company; Docket U-89-2688 - Puget Sound Power & Light Company; Docket D-2576 - Bremerton-Kitsap Airporter, Inc.; and Docket U-88-2294-T - Richardson Water Companies. I have also analyzed or assisted in the analyses of numerous other transportation and utility rate filings. I attended the Seventh Annual Western Utility Rate Seminar in 1987, and the 1988 Annual Regulatory Studies Program, sponsored by the National Association of Regulatory Utility Commissioners.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. Please describe the scope of your testimony.

A. I will address a fundamental ratemaking issue raised in the Company's filing, specifically the Company's interpretation of a pro forma adjustment and the matching principle. I will also present Staff's recommended treatment of the Energy Recovery Mechanism (ERM) surcharge, and present an overview of the other witnesses testifying for Staff in these dockets. That overview indicates that Staff recommends an increase to electric revenues of $20,109,000 or 5.15%, and to natural gas revenues of $280,000 or 0.13%.

Q. Do you have general comments in regards to the Company's filing?

A. Yes. The Company filed its current rate request 23 days after the effective date of its last general rate increase. In that case the settling parties agreed to defer the recovery of expenses related to the Coeur d' Alene (CDA) Tribe Settlement and the Spokane River Relicensing, since those issues were not yet fully resolved and therefore, not fully known and measurable. These issues have now been resolved and are included in the Company's present case. If one were to look at the significant changes since the last rate case there would be only three items: the two deferred issues from the previous rate case, and changes in power costs.

Q. What is the effect of the two deferred issues and the change in power costs since the last rate case?

A. These three items total over $14 million in revenue requirement[1]. This amount accounts for the majority of Staff's recommended revenue requirement increase.

Q. What is the major driver for the difference in revenue requirement between the Company's request and the Staff recommendation?

A. Other than updating the power supply adjustment to reflect more recent fuel (primarily natural gas) prices and load changes, the majority of the Company's rate

1 Exhibit No. ___ (DPK-2), Schedule 1.4, page 13 of 18, column (g), lines 27+28+37+38.

increase request is for adjustments that simply do not meet the definition of a proper pro forma adjustment. My testimony will explore this fundamental issue further.

III. A FUNDAMENTAL RATEMAKING ISSUE - PROPER PRO FORMA ADJUSTMENTS

Q. Please explain the purpose of this portion of your testimony.

A. The purpose of this portion of my testimony is to identify how the Commission defines “pro forma adjustment,” and explain appropriate regulatory theory and policy supporting this definition. I then explain how many of the adjustments proposed by Avista in this case are inconsistent with this definition, regulatory theory, and policy. Mr. Danny Kermode and Ms. Ann LaRue provide Staff’s analysis on individual adjustments.

Q. How do Commission rules define “pro forma adjustment?”

A. According to WAC 480-07-510(3)(iii), “Pro forma adjustments" give effect for the test period to all known and measurable changes that are not offset by other factors.

Q. What concepts underlie this definition?

A. There are two basic concepts: the “known and measurable” concept and the “offset by other factors” concept.

Q. Please explain the known and measurable concept.

The known and measurable concept requires that the event that causes a change in revenue, expense or rate base must be known to have occurred during or after the historical 12 months of actual results of operations,[2] but the effect will be in place during the 12-month period when rates will likely be in effect.[3] Furthermore, the actual amount of the change must be measurable.

Q. Please give a simple example applying the known and measureable concept.

A. A classic example is an increase in postage rates that the United States Postal Service has ordered to go into effect by a date certain. This will affect the Company's cost of mailing utility bills to its customers. This price change is known because it is certain to occur and the change in price is known. The price change is measurable because the new price can be applied to the test year units of postage, to calculate the pro forma level of postage expense. The adjustment for the change in postage rates is therefore "known and measurable."

Q. Please explain the "offset by other factors" concept.

A. This concept requires that all factors affecting the known and measurable change, in a price, for example, be considered in determining the pro forma level of expense. An offsetting factor is one that "cancels out" or mitigates the impact of the known and measurable event. If the offsetting factors are not taken into account, that would

2 This is also known as the "test year," "test period" and "historical test year."
3 This is also known as the "rate year."

overstate or understate the known and measurable change, and create a mismatch in the relationship of revenues, expenses, and rate base.

