

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NOS. UE-120436 & UG-120437

DOCKET NOS. UE-110876 & UG-110877

CROSS-ANSWERING TESTIMONY OF

KELLY O. NORWOOD

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, employer and business address.

A. My name is Kelly O. Norwood and I am employed as the Vice President of State and Federal Regulation for Avista Utilities (Company or Avista), at 1411 East Mission Avenue, Spokane, Washington.

Q. Have you previously provided direct testimony in these Dockets?

A. Yes. I have sponsored Exhibit Nos. ____ (KON-1T) through (KON-5). My testimony relates to, among other things, the Company's proposed Attrition Adjustment.

Q. Are you sponsoring any Exhibits with this testimony?

A. No, I am not.

Q. What is the purpose of your testimony in this matter?

A. The purpose of my testimony is to provide the Company's Cross-Answering testimony to the testimonies filed by the Staff of the Washington Utilities and Transportation Commission ("UTC Staff"), the Public Counsel Section of the Washington Office of Attorney General ("Public Counsel"), and the Industrial Customers of Northwest Utilities ("ICNU"), regarding the decoupling mechanism the Northwest Energy Coalition (NWECC) proposed for Avista.

Q. Do you have any general observations related to the testimony filed by the three parties, before you begin addressing some of the specific issues?

A. Yes. In reading the Commission's Policy Statement on Decoupling issued November 4, 2010 in Docket U-100522, and the Commission's recent Order No. 08 in Puget Sound Energy's Dockets UE-111048 and UG-111049, I believe the Commission is interested in seriously considering some form of decoupling. And we are too if the

1 decoupling mechanism, and other ratemaking treatment, is designed in a way that is fair to
2 both customers and the Company. None of the three parties (UTC Staff, Public Counsel,
3 or ICNU), however, have been constructive in assisting the Commission with a specific,
4 fleshed-out electric decoupling proposal that could be acted upon by the Commission in
5 this Docket. Much of the focus of their testimony is on why decoupling should not be
6 adopted, identifying alleged shortcomings with the NWECE's proposal, and/or
7 recommending conditions related to adoption of decoupling that would cause the
8 mechanism to be of little or no value, or even harmful, to the utility if adopted by the
9 Commission.

10 Although some of the arguments presented by the three parties may initially make
11 intuitive sense, a closer examination of the facts shows that they are simply not true. I will
12 provide specific examples later in my testimony.

13 In Avista's responsive testimony sponsored by Mr. Ehrbar in this Docket related to
14 decoupling, we provided specific details that fleshed-out the decoupling proposal presented
15 by NWECE, in a form that, if approved by the Commission, would be fair to both customers
16 and the Company. We also explained the importance of addressing the regulatory lag, or
17 attrition, issue along with decoupling, otherwise the Company would be even worse-off
18 with decoupling than without it.

19 In presenting its decoupling proposal, NWECE essentially had two primary
20 objectives related to decoupling; 1) remove the disincentive to the utility related to the
21 acquisition of energy efficiency, and 2) remove the direct link between sales of kWhs and
22 profits. I will circle back to these later in my testimony.

1 **Q. What is the first concern you have from the testimony of the three**
2 **parties?**

3 A. On page 19 of the direct testimony of Dr. Dismukes (Exhibit No. _____
4 (DED-1T)), he included the following question and answer:

5 *Q. Even if NWECE's assertions were correct, do utilities have a remedy should*
6 *earnings become compromised by its energy efficiency efforts? (emphasis*
7 *added)*

8 *A. Yes. Utilities have the ability to file a rate case should they believe their*
9 *opportunity to earn a return on and of their prudently incurred investments*
10 *and expenses are compromised. Avista has consistently taken advantage of*
11 *this rate case opportunity over the past several years. The pursuit of energy*
12 *efficiency, even aggressive energy efficiency, does not change that*
13 *fundamental fact of utility regulation.*
14

15 One of the primary objectives of entertaining decoupling in the first place is to
16 address the impacts of energy efficiency savings in between general rate cases. Such a
17 statement suggests that he does not fully appreciate the ratemaking effect that energy
18 efficiency savings have on a utility between rate cases, i.e., filing a new general rate case
19 would not address the earnings short-fall associated with energy efficiency savings, unless
20 the case were to include a specific adjustment or mechanism, such as decoupling, to
21 address the short-fall between rate cases.

