Exhibit No. ___(MPG-24T)
Docket Nos. UE-140188/UG-140189
Witness: Michael P. Gorman

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. AVISTA CORPORATION, DBA AVISTA UTILITIES, Respondent.	)	DOCKET NOS. UE-140188 and UG-140189 (*Consolidated*)

RESPONSE TESTIMONY OF MICHAEL P. GORMAN

ON BEHALF OF

THE NORTHWEST INDUSTRIAL GAS USERS

July 22, 2014

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017.

Q. WHAT IS YOUR OCCUPATION?

A. I am a consultant in the field of public utility regulation and a managing principal of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. These are set forth in Exhibit No. ___(MPG-2) attached to my other response testimony in this proceeding, Exhibit No. ___(MPG-1CT).

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the Northwest Industrial Gas Users ("NWIGU").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will respond to Avista Corporation's ("Avista" or the "Company") gas attrition revenue requirement study.

SUMMARY

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND FINDINGS CONCERNING THE REVENUE REQUIREMENT FOR GAS OPERATIONS BASED ON AVISTA'S ATTRITION REVENUE REQUIREMENT STUDY.

A. I take issue with the Company's development of claimed revenue deficiency for gas operations. I find the Company's use of an attrition cost of service study substantially increases the revenue deficiency for gas operations relative to reflecting the Company's actual known and measurable actual cost of service at year-end June 30, 2013. Second, I find that the Company has overstated the claimed revenue deficiency if its 2015 attrition test year methodology is adopted.

Q. WHY DO YOU BELIEVE THAT THE COMPANY'S 2015 ATTRITION YEAR COST OF SERVICE STUDY PRODUCES A SIGNIFICANTLY HIGHER REVENUE DEFICIENCY THAN THE COMPANY'S ACTUAL RESULTS OF JUNE 30, 2013?

A. As shown on my Exhibit No. ___(MPG-25), the revenue deficiency at the actual results of operations at June 30, 2013, and the normalized results of operation at June 30, 2013, as proposed by the Company but at my recommended rate of return of 7.18%, produces a revenue deficiency of $4.77 million and $4.30 million, respectively.

The Company substantially increases its claimed revenue deficiency up to $13.5 million (or approximately $11.0 million at my proposed rate of return) based on a 2015 attrition year revenue requirement methodology.

Q. DO YOU BELIEVE THAT THE COMPANY'S RATES SHOULD BE ADJUSTED TO REFLECT THE ATTRITION YEAR METHODOLOGY AS PROPOSED BY THE COMPANY?

A. No. The Company's cost of service should be based on actual known and measurable and verifiable costs of service. At a minimum, if a forecasted test year is used, there should be adequate detail to review and verify the accuracy of the Company's forecasted cost of service.

The Company's proposed use of an attrition year forecast does not produce a reasonable forecast, and fails to measure a known and verifiable projected cost of service. Therefore, I believe the most appropriate method of estimating a revenue deficiency in this case is based on the Company's actual cost of service methodology reflecting its June 30, 2013 normalized cost of service. With my recommended return on equity, again, the Company's revenue deficiency would be approximately $4.3 million based on a normalized June 2013 test year.

Q. DO YOU HAVE SPECIFIC CONCERNS ABOUT THE COMPANY'S USE OF AN ATTRITION METHODOLOGY FOR SETTING RATES IN THIS PROCEEDING?

A. Yes. The Company's attrition methodology is being used to set a revenue requirement that will support a significant increase in capital spending through a 2015 forecasted test year. Company witness Andrews' 2015 attrition year cost of service is approximately the same as the revenue requirement produced from her Pro Forma adjusted 2015 test year. This Pro Forma test year reflects significant increases in capital spending beyond 2013 compared to the Company's actual capital expenditures before 2013. The need for a substantial increase in annual capital expenditures has not been justified by the Company. Indeed, the Company's plan to install new information technology equipment, and accelerate its pipe replacement program should continue, but Avista has not proven that it should be increased as significantly as Avista proposes. Moderating the projected capital spend program will mitigate the rate increase estimated for 2015.