Q. Please provide examples of the "not offset by other factors" concept.

A. Using my previous example of the postage rate increase, there likely are no offsetting factors that will affect the number of bills the utility mails out. If that is correct, then there are no offsetting factors.

Similarly, a union wage increase for certain of the utility's employees that is called for by a collective bargaining agreement likely would not be offset by other factors, if it would not affect the number of hours worked during the test period.

Q. Please give an example of an expenditure that would have offsetting factors.

A. One example would be when a utility replaces an older piece of equipment with a new, perhaps more efficient piece of equipment; the offsetting factors would include gains in efficiency and/or reduced maintenance expense. If the piece of equipment were included in rate base without reflecting these offsetting factors, a mismatch is created.

Q. You have used the term "mismatch" in your prior answers. Please explain what this means.

A. I use this term to reflect the "matching principle" of ratemaking. Historical test year ratemaking is premised on the "matching principle" of accounting, where the relationship between revenues, expenses, and rate base is established. For example, if a company has a plant asset at the beginning of the test year, then all of the other components, i.e., test year revenues, expenses, and service levels, reflect that plant asset being in place; and all components - revenues, expenses, and rate base - are properly matched.

However, if the utility were to replace a plant asset during the test year, the replacement asset would have effects on such things as reducing maintenance expense and/or increasing revenues, if the system is made more reliable or expanded. In most instances, these offsetting factors of the replacement asset will not be fully known until they are embedded in the utility's historical test year results.

Pro forma adjustments are made to the test year for known and measurable changes with no offsetting effects, thus, maintaining the historical test year matching principle. Pro forma adjustments based on the examples described earlier in my testimony, related to postage increases or union contract wage increases, are known and measurable with no offsetting factors. Pro forma rate base adjustments typically have offsetting factors, so an adjustment can be made only if the offsetting factors are measured and accounted for, in order to properly match the revenues, expenses, and service levels.

Q. What does your discussion imply for pro forma adjustments to rate base, such as an asset that is added at mid-year?

A. Conceptually, such an adjustment can be appropriate, so long as all offsetting factors are considered. However, it is extremely difficult, if not impossible; to measure the offsetting effects a rate base change has on the revenues, expenses, and/or service levels. Virtually all rate base additions have an impact on service, costs, and/or revenue whether the addition is a replacement, for growth, or simply a required addition.

Traditional ratemaking is premised on the utility making the investment, and once it is in service for a period of time (typically a test period) the utility would examine its overall operation and determine if it had or will have the opportunity to earn its Commission-authorized rate of return. If the answer is "no," then the utility would file a rate case with the asset and all associated expenses (up or down), revenues, and service reflected in the test year, all properly matched.

Q. Is there a concern about regulatory lag?

A. On an asset by asset basis, that can be a concern. However, because any investment a utility makes should be supported by a rational and prudent management decision, there is inherently a return on such investment immediately upon its being placed into service, whether it is an efficiency improvement leading to reduced maintenance, fewer outages (reliability), or growth in customers (revenues). If there is no such benefit, the Commission should question why the decision to invest was made.

Moreover, regulatory lag, to the extent it exists, provides an incentive for the utility to manage its costs in areas it can control, so that it has the opportunity to earn its authorized rate of return. Also, the risk of regulatory lag, if any, should be taken into account by investors, and reflected in the cost of capital.

Q. Has the Commission previously addressed this concern regarding regulatory lag?

A. Yes. In a recent general rate filing by Puget Sound Energy, the Commission confirmed that regulatory lag is an inherent component of the long-standing historical rate making concept and that it has both positive and negative attributes. *WUTC v. Puget Sound Energy, Inc*., Dockets UE-060266 and UG-060267, Order 08 at ¶37 and footnote 24 (January 5, 2007).