22 As Mr. Ehrbar explained in his direct testimony (Exhibit No. ____ (PDE-9T)),
23 beginning on page 4, rates are established in a general rate case using historical test-period
24 loads. At the same time, Avista is obligated by law to assist its customers to use less
25 energy following the test-period (in between rate cases), through its energy efficiency
26 programs. Therefore, after new retail rates are established in a rate case, all other things
27 being equal, Avista's customers will, in fact, consume a lower volume of kWhs than that
28 included in designing the rates, and the resulting revenues will not be sufficient to cover

1 Avista's costs and provide the opportunity to earn the authorized return.

2 Furthermore, the presumption in Washington using "modified test-period"
3 ratemaking is that revenue growth following the historical test-period should be available
4 to offset growth in costs to maintain a proper matching of revenues and expenses over
5 time.¹ Any proposal to use "found margins" from higher retail sales following the
6 historical test-period, either from an increased number of customers or increased use-per-
7 customer, would violate this fundamental matching principle, unless other ratemaking
8 adjustments are made to properly reflect in rates the growth in costs for the future rate
9 period, such as additional pro forma adjustments or an attrition adjustment. Mr. Ehrbar
10 explained this in some detail in his testimony, along with supporting analysis.

11 **Q. Continuing along the same vein of growth in revenues following the**
12 **historical test-period, Mr. Deen, on behalf of ICNU, recommends the use of revenue**
13 **per customer class rather than revenue per customer in any decoupling mechanism**
14 **adopted by the Commission. How would this recommendation affect ratemaking?**

15 A. Mr. Deen included the following question and answer on page 9 of his
16 responsive testimony (Exhibit No. _____ (MCD-1T):

¹ See Order No. 10 in Dockets UE-090134, UG-090135 and UG-060518 (consolidated), at ¶ 42 related to proper matching of revenues and expenses. Specifically, the Commission states: "(t)he Commission recognizes that the test year is a snapshot in time. The typical test year is the twelve month period preceding the rate filing, ended as of the most recent auditable results of operations. A utility, however, continues to operate, incur costs (including capital additions), achieve savings, and receive revenues during the pendency of its rate review subsequent to the test year that would carry over into the year in which the rates would be effective (known as the "rate year") and beyond. The theory, well supported by ratemaking theory and past commission practice, is that once the relationship is set, it will continue to provide appropriate income to the company in the future. If the utility hooks up new customers, the revenues and expenses will increase in the same proportion as existed in the test year. If new facilities are put into service to serve those customers, then the resulting revenues would not only cover the company's added expenses, but also effectively provide a return on that new investment".

1 *Q. How do you recommend NVEC's mechanism be adjusted?*

2 *A. Under the WUTC standards, a utility's revenue requirement is established*
3 *in a GRC, and that revenue is allocated by class according to accepted*
4 *ratemaking principles. This would maintain current practice during the*
5 *GRC.*

6 *One year after the GRC, the utility would calculate the difference, per*
7 *included class, between the revenue projected by the adjusted historic test*
8 *year and the actual revenue attributable to each class. Subject to a*
9 *conservation test and an earnings test, any over collection would be*
10 *returned to the customer class over the following rate year and any under*
11 *collection would be charged to the customer class over the following rate*
12 *year.*

13
14 Mr. Deen is recommending that any growth in revenue for each customer class
15 following the historical test-period be refunded to customers (and any decrease in revenue
16 be surcharged). This would be okay if all of the growth in costs and investment following
17 the historical test period are also somehow reflected in establishing base retail rates. Under
18 current ratemaking practices in Washington, Mr. Deen's recommendation would refund
19 any growth in revenues following the historical test-period, but shareholders would bear
20 any growth in costs and investment that are not built into base retail rates, either through
21 pro forma adjustments or an attrition adjustment.

22 This example helps illustrate how critically important it is for any decoupling
23 mechanism adopted by the Commission to be "harmonized" with the ratemaking practices
24 used to established base retail rates in a general rate case.