If the Company believes it necessary to accelerate its capital program, then it should provide a clear justification for the need to significantly accelerate its capital spending, and identify and justify the increased cost of service to accomplish its budgeted capital program. Also, the Company should demonstrate that it has the personnel and contract resources to maintain an elevated level of capital spending, while accomplishing the significant increased capital program while maintaining high quality and reliable service. I believe this justification is missing from the Company's current filing.

The second concern I have with the Company's attrition year program, is it would put rates into effect in late 2014, that would reflect a capital investment at

approximately June 30, 2015. As such, customers would be paying higher rates before the capital investment is actually placed in service. This causes customers for a time to pay higher rates for plant that is not yet used and useful in providing service.

To the extent the Company can justify significantly increasing its capital program, then it is free to file for more frequent rate changes if it believes it can justify increased rates to support an increased level of capital investments. Placing more weight on actual data, that can be verified and confirmed as in-service and providing service, better ensures that rates customers pay are just and reasonable.

Q. PLEASE DESCRIBE YOUR ADJUSTMENTS TO THE COMPANY'S ATTRITION YEAR 2015 COST OF SERVICE METHODOLOGY, IF THE COMMISSION FINDS THIS IS AN APPROPRIATE METHOD FOR SETTING THE GAS REVENUE DEFICIENCY.

A. While I do not support the use of an attrition methodology for setting rates, if one is used I propose certain adjustments to Avista's study.

I propose reducing the claimed 2015 test year revenue deficiency from $13.5 million as requested by Avista, down to a revenue deficiency of $7.9 million. The specific adjustments I propose to Avista's natural gas attrition study include the following:

1. I reflected my overall rate of return as described in my other response testimony in this proceeding, Exhibit No. ___(MPG-1CT).
2. I take issue with Avista's claimed inflation rate for operating expenses.
3. I take issue with the Company's escalation rate for depreciation expense.
4. I take issue with the Company's escalation rate for net plant after deferred federal income tax ("DFIT").

Each of these adjustments impacts the claimed revenue deficiency and produces a reasonable projection of growth to rate base, revenues and expenses that

reflect sound management, aggressive cost control, and reflect many of the changes that have taken place at Avista since its last rate proceeding.

Q. HOW DID AVISTA DEVELOP ITS PROPOSED REVENUE REQUIREMENT IN THIS CASE BASED ON A GAS ATTRITION REVENUE REQUIREMENT STUDY?

A. Avista witness Elizabeth M. Andrews sponsored this study in her direct testimony (Exh. No. ____(EMA-1T), and the details of the gas attrition study was presented on her Exh. No. ____(EMA-3).

As shown on her Exh. No. ___(EMA-3), Ms. Andrews makes normalizing adjustments to the gas utility's June 2013 actual data, to create a normalized "escalation base" at June 2013. She then develops the following escalation factors: General Business Revenues, Total Transportation Revenues, Other Revenues, Operating Expenses, Depreciation and Amortization Expenses, Taxes, and Net Plant after Deferred Income Tax ("NP-DIT").

Based on this study, she estimates a revenue deficiency using her attrition study would increase from $6.59 million (based on unadjusted June 2013 actual data) to $13.5 million (based on an attrition adjusted cost of service for a 2015 calendar test year).

Q. DO YOU BELIEVE THAT MS. ANDREWS' PROJECTED REVENUE DEFICIENCY BASED ON HER ATTRITION METHODOLOGY IS REASONABLE?

A. No. I believe Ms. Andrews' claimed revenue deficiency for gas operations of $13.5 million for calendar year 2015 is significantly overstated. Reasonable and accurate adjustments to her attrition study, would support a revenue deficiency of $7.98 million.

Q. PLEASE DESCRIBE THE ADJUSTMENTS YOU PROPOSE TO MS. ANDREWS' GAS ATTRITION REVENUE REQUIREMENT STUDY.

A. I propose the following adjustments:

1. Ms. Andrews' proposed escalator for operating expenses is overstated. The operating expense escalator should reflect material efforts to manage costs, and minimize Avista's projected cost of service.
2. Ms. Andrews' developed escalators for net plant in-service after DIT and depreciation expense are mathematically flawed, and overstate reasonable escalation of Avista's net capital growth to its Washington retail rate base.