Q. Has the Commission allowed pro forma rate base adjustments in past cases?

A. On occasion, the Commission has allowed such adjustments. For example, in the last several rate cases for Avista, the Commission has allowed certain generating facilities into rates, even though the acquisition was after the test period. Examples include: Coyote Springs and the Noxon Dam upgrades. The main reasons for allowing such pro forma adjustments were the materiality of the resource acquisition and the fact that through the power supply adjustment, the offsetting factors were measured. The Commission has also allowed certain pro forma transmission investment related to Avista’s 230kv, five year, upgrade project. The Commission included this project in rate base to promote system reliability. The additions did not increase overall capacity, and any offsets from reduced interruptions and reduced maintenance were demonstrated to be minimal, as compared to the test year.

Q. Has Avista completed the 230kv transmission project?

A. Yes[4].

Q. In this case, is the Company proposing to include investments beyond those you have already identified?

A. Absolutely! The Company is proposing to include virtually every proposed capital project and budgeted expense, as long as they cannot be tied directly to customer additions (i.e., revenue producing).

Q. Does the Company's own testimony identify offsetting factors that are not measured in its proposed adjustments?

A. Yes. The following are several statements that identifying offsetting factors:

- "…enhance transmission system reliability and efficiency, provide cost-effective region transmission planning,…" Exhibit No. ___ (SJK-1T), page 3, lines 4-6
- "…enhance reliability in Columbia Grid Footprint. …expanding the existing regional coordinating outage management process, … improved system modeling,…" Exhibit No. ___ (SJK-1T), page 4, lines 8-11
- "…meet capacity needs, eliminate thermal loading issues, replace deteriorating equipment,…" Exhibit No. ___ (SJK-1T), page 12, lines 17-18
- "…increase the capacity of the substation bus,…improves reliability and operating flexibility." Exhibit No. ___ (SJK-1T), page 13, lines 8-10

4 Direct Testimony of Scott J. Kinney, Exhibit No. ____ (SJK-1T), page 12, lines 14-15.

- "…provide improved service to customers." Exhibit No. ___ (SJK-1T), page 14, line 5
- "…mitigate thermal overloads experienced…" Exhibit No. ___ (SJK-1T), page 14, lines 17-18
- "All these individual projects improve system reliability and customer service." Exhibit No. ___ (SJK-1T), page 15, line 30
- "…meet capacity needs of the system, improve reliability,…" Exhibit No. ___ (SJK-1T), page 16, lines 11-12

Q. All the above points are taken from the testimony of Company witness Mr. Scott Kinney. Does Company witness Mr. Dave DeFelice also testify to plant additions?

A. Yes. Mr. DeFelice has approximately eight pages of testimony describing proposed projects, but without identifying why the projects are being performed. By asking the question "why," one can start to identify the offsetting factors.

Q. Mr. DeFelice includes a number of regulatory arguments why the Company proposed 2008 and 2009 additions are appropriate to be included in the current rate case. Do you agree with his presentation?

A. No. Mr. DeFelice indicates that the Company's proposal is consistent with prior ratemaking in Washington. Exhibit No. ___ (DBD-1T), page 2, lines 9-10. This is not correct. I identified, earlier in my testimony, the rare instances when the Commission has allowed pro forma rate base additions in rates: essentially for major resource acquisitions where offsetting factors have been identified.

Mr. DeFelice also states that the Company's approach is consistent with the methodology sponsored by the Company in the last general rate case. This is correct. However, the last rate case resulted in a settlement between Staff and the Company. The Company's sponsored adjustment was adjusted for use in the parties' settlement presentation of the revenue requirement. The settlement also included language that stated:

> "By executing this Multiparty Settlement Stipulation, no Stipulating Party shall be deemed to have accepted or consented to the facts, principles, methods or theories employed in arriving at the Multiparty Settlement Stipulation, and, except to the extent expressly set forth in the Multiparty Settlement Stipulation, no Stipulating Party shall be deemed to have agreed that such a Multiparty Settlement Stipulation is appropriate for resolving any issues in any other proceeding."

Q. Mr. DeFelice references a Commission order as support for the acceptance of pro forma rate base additions. Exhibit No. ___ (DBD-1T), page 2, line 21 to page 3, line 2. Can you elaborate on this reference?