25 **Q. What response do you have related to the testimony of Ms. Deborah**
26 **Reynolds?**

27 **A.** Ms. Reynolds begins her decoupling-related testimony in this Avista
28 Docket with the following questions and answers beginning on page 2:

29 *Q. What is the purpose of your testimony in this proceeding?*

30 *A. My testimony responds to the full electric decoupling proposal of the NW*

1 *Energy Coalition, presented by Mr. Ralph Cavanagh.*

2
3 *Q. Have you responded to a decoupling proposal by NWEA in another*

4 *Commission docket?*

5 *A. Yes. I filed and defended testimony on this issue in consolidated PSE*

6 *Dockets UE-111048 and UG-111049.*

7
8 *Q. In those PSE dockets, did staff file a response to a Bench Request regarding*

9 *decoupling?*

10 *A. Yes. In those PSE dockets, the Commission issued the same (or*

11 *substantially the same) decoupling-related Bench Request that the*

12 *Commission issued in this general rate case. Although the Commission*

13 *relieved the Staff from filing a response in these Avista dockets, I am*

14 *including a copy of the Bench Request response Staff filed in the PSE*

15 *dockets so the Commission will have that information available here.*

16 *Staff's response in my Exhibit No. ____ (DJR-2).*

17
18 Then in Ms. Reynolds' response to her next question she states that, "The

19 Commission should reject Mr. Cavanaugh's decoupling proposal because it does not

20 comply with the Commission's Policy Statement." (Exhibit No. ____ (DJR-1T), page 3,

21 line 20)

22 The point is, the UTC Staff has, thus far, passed up an opportunity to be

23 constructive in assisting the Commission in developing a workable decoupling mechanism

24 for Avista in this Docket, should the Commission desire to approve one. Instead, the UTC

25 Staff chose to provide the Commission an incomplete assessment of a potential decoupling

26 mechanism for another utility, from another docket, in the form of a copy of their response

27 to a Bench Request in the PSE docket. In the UTC Staff's response to the Bench Request

28 in the PSE docket (Exhibit No. ____ (DJR-2), page 5), Staff states, regarding their

29 assessment of a potential decoupling mechanism for PSE, "While the Mechanism does not

30 contain all of the details necessary for implementation, it is sufficiently concrete to permit

31 a robust discussion of the key issues, and to identify the areas requiring further

32 examination." (emphasis added) And yet, she has not provided constructive solutions in

1 this docket, to build on the discussions in the prior PSE docket.

2 **Q. On page 7, beginning on line 13, of Ms. Reynolds' testimony, she states,**
3 **regarding her interpretation of Mr. Cavanagh's testimony, that, "If full decoupling**
4 **were in effect, and Avista experienced lower retail sales due to conservation, Avista**
5 **would be able to sell the unused power in the wholesale market, thus recovering much**
6 **or all of this cost twice: once through the decoupling mechanism, and once from**
7 **wholesale customers." Do you have any comments on this part of her testimony?**

8 A. Yes. Although Mr. Cavanagh's decoupling presentation did not include all
9 the details of the mechanics of NWEC's decoupling proposal, I believe it was not his
10 intention for the ultimate design of the mechanism to provide for a double-recovery of
11 power supply costs. In fact, it is relatively straight-forward to adjust for this in the details
12 of the design of the mechanism to ensure that it does not occur.

13 The decoupling mechanism that Mr. Ehrbar fleshed-out, in his responsive
14 testimony (Exhibit No. ____ (PDE-9T)), includes such an adjustment to remove power
15 supply costs from any decoupling deferral. In fact, Avista spent a significant amount of
16 time to develop, and present, the details of a decoupling proposal that, if approved by the
17 Commission, would be fair to both customers and the Company. The Avista decoupling
18 proposal would also meet the two primary objectives of 1) eliminating the disincentive
19 related to implementing energy efficiency, and 2) remove the direct linkage between the
20 volume of KWh sales and recovery of costs/return on investment.

21 **Q. All of the three parties recommend, or at least suggest, that the**
22 **Commission consider a reduction to return on equity (ROE), and/or a reduction to**
23 **the equity layer in conjunction with the approval of a decoupling mechanism? What**

1 **is your response to this testimony?**

2 A. Mr. Ehrbar has already addressed in his testimony (Exhibit No. ____ (PDE-
3 9T)) our views on an ROE reduction associated with decoupling, and I will not belabor it
4 here. If the Commission believes that an ROE reduction is necessary, then the Company
5 respectfully requests that the Commission not approve a decoupling mechanism for Avista.
6 An ROE reduction of 25 basis points is equal to the amount of estimated annual lost
7 margin associated with Avista's programmatic energy efficiency programs (approximately
8 \$2 million/year). Even if the Commission were to approve what Avista would consider to
9 be an effective decoupling mechanism, all other things being equal, the Company would
10 still be worse off for promoting energy efficiency, because the ROE reduction would offset
11 any gains from the decoupling mechanism.

12 A reduction to the equity layer could also provide a similar result. A reduction of
13 the equity layer by 2% (e.g., from 48.4% to 46.4%) would reduce margin for the Company
14 even more than the estimated lost margin associated with Avista's programmatic energy
15 efficiency programs.² In reality, Avista would likely be unable to reduce its equity layer,
16 given the importance of an adequate equity layer to accommodate Avista's operating risks
17 and the pressures of funding significant capital investments as explained by Company
18 witness Mr. Avera in Exhibit No. __ (WEA-IT), at page 6. There should be no reduction to
19 the equity layer or to the equity cost as a result of lost margin recovery. Lost margin
20 recovery simply restores revenue back to the Company that was assumed to exist when the
21 capital structure and capital costs were determined in a general rate case.

22 **Q. On page 5 of her testimony, beginning on line 10, Ms. Reynolds states**

² \$1.22 billion rate base x 2% x (after-tax equity return 10.9% - after-tax debt cost 3.74%) divided by 0.65.

1 **that, “. . . Avista alleges it is experiencing growth in costs that are not reflected in**
2 **rates. It is Staff’s view that an attrition adjustment is the best way to deal with this**
3 **issue, including any lost revenues due to conservation.” (footnotes omitted) Do you**
4 **have any comments on this testimony?**

5 A. Yes. We agree with UTC Staff that an attrition adjustment is the preferred
6 approach to addressing the revenue short-fall related to increased costs following the
7 historical test period (regulatory lag), including the lost margin associated with energy
8 efficiency. Avista has proposed such an attrition adjustment in these consolidated dockets
9 (see the direct testimony of Norwood (Exhibit No. ____ (KON-1T)), Andrews (Exhibit No.
10 ____ (EMA-1T)), and Lowry (Exhibit No. ____ (MNL-1T)).

11 However, a properly designed decoupling mechanism would also be an acceptable
12 solution to the energy efficiency lost margin issue, as long as regulatory lag is also
13 addressed (through an attrition adjustment, additional pro forma adjustments, or other
14 means) along with the decoupling mechanism. It is critically important that the regulatory
15 lag issue be addressed for a number of reasons, but especially with the adoption of
16 decoupling. Decoupling would rebate to customers the growth in revenues following the
17 historical test period that is intended to be available to offset growth in costs, under the
18 current historical test-year regulatory construct, i.e., growth in revenues are presumed to
19 cover growth in costs following the historical test-year.

20 Therefore, if the Commission were to adopt even a properly designed decoupling
21 mechanism, but not address the regulatory lag issue, the Company would be worse off with
22 the adoption of decoupling, which would compound the under-earning the Company is
23 continuing to experience, as explained in detail in other Avista testimony in these

1 consolidated dockets (see Norwood testimony (Exhibit No. ____ (KON-1T), beginning on
2 page 10). And if the Commission were to adopt decoupling together with an ROE
3 adjustment, without addressing regulatory lag, it would further compound the under-
4 earning for Avista.

5 Thus, it is imperative that the Commission carefully consider the interrelationship
6 and impact of any decoupling mechanism with all other aspects of ratemaking, as it
7 entertains the possibility of approving a decoupling mechanism.

8 **Q. Does this conclude your pre-filed, cross-answering testimony related to**
9 **decoupling?**

10 A. Yes, it does.