Q. PLEASE EXPLAIN WHY YOU BELIEVE MS. ANDREWS' ESCALATOR FOR OPERATING EXPENSES IS UNREASONABLE.

A. Ms. Andrews develops an operating expense escalator of 4.0% per year. She bases this largely on historical actual changes in operating expenses, but then proposes modest reductions to reflect some efficiencies going forward.

Q. DO YOU BELIEVE THAT MS. ANDREWS' OPERATING EXPENSE ESCALATOR IS REASONABLE?

A. No. Significant changes are occurring at Avista Resources, all of which should help Avista moderate its operating expense escalation, or to spread its operating expenses over a larger customer base.

Specifically, Avista is implementing a new software program which should help improve efficiency in responding to customer calls, and billing and customer collection data. Second, Avista has a significant capital improvement program replacing older pipe with new modern piping material. This will have the effect of reducing the maintenance activity on its distribution system as it modernizes its distribution system. Further, Avista Corporation has acquired another utility. In July

2014, Avista acquired Alaska Energy and Resources, a regulated utility that operates in Alaska. Acquiring this utility should allow Avista to spread operating expenses (e.g., executive, legal, accounting, regulatory staff, etc.) over a larger utility customer base. This should help to lower the allocated Washington jurisdictional cost of certain operating expenses and mitigate related expense escalation. All of this should help Avista moderate its escalation and increases to operating expenses.

Q. WHAT OPERATING EXPENSE ESCALATOR DO YOU PROPOSE BE USED IN THIS CASE?

A. Based on all the cost reduction activities outlined above, I believe a reasonable escalator for Avista's operating expense should be set conservatively equal to the rate of expected inflation through 2015. The proposed inflation factor I recommend is a GDP deflator. This deflator is the most appropriate basis to use for estimating non-personal inflation items out over time. As shown in Table 1 below, the inflator projected by the consensus *Blue Chip Financial Forecasts* is 1.9% from the current quarter, on average, out through the end of 2015.

TABLE 1

Blue Chip Financial Forecasts

	2013			
Description	**3Q**	**4Q**	**2014[1]**	**2015[2]**
GDP Deflator	2.0%	1.6%	1.9%	2.0%
Composite GDP Deflator	1.9%			

Source and Notes: *Blue Chip Financial Forecasts*, July 1, 2014, at 2.

[1]Range 1Q/2Q Actual 1.3%/2.0%, 3Q/4Q Projected 1.9%.

[2]Projected 1Q/2Q/3Q/4Q 2.0%/1.9%/2.0%/2.1%, respectively.

Q. DO YOU PROPOSE TO USE THE COMPOSITE GDP DEFLATOR FOR OVERHEAD EXPENSES?

A. No. Avista witness Elizabeth Andrews projects that Avista's pension and OPEB expenses will decline from the 2013 period. (Exhibit No. ___(EMA-1T) and Karen Feltes' Exhibit No. ___(KSF-1T). This decrease will be significant, and should eliminate the need for an escalation for Avista's Administrative and General operating expense. Therefore, for operating expenses related to Administrative and General, I propose a 0% operating expense escalator.

Q. PLEASE EXPLAIN WHY YOU BELIEVE MS. ANDREWS' DEVELOPMENT OF AN ESCALATOR FOR HER PLANT IN-SERVICE AND DEPRECIATION EXPENSE IS MATHEMATICALLY IN ERROR.

A. Ms. Andrews developed an escalation factor based on actual realized inflation over the period 2007-2012. This is mathematically an erroneous method of developing an expected escalator of plant in-service. It is incorrect for the following reasons:

1. Avista is planning relatively high level but flat annual contributions to plant in-service. [1/]
2. The growth in net plant in-service should reflect the expected annual increase in gross plant, offset by increases in accumulated depreciation and accumulated DFIT. This produces a method of estimating an escalator based on the current level of embedded plant. In contrast, Ms. Andrews estimates the percentage change to embedded plant based on historical percentage change. This distorts the expected escalator for net plant going forward because it ignores growth in embedded plant and declines to growth as embedded plant increases.

[1/] See Avista response to ICNU DR 3.6C.