A. The Third Supplemental Order in U-85-36 was referencing the major resource acquisitions of Colstrip 3 and 4. The offsetting factors associated with these additions were also identified and included in the analysis, thus meeting the pro forma definition as well as the matching principle.

Q. Mr. DeFelice also states that the Company-sponsored adjustments are necessary to properly "match" the revenues from customers with the costs to

serve customers. Exhibit No. ___ (DBD-1T), page 2, lines 16-17. Do you agree with this statement?

A. No. Because offsetting factors are not identified and measured, it is not possible to properly match the revenues with the costs to provide service. The fundamental basis of historical ratemaking is that average of monthly average (AMA) rate base during the test year properly matches the revenues and expenses of that same test year.

Q. What is Staff's recommendation regarding the Company's proposed Pro Forma 2008 and 2009 Capital Additions adjustments?

A. The Company has not carried its burden to demonstrate that the individual projects within these adjustments are known and measurable and the offsetting factors have been identified. Therefore, the Commission is justified in removing these adjustments in total.

Q. Has Staff presented an alternative instead of fully removing the adjustments?

A. Staff witness Mr. Kermode has spent countless hours analyzing individual projects and even spent several days at the Company's offices discussing and gathering information in order to possibly decipher which of the proposed projects could be considered as meeting the definition of a proper pro forma adjustment. Mr. Kermode's testimony and exhibits identify the various projects that meet the definition of a pro forma adjustment. Mr. Kermode was very liberal in his recommendation, as it is questionable whether the offsets associated with all projects selected have been measured and accounted for in the analysis.

IV. ERM SURCHARGE

Q. Can you briefly describe the Company's proposal with regards to the Energy Recovery Mechanism (ERM) Surcharge?

A. The Company is requesting that the ERM surcharge be reduced to zero coincident with the rates approved in this filing regardless of the deferred ERM balance.

Q. **What is Staff's response to the Company's request?**

A. Staff disagrees with this approach.

Q. Please elaborate.

A. The original surcharge was put in place to recover extraordinary power costs associated with the power crisis of 2000-2001. The surcharge was designed to stay in place until the authorized deferral balance goes to zero. Based on the authorized deferred balance of approximately $37 million, as of December 31, 2008, the balance is estimated by the Company to reach zero at the end of January 2010. The end of the suspension period in this case is December 23, 2009. Staff's opinion is that it is appropriate for customers to see the surcharge be reduced to zero on its own merits, and not simply be used to offset a general rate increase. If a general rate increase goes into effect in December and the surcharge is reduced to zero at the end of

January, customers are made distinctly aware of the general rate increase as well as seeing the ERM surcharge finally go away after being in place since October 2001.

V. OTHER STAFF WITNESSES

Q. Please list the other Staff witnesses and their general area of responsibility in this proceeding.

A. The following witnesses present testimony on behalf of Staff in this proceeding:

Danny P. Kermode presents Staff's recommended revenue requirement for both the electric and natural gas operations. His summary exhibits show that Staff recommends an increase to electric revenues of $20,109,000, or 5.15%, and to gas revenues of $280,000, or 0.13%. He also testifies on ratemaking adjustments addressing capital additions, pensions, production property, asset management, information services, and property taxes.

Alan P. Buckley and Donald W. Schoenbeck testify jointly to the appropriate level of power supply costs that should be included in rates including adjustments for gas price update, contract update, water filtering, retail load, hydro filtering, Colstrip availability, and WNP-3.

Joanna Huang presents Staff's recommended rate spread and rate design. She will also address the Company's cost of service studies.

Ann M. C. LaRue presents Staff's recommendation on several rate making adjustments including wages and incentives, O&M expenses, directors and officer's insurance, and mercury emissions.

Deborah Reynolds addresses Staff's analysis and recommendations regarding the decoupling mechanism. She will also address the prudency of the Company's conservation efforts.

Vanda Novak presents Staff's analysis of the weather normalization adjustments both in the electric and natural gas proceedings.

David C. Parcell provides Staff's recommendation on the cost of capital to be used for ratemaking purposes. His overall recommendation is 8.13 percent, which is based on a 10 percent return on equity and the capital structure as of December 31, 2008.

Q. Does this conclude your testimony?

A. Yes, it does.