BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC V. AVISTA

DOCKETS UE-120436 *et. al.,*

DIRECT TESTIMONY OF JAMES R. DITTMER (JRD-10T)

ON BEHALF OF

PUBLIC COUNSEL (PC),

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES (ICNU)

AND

NORTHWEST INDUSTRIAL GAS USERS (NWIGU)

REGARDING ATTRITION ISSUES

SEPTEMBER 19, 2012

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I. INTRODUCTION AND SUMMARY

Q: Please state your name and address.

A: My name is James R. Dittmer. My business address is Post Office Box 481934, Kansas City, Missouri 64148.

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

A: I am a Senior Regulatory Consultant with the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate work. The firm's engagements include review of utility rate applications on behalf of various federal, state and municipal governmental agencies as well as industrial groups. In addition to utility intervention work, the firm has been engaged to perform special studies for use in utility contract negotiations.

Q: On whose behalf are you testifying?

A: Utilitech, Inc., has been retained by the Public Counsel Section of the Office of the Attorney General of the State of Washington (Public Counsel), the Industrial Customers of Northwest Utilities (ICNU) and the Northwest Industrial Gas Users (NWIGU) to review and respond to Avista Corporation's ("Avista" or the "Company") proposed attrition adjustment–which purportedly justifies approximately one-half of Avista's Washington electric jurisdictional revenue requirement increase and approximately one-third of Avista's Washington gas jurisdictional revenue requirement increase. Thus, this testimony addressing Avista's proposed attrition adjustments, and responses thereto, is being jointly sponsored by Public Counsel, ICNU and NWIGU.

Additionally, I have been separately retained by the Public Counsel to more broadly review other potential issue areas that are significant in terms of the revenue requirement impact to Washington retail ratepayers and/or of particular concern to the Public Counsel. Thus, I am filing additional testimony in this docket addressing adjustments and issues *other than attrition* that is being sponsored exclusively on behalf of the Public Counsel and is separately identified as Exhibit No. JRD-1T. Within this testimony, I specifically recommend modifications to certain adjustments originally proposed by Avista that pertain to Public Counsel, ICNU and NWIGU's position on attrition. Those modifications to Company-proposed adjustments have been incorporated within summary revenue requirement exhibits that support my Public Counsel testimony identified as Exhibit No. JRD-1T. Within this testimony I delineate where adjustments discussed in this testimony have been reflected in exhibits and schedules that support Exhibit No. JRD-1T.

Q: Please state your educational background.

A: I graduated from the University of Missouri-- Columbia, with a Bachelor of Science Degree in Business Administration, with an Accounting Major, in 1975. I hold a Certified Public Accountant Certificate in the State of Missouri. I am a member of the American Institute of Certified Public Accountants.

Q: Please summarize your professional experience.

A: My professional experience is summarized in Exhibit No. JRD-11.

Q: Have you previously filed testimony before the Washington Utilities and Transportation Commission?

A: Yes. I have filed testimony with the Washington Utilities and Transportation Commission ("UTC" or "Commission") on several occasions over approximately the past 25 years.

Q: What is the purpose of your testimony?

A: I am responding to Avista's request for recognition of a very significant attrition adjustment for its Washington retail electric and gas operations. My testimony opposes Avista's specific requests for attrition adjustments on the basis that they are unwarranted. However, I propose alternatives to improve the timeliness of Avista's recovery of its costs being incurred to provide utility service in Washington.

II. SUMMARY OF TESTIMONY

Q: Please summarize your major findings and recommendations regarding attrition.

A: First, I find that most of the conditions prevalent in the early 1980s when this Commission authorized some utility rates to be based, in part, on an attrition allowance or attrition adjustment, are not present today. As I elaborate upon in greater detail in ensuing testimony, the primary conditions that appear to have driven the UTC's decisions to authorize attrition adjustments at that time, exceedingly high inflation, exceedingly high borrowing costs, and grave concerns about financial integrity, are not only absent, but are in fact diametrically opposite today. Accordingly, I am recommending that the Company's proposed attrition adjustment for its electric and gas operations be rejected.

Given Avista's recent history of, and ongoing projection for, fairly robust additions to Plant in Service, I do believe that this Commission's long-standing

approach to developing rate base by employing an average-of-the-monthly-averages historic rate base is causing Avista to experience some regulatory lag in the recovery of return and depreciation on new plant additions. Accordingly, while I am recommending rejection of the Company's proposed attrition adjustments, I am also recommending that rates in this proceeding be established by employment of a *year-end* rate base valuation - which brings the *cost measurement period* closer to the *rate effective period.*

In addition, I believe regulatory lag in the recovery of return and depreciation could be further addressed through consideration of updating for additional months' growth in actual post-test year Plant in Service net of offsets for growth in the Accumulated Depreciation Reserve and Accumulated Deferred Income Tax balances that could still be verified, at least to some degree, by the UTC Staff and intervenors, during the discovery and audit phase of base rate dockets such as this. If such post-test year *actual* growth in rate base is to be undertaken, it should be accompanied by at least partially offsetting adjustments to recognize annualized growth in revenues associated with customers taking service at the same point in time when the measurement of major rate base components is being cut off, as well as any other annual operating savings that might be facilitated by the plant added beyond the end of the historic test period.

I have not undertaken such a post-test year "update" for growth in rate base in this docket. This is primarily because updating major rate base values for data in 2012 that was available at the time that this testimony and exhibits were prepared did not appear to cause a meaningful change to the revenue requirement that is generated

by considering an end-of-2011 rate base valuation. More specifically, the Net Plant in Service values reported for Avista's Washington jurisdictional electric and gas operations in most-recently-received Results of Operation reports are not materially different than the rate base values calculated at the end of the 2011 historic test year. That stated, I do believe that updating the major, or the most significant, cost of service components for post-test year changes that can still be verified during the discovery and audit phase of a base rate proceeding will adequately address the Company's claim of regulatory lag. I believe the update of rate base, along with attendant offsets, is a much preferred approach to addressing regulatory lag than employment of an attrition adjustment such as that being proposed by Avista in this proceeding. Such an update would provide a better balance between shareholders and ratepayers in addressing regulatory lag, while eliminating potential biases, judgment calls and uncertainty--for both shareholders and ratepayers—that will result if the Company's attrition adjustments are adopted in this and future base rate proceedings.

III. HISTORY AND PRECEDENT

A. History Of Attrition Adjustments In Washington.

Q: What is an "attrition adjustment" or "attrition allowance" as those terms are generally used in utility rate setting proceedings such as this?

A: From the perspective of my personal professional experience, attrition adjustments or attrition allowances are rarely used mechanisms wherein the regulator permits revenues, investment (i.e., rate base) and expenses incurred and recorded in an historic test period to be escalated in some fashion in an attempt to estimate changes anticipated to be experienced through the rate effective period. I have not researched

how many, and in what ways, attrition adjustments may have been adopted by all state utility regulatory commissions over the years. However, besides Washington, I have only worked in one other jurisdiction (Florida) where I was aware that attrition adjustments were being, or had previously been, adopted.

Q: Were Avista's attrition adjustments developed so as to capture the escalation or expected changes in revenues, investment, and expenses estimated to occur between the 2011 historic test period and the first rate effective period?

A: I explain the Company's approach in greater detail in an ensuing section of testimony, but basically, for electric operations, the Company calculated average historic escalation rates for investment and expense components that it then applied to adjusted or "normalized" 2011 results of operations to project out expected values for 2013 – or the first full calendar year in which new rates would be in effect. For gas operations the Company simply reflected budgeted net changes in Plant in Service, Accumulated Depreciation and Accumulated Deferred Income Taxes expected to occur between the 2011 historic test period and 2013.

Q: Has this Commission previously granted an attrition adjustment similar to what Avista is proposing in this docket?

A: As Dr. Lowry's direct testimony briefly addresses, there was a period of time in the early 1980s when Avista rates were established in part with inclusion of attrition adjustments that appear to have similarities to what Avista is proposing in the instant case. Dr. Lowry's testimony focuses on a period when attrition adjustments were approved, but does not comprehensively address UTC treatment of this issue or address attrition requests before or after the early 1980s. Further, his testimony does

not address some of the specific conditions and criteria considered by the UTC when adopting or rejecting proposed attrition adjustments.

Q: Have you reviewed UTC orders *other than those addressed in Dr. Lowry's testimony* wherein the issues of attrition allowances or attrition adjustments were addressed?

A: Yes. I have reviewed a number of UTC orders addressing proposals for attrition adjustments beyond those summarized by Dr. Lowry.

Q: Did Washington utilities request attrition adjustments prior to the early 1980s?

A: I am aware of at least a few situations where utility companies requested use of forecasted test years and other approaches that differed from strict adherence to historic test years employing average-of-monthly-average rate base valuation that were being sought in light of claimed earnings erosions. To my knowledge, the UTC did not accept an attrition adjustment similar to that being requested by Avista in this docket until 1981.

Q: What is the first order that you are aware of wherein the UTC *allowed* an attrition adjustment?

A: It appears that the first time the UTC allowed an attrition adjustment was in a 1981 general rate case filed by Washington Water Power Company (WWP), Avista's predecessor.[1] Upon the recommendations of its Staff, the UTC authorized an attrition adjustment to reflect rate year predicted revenues, expense and rate base levels.

[1] *Washington Utilities & Transportation Commission v. The Washington Water Power Co.*, Cause Nos. U-81-16, Second Supplemental Order (November 25, 1981), 1981 Wash. UTC Lexis 3.

Q: In the 1981 WWP rate order, did the Commission describe events, conditions and evidence considered and relied upon when authorizing its first-ever attrition adjustment?

A:. Yes. When discussing its decision regarding attrition, the UTC cited evidence in support of the adjustment that was said to be "vastly different" from that it had previously considered. Specifically, the 1981 rate order noted:

- WWP had an extensive construction program planned through 1985 to which it was committed.
- Such extensive construction program was creating an "imbalance" in its ability to raise construction funds from internal sources which was, in turn, limiting WWP's ability to preserve financial indices necessary to maintain the Company's financial integrity.
- That to *not* allow an attrition adjustment would jeopardize the Company's financial integrity and adversely affect its ability to render required service to its customers at reasonable rates.[2]

In summary, the UTC was specifically concerned about WWP's financial integrity and ability to raise capital at reasonable rates when it broke from its prior precedent, which consisted of routinely limiting utility rate development to use of historic test years with traditional restating and proforma adjustments. It is also noteworthy that when adopting its first-ever attrition adjustment, this Commission emphasized attrition adjustments for WWP or any other utility under its jurisdiction would be evaluated on a case-by-case basis.

[2] *Id.,* 1981 Wash. UTC Lexis 3, 41-42.

Q: Did this Commission consider events, conditions and evidence on a case-by-case basis following the issuance of its order in Docket Nos. U-81-15 and U-81-16?

A:. Yes. For example, in a Puget Sound Energy (PSE) rate order issued three months later, this Commission rejected a Staff and Company proposal for a general attrition adjustment[3]. In the attrition adjustment proposed for PSE revenues, expense and rate base were trended from historic test year levels to rate year levels utilizing an approach that appeared to have been similar to that employed when developing the attrition adjustments allowed in the WWP cases discussed above. Interestingly however, in the PSE order the Commission did adopt a "financial attrition" adjustment that was designed to capture the impact of increasing debt costs expected to be experienced during the rate effective period. In other words, with its "financial attrition" adjustment, the Commission accepted a higher weighted cost of debt than the "embedded cost of debt" existing at test year end which anticipated issuance of new higher-cost debt for refinancing maturing debt securities, as well as simply financing new construction that was expected to occur during the rate effective period.[4]

Like the other attrition adjustments allowed during this period, this "financial attrition" adjustment was authorized in an interest rate environment that is diametrically opposite of what is occurring today. Specifically, *in the early 1980s long term interest rates were at all time highs* such that incremental financings to pay off maturing debt securities or simply fund new construction were routinely

[3] *Washington Utilities & Transportation Commission v. Puget Sound Power & Light Co.,* Cause No. U-81-41, Second Supplemental Order, 45 P.U.R. 4th 605, 622 (March 12, 1982).
[4] *Id.,* 45 P.U.R. 4th at 614.

significantly above the utilities' then-existing "embedded cost of debt" which reflected the average cost of securities issued in prior periods when interest rates had been significantly lower. With *today's modern-day historic low long term debt interest rates*, new financings have interest rates that are routinely and often times significantly *lower* than the utility's average embedded cost of debt calculated just prior to considering such new financings.

In rejecting Staff's proposed attrition adjustment in the PSE docket, the UTC made the following observations and conclusions:

- [N]ear-term future inflation levels may not be accurately predicted by recent term past inflationary levels and the attrition estimates of the witnesses may be significantly higher than the actual levels to be experienced.
- [T]estimony by….the public gives us substantial reason to believe that serious efforts at improving efficiencies and at achieving economies in day-to-day operations would produce substantial results for the respondent.
- [W]e do believe that an attrition adjustment would tend to dampen management incentive to achieve efficiencies in staff and in use of other resources.
- Under the circumstances of this case, we believe that it is proper to deny the requested attrition adjustments in light of recent positive company performance, recent trends toward the abatement of inflation, and the effect of

such an adjustment to reduce substantially management incentive to achieve efficiencies in operation.[5]

Following rejection of the Staff attrition proposal in PSE Cause No. U-81-41, through approximately the end of 1986, the UTC accepted attrition adjustments for major energy utilities on six occasions while rejecting one attrition request. Notably, one attrition adjustment resulted in a *significant downward adjustment* to the revenue requirement that had been calculated utilizing traditional adjustments to an historic test year cost of service.[6]

Q: Notwithstanding Commission approval of attrition adjustments during the 1980s, was there nonetheless disagreement among the parties regarding the proper *development* of attrition adjustments?

A: Yes. The orders from the early-to-mid 1980s era addressing proposed attrition adjustments indicate that a number of key issues were in dispute, including: the methodology of the adjustment, the historical period to be considered in the development of growth or escalation factors to be applied to restated historic test year operations, and the injection of budgeted rather than trend-forecasted data.

Q: When addressing the attrition issue, has the UTC set forth specific criteria for adoption or rejection of attrition adjustment proposals?

A: The Commission has not set out a specific "test" or formula in the orders which I reviewed. However, frequent references were made to the following conditions

[5] *Id.,* 45 P.U.R. 4th at 642.
[6] In Docket No. U-85-53 an $11.4 million downward attrition adjustment to the revenue deficiency that had been calculated utilizing a traditional adjusted test year approach was ordered for Puget Sound Energy. *Washington Utilities & Transportation Commission v. Puget Sound Power & Light Co.,* Cause No. 85-53, Second Supplemental Order, 74 P.U.R. 4th 536, 579-581 (May 16, 1986).

existing when attrition adjustments were accepted (or noted to be absent when attrition adjustments were rejected):

- High inflation
- High financing costs or interest rates– relative to embedded costs existing on the various companies' balance sheets at the time
- Large construction programs
- Vastly different rates of change in revenues, expenses and rate base
- Deteriorating financial integrity – jeopardizing credit ratings and ability to economically finance needed construction

The last attrition adjustment that I am aware of that the UTC approved was in a 1986 Pacific Power and Light general rate case order.[7] Subsequent to that docket, the next time a Washington utility sought an attrition adjustment was in the Washington Natural Gas 1992 general rate case. The UTC rejected WNG's attrition request, stating:

> The Commission concludes that no attrition adjustment should be granted in this case. An adjustment for attrition is an extraordinary measure, not generally included in general rate relief. A request for attrition should be based on extraordinary circumstances, not shown by the company to be present in this case.[8]

Subsequent to the Washington Natural Gas case just cited, I am not aware of any utility requesting an attrition adjustment until this docket.

[7] *Washington Utilities & Transportation Commission v. Pacific Power & Light Co.,* Cause No. U-86-02, Second Supplemental Order, 1986 Wash. UTC Lexis 7, 47-50.
[8] *Washington Utilities & Transportation Commission v. Washington Natural Gas,* Docket No. UG-920840, Fourth Supplemental Order, 1993 WL500058, at 20. (September 27, 1983).

B. Comparison Of Current Conditions Relative To The Early 1980s.

Q: Do the conditions cited by the Commission when allowing attrition adjustments in the early 1980s exist today for Avista?

A: No. At least three key conditions are noticeably absent: high inflation, high interest rates, and concerns about financial soundness. I have not researched or attempted to quantitatively compare Avista's construction program today relative to what it was experiencing in the early 1980s. I also have not researched and attempted to quantitatively compare "changes in revenues, expenses and rate base" occurring within the last few years relative to what Avista was experiencing in the early 1980s. Indeed, it would entail a very challenging research effort just to accumulate such dated information on a Washington jurisdictional basis.

Q: How does today's inflation compare to the period leading up to, and existing when Washington utilities were granted attrition allowances?

A: As anyone over the age of 50 will remember from experience--as opposed to reading within text books--today's inflation environment is extremely tame relative to that experienced in the period leading up to and existing when attrition adjustments were granted by this Commission. On Table 1 below I show inflation as measured by two broad indicators--namely, the Consumer Price Index and the Gross Domestic Product Implicit Price Deflator[9]--from the mid-1970s through the mid-1980s, as well as for the most recent five-year period available.

[9] The GDP Implicit Price Deflator is commonly thought to be the broadest measure of inflation in an economy as it captures the changes in price levels for the output of all goods and service produced within an economy even as the bundle of goods and services produced changes over time.

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Table 1
Comparison of Inflation Rates
Years Leading Up To and Including the Period When
the UTC Authorized Attrition Adjustments *Versus*
The Most Recent Five Years[10]

Period – Years	Consumer Price Index	GDP Implicit Price Deflator
Period Leading Up to/Existing When Attrition Adjustments Were Granted by the UTC		
1976	5.8	5.42
1977	6.5	6.68
1978	7.6	7.27
1979	11.3	8.70
1980	13.5	9.73
1981	10.3	8.26
1982	6.2	5.17
1983	3.2	3.34
1984	4.3	3.62
1985	3.6	2.77
Last Five Calendar Years		
2007	2.8	2.66
2008	3.8	2.19
2009	-0.4	0.59
2010	1.6	1.55
2011	3.2	2.18

2

3 It is easily gleaned from Table 1 that during the period leading up to the time
4 that the UTC began authorizing attrition adjustments, inflation rates were
5 dramatically higher than those experienced during the most recent five years shown.

[10] Source documents are provided in my workpapers.

Following the period of relatively low inflation occurring in the mid-1980s (i.e., 1983 – 1985) the UTC ceased granting attrition adjustments. Inflation in the most recent years ending in 2011 is *even lower* than that experienced during the mid-1980s.

Q: How does today's interest rate environment compare to that experienced just prior to, and during, the period when the UTC authorized attrition allowances for energy utilities?

A: Interest rates were at modern-day highs during the period 1979 through 1985. The interest rates being experienced today are at modern-day lows. Such conclusions are easily observed by viewing the interest rate yield on 30-year US Treasury Securities

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shown on Table 2 below.

Table 2

Comparison of Long Term Interest Rates Years Leading Up To and During the Period When the UTC Authorized Attrition Adjustments *Versus* The Most Recent Five Years[11]

Period - Years	30 Year US Treasury Interest Rates
Period Leading Up To/Existing When Attrition Adjustments Were Granted	
1977	7.75
1978	8.49
1979	9.28
1980	11.27
1981	13.45
1982	12.76
1983	11.18
1984	12.41
1985	10.79
Last Five Years	
2007	4.84
2008	4.28
2009	4.08
2010	4.25
2011	3.91

From the mid-1970s through the mid-1980s, generally speaking, incremental financings for new construction that could not be supported from funds generated internally would have been at rates higher--and often times *considerably higher*--than the utilities' then-existing average embedded cost of debt. Further, even if a utility

[11] Source documents are provided in my workpapers.

was not required to go to the market to obtain *incremental* debt financings, merely *refinancing* a maturing long term debt security would result in its average embedded cost of debt rising as a low-cost maturing debt instrument was replaced with a new issuance that bore a much higher interest rate cost. Such interest rate environment is diametrically opposite of that now being experienced--with long term interest rates being at modern-day lows. The average embedded cost of debt for utilities has been consistently falling in the last five years as incremental issues and refinancing of debt securities occurs.

Q: What is the status of Avista's financial health as measured or indicated by its current credit ratings?

A: Standard and Poor's rates Avista's first mortgage bond as "A-" while Moody's assigns Avista's first mortgage bonds a rating of "A3." Avista's corporate credit rating is "BBB" as given by Standard and Poor's while Moody's rates Avista's unsecured debt as Baa2. The current Standard and Poor's first mortgage bond rating, first given for Avista in August 2011, represented a one notch upgrade from its previous rating (i.e.,BBB+), while Standard and Poor's current corporate rating, first given Avista in March 2011, also represented a one notch upgrade from its previous corporate credit rating (i.e., BBB-). The current Moody's ratings were issued in March 2011 and also represented one notch upgrades from immediately preceding ratings. Notably, all recent upgrades occurred during a period of time when Avista was *not* being granted attrition adjustments for its largest jurisdictional operating division, its Washington service territory.

Q: Do rating agencies routinely discuss their opinions regarding regulatory treatments being afforded utilities?

A: Yes. In Moody's most recently issued rating of Avista, the investor service stated, in relevant part, the following:

> **Ratings Rationale**
>
> Avista's Baa2 senior unsecured rating is principally based on the relatively supportive treatment that it receives in its three service area jurisdictions which has translated to improved credit metrics over the past five years. The ratings also consider Avista's improved liquidity profile, following the recent execution of a new $400 million, four year revolving credit facility and its heavy reliance upon low cost hydro supply resource.
>
> **Ratings Outlook**
>
> The stable outlook incorporates Moody's view that Avista will continue to receive timely and predictable cost recovery in each of its regulatory jurisdictions and that the company's credit metrics will approximate current levels, or decline modestly. It also assumes that Avista will finance an increasing capital expenditure budget with a balanced mix of debt and equity and will maintain sufficient liquidity levels throughout the construction period.[12]

The most recent guidance issued by Standard and Poor's was in January 2012. Relevant excerpts regarding Standard and Poor's opinion of current rate regulation affecting Avista include the following:

> **Rationale**
>
> The 'BBB' rating on Avista Corp., based in Spokane, Wash., reflects an excellent business risk profile and an aggressive financial risk profile under Standard & Poor's Ratings Services' corporate risk profile matrix. The business risk profile reflects our view of Avista's stable regulated electric and gas utility operations with low rates. Regulated businesses operate in the near absence of competition with regulated returns. The company's chief risks are the electric utility's exposure to replacement power costs (particularly in low-water years), which its fuel and purchased-power mechanisms in Idaho and

[12] Moody's Investors Service release, March 16, 2012. Provided in Avista Response to Public Counsel Data Request No. 128, Attachment A.

> Washington help to manage, and recovery of utility expenditures in a timely manner. The company's management of regulatory relationships in its three jurisdictions, in addition to its strategic focus on regulated utility operations, is a critical underpinning of its investment-grade credit quality.
>
> We anticipate that the company's satisfactory management of regulatory relationships will continue to support the current rating. The company has filed frequent rate cases during the past few years to lessen rate lag, which can weaken credit metrics during periods of heavy capital spending or rising operating expenses. The company's most significant regulatory exposure is in Washington, where in December 2011 a settlement was approved by the Washington Utilities and Transportation Commission (UTC) that resulted in a $20 million increase in electric revenue and a $3.8 million increase in gas revenue – a 4.6% and 2.4% increase in customer rates, respectively. The order was silent on authorized returns, which have been declining, but approved a temporary collection mechanism for expected volatility in operations and maintenance costs associated with the Coyote Springs and Colstrip plants. A year ago, the company received electricity and gas revenue increases of $34 million with an authorized return on equity of 10.2%.
>
> **Outlook**
>
> The stable outlook reflects that we anticipate the company will continue to manage regulatory risks, fund capital expenditures in a manner that does not increase leverage, preserve adequate liquidity, and maintain financial performance.[13]

In sum, Avista's credit ratings have recently been raised--during a period in which no attrition allowances have been granted. Further, the rating agencies are not expressing undue concern about regulatory lag or regulation in general. To the contrary, such agencies view Avista's current regulatory profile as "stable" and "relatively supportive."

[13] Standard & Poor's January 26, 2012, release. Provided in Avista Response to Public Counsel Data Request No. 128, Attachment A.

IV. AVISTA'S PROPOSAL

A. Summary Of Avista's Proposed Attrition Adjustment.

Q: Please state your understanding of Avista's proposed attrition adjustment for its Washington jurisdictional *electric* operations.

A: Dr. Mark Lowry has developed an attrition adjustment for Avista's Washington jurisdictional electric operations that *increases* the claimed revenue deficiency by approximately $21 million above and beyond what Avista calculates using a traditional test year approach that considers "restating" as well as "proforma" adjustments.

Dr. Lowry's attrition adjustment was developed, in part, by calculating a multi-year average of year-over-year percentage changes in Washington jurisdictional electric rate base, as calculated and presented within Commission Basis Reports prepared for, and filed with, this Commission. The multi-year annual historic average of the percentage change in Washington jurisdictional electric rate base was then applied to the 2011 "restated" average-of-monthly-averages rate base valuation that Avista had calculated in the development of its "traditional" adjusted historic test year cost of service presentation. Because Dr. Lowry was attempting to develop a projected rate base for the 2013 "rate effective" period, occurring two years beyond the 2011 "restated" historic test year rate base valuation time frame, the multi-year annual historic average was compounded over two years to derive Dr. Lowry's proposed 2013 electric operations adjusted rate base valuation.

Dr. Lowry also developed multi-year historic averages of year-over-year changes in expenses grouped into three very large categories. More specifically, Dr.

Lowry developed a multi-year historic average of operation and maintenance expense--excluding production expenses which were separately addressed in the development of Avista's proposed power supply costs. Additionally, Dr. Lowry developed a multi-year historic average of year-over-year changes in depreciation expense as well as multi-year average of year-over-year changes in Taxes Other Than Income Tax expense.

Q: How were power supply costs developed for inclusion in Avista's revenue requirement calculation?

A: As noted, Dr. Lowry's attrition study did not include power supply costs. Instead, power supply costs were developed by other Avista witnesses through a methodology that I understand has generally been adhered to in recent prior Avista base rate proceedings. Specifically, projected fuel prices and energy prices were developed by utilizing the Aurora energy model which also considered adjusted test year energy sales levels and wholesale market conditions.

Q: Please continue with your understanding of Dr. Lowry's development of an electric operations attrition adjustment.

A: Dr. Lowry also developed a multi-year historic average of year-over-year changes in miscellaneous Other Revenues that he applied (again, two years compounded) to 2011 restated historic test year Other Revenue amounts. However, for development of 2013 "rate year" revenues resulting from traditional retail energy sales, Dr. Lowry employed the Company's current revenue model--or what I understand to be the billing determinants model underlying the Company's 2013 revenue budget.

To summarize, 2011 "restated" expenses other than expense components considered in the development of Avista's power supply cost adjustment, 2011 "restated" Other Revenues, as well as 2011 "restated" average-of-monthly-averages rate base were all escalated by considering multi-year historic average percentage changes in year-over-year levels calculated from Washington jurisdictional Commission Basis Reports. Power supply costs were developed in the manner traditionally