Q. CAN YOU OFFER AN EXAMPLE TO ILLUSTRATE THIS MATHEMATICAL RELATIONSHIP?

A. Yes. A simple illustration will help explain how Ms. Andrews is overstating an escalator of plant in-service, and net plant. As shown on Exhibit ___(MPG-26), an example is provided. In this example, I am assuming a utility with current gross plant, or $1,000, and net plant of $700. This utility is spending $125 on capital improvements which escalates by inflation of 3%/year over the forecast period. The annual depreciation expense is approximately 3% of gross plant, or $30.00 in year 1.

As shown in Exhibit No. ____(MPG-26), the annual escalation rates of gross plant, net plant and depreciation expense decrease each year even though the dollar amount of capital additions increases in each year. The reason the escalation rate is decreasing is because of the embedded plant (or denominator in the escalation rate equation) increases from year to year as capital additions are recorded as embedded plant.

Therefore, a company that has a large sustained capital program will have significant dollar capital additions to its plant accounts each year over a forecast period, but the escalation rate or growth to plant account will decline over time as its embedded plant increases each year. This happens simply because of the mathematical relationship when the denominator in the equation (capital additions) is divided by an increased denominator embedded debt.

As shown in the exhibit, Ms. Andrews' proposed method to develop an escalator based on the five-year average escalation rates produced and overstated an escalation rate for future escalation of plant additions.

This is illustrated in my hypothetical example shown on my Exhibit No. ____(MPG-26). There, the most recent growth in plant additions for gross plant and net plant DFIT are 7.2% and 6.1%, respectively. However, the five-year averages of the growth rates for these same plant accounts are 8.3% and 7.6%, respectively. Hence, using a five-year compound average escalator as Ms. Andrews proposes overstates a reasonable escalation rate based on historical plant addition amounts. Therefore, her attrition study overstates reasonable escalation rates to these components.

Q. PLEASE EXPLAIN HOW YOU PROPOSE TO DEVELOP AN ESCALATOR FOR PLANT IN-SERVICE AND DEPRECIATION EXPENSE BASED ON AVISTA'S PROPOSED TRENDING ANALYSIS.

A. Rather than use historical data to develop historical escalation rates, I propose to instead use historical data to estimate the average annual amount of additions to gross plant in-service, and net plant in-service in "dollar" amounts. This reflects sustained capital additions to plant accounts and can be used to estimate a growth rate in plant accounts, Avista's gross plant, net plant, and net plant after DFIT from the 2013 escalation balance.

This revised methodology still is based on Avista's actual historical data used by Ms. Andrews. As shown on my Exhibit No. ___(MPG-27), I show that actual annual contributions to plant in-service have averaged approximately $20 million over the five-year period 2008-2012, which represents an approximate 5.5% escalator to the June 30, 2013 gross plant escalation base.

Doing the same for net plant, and net plant after DFIT, shows an annual increase of net plant after DFIT of $9.96 million per year, or a 5.1% escalation from the June 30, 2013 base.

Q. BASED ON YOUR ANALYSIS, WHAT GROWTH RATE DO YOU RECOMMEND FOR GROSS PLANT IN-SERVICE, AND NET PLANT AFTER DFIT?

A. Based on annual contributions to gross plant and net plant consistent with the historical trend, I recommend an escalator from the 2013 escalated plant balance of 5.5% for gross plant, and 5.1% for net plant after DFIT.

Further, I recommend an escalator for depreciation expense equal to my estimated escalator for gross plant. The Company's depreciation expense should increase with additions to gross plant. Therefore, this gross plant escalator is far more reasonable than the escalator proposed by Ms. Andrews.

Q. HOW DID MS. ANDREWS DEVELOP A DEPRECIATION EXPENSE ESCALATOR?

A. She developed a depreciation expense escalator based on her review of depreciation expense trending methodology shown on her Exhibit No. ___(EMA-3), page 9. As shown on that exhibit, she has a historical adjusted trend of depreciation and amortization expense of 7.6%. This escalator of depreciation and amortization expense is simply inflated and should be rejected.

Q. ARE THERE SPECIFIC REASONS WHY YOU BELIEVE MS. ANDREWS' DEPRECIATION AND AMORTIZATION EXPENSE ESCALATOR OF 7.6% IS INFLATED?

A. Yes. It is inflated for several reasons including the following:

1. It significantly exceeds the trending and planned level of plant additions to gross plant. Depreciation expense is based on depreciation rates applied to the Company's gross plant. As such, increases in depreciation expense should be directly tied to changes in gross plant.

2. Ms. Andrews' methodology reflects a historical trend of depreciation expense over the period 2007-2012. That period reflects both changes in gross plant, and changes in depreciation rates. Avista witness Dave B. DeFelice at page 5 of his testimony states that the Washington Commission in Order No. 09 dated December 26, 2012 approved new depreciation rates for Avista. Ms. Andrews' depreciation expense escalation rate reflects both changes to plant accounts and changes to depreciation rates. The escalator attributed to changes in depreciation rates is not an annual recurring factor, and therefore, overstates a reasonable estimate of forward-looking changes to depreciation expense.

For these reasons, I believe Ms. Andrews' estimated depreciation expense escalator is flawed and overstates reasonable estimates of forward-looking depreciation expense for Avista Gas.

Q. IF YOUR PROPOSED ADJUSTMENTS ARE MADE TO THE AMOUNT OF MARGIN REVENUE AT JUNE 2013, AND MODIFIED OPERATING EXPENSE, PLANT IN-SERVICE, AND DEPRECIATION EXPENSE ARE ADOPTED, HOW WOULD AVISTA'S ESTIMATED REVENUE REQUIREMENT DEFICIENCY CHANGE?

A. I made the three adjustments I described above to Ms. Andrews' attrition adjustment for gas operations. Again, the adjustments include the following:

1. I reflect my proposed overall rate of return.
2. I decreased the operating expense annual escalator to 1.9% from Ms. Andrews' proposed 4.0%.
3. I included an annual escalation factor for gross plant of 5.5%, rather than Ms. Andrews' estimated 6.06%.
4. I increased net plant by 5.1%, rather than Ms. Andrews' net plant increase of 6.06%.

All of these factors reflect annual contributions to gross plant, accumulated depreciation, DFIT, and finally, net plant after DFIT. Further, I developed the escalation factor based on annual contributions to these amounts and as a proportion to year-end plant 2012 balance.

Q. WHAT IS THE REVENUE REQUIREMENT DEFICIENCY ESTIMATED FROM YOUR GAS ATTRITION STUDY WITH YOUR PROPOSED ADJUSTMENTS?

A. As shown on my Exhibit No. ____(MPG-25), I estimate Avista's gas revenue requirement deficiency of $7.98 million based on my revised gas attrition revenue requirement study.

Q. HAVE YOU PERFORMED A CROSS-CHECK ON THE RESULTS OF YOUR GAS ATTRITION COST OF SERVICE STUDY?

A. Yes. Similar to Ms. Andrews at page 29, I compared my attrition rate base to the Company's budgeted rate base during 2015. The Company's pro forma or budgeted rate base was included in the Direct Testimony of Avista witness Dave B. DeFelice (Exhibit No. ___(DBD-1T). Mr. DeFelice goes through the Company's planned capital improvements for gas operations, and projects the average year 2015 net plant less DFIT for Avista gas operations. There, based on the Company's pro forma adjustments to a June 30, 2013 end-of-period plant basis, he estimates net plant less DFIT of $232.7 million. Significantly, Ms. Andrews' attrition adjusted rate base of $232.3 million is nearly the same as Mr. DeFelice's rate base.[2/] Also, significantly, Ms. Andrews acknowledged that the pro forma adjustment is simply used as a cross-check on the attrition methodology.

[2/] Exh. No.___(EMA-3) at 5.

The Company is not proposing to use a pro forma methodology to establish its 2015 cost of service. Rather, she simply used the pro forma projections as a reasonableness check on the Company's attrition methodology.

My attrition net plant less DFIT is $228.1 million. This is approximately 2% lower than that estimated by Mr. DeFelice of $232.7 million. I believe this successfully complies with a reasonable cross-check of my attrition projection. The Company's pro forma adjustment is based on its budgeted amounts. Actual budgeted amounts can vary based on contingency included in projected future capital expenditure amounts, and the timing of when projected actual capital expenditures will be made is also uncertain. As such, to the extent my attrition is reasonable, and my estimates are comparable to a pro forma check, I believe my attrition study produces reasonable results that should be used to set rates.

Q. DOES THIS CONCLUDE YOUR RESPONSE TESTIMONY?

A. Yes, it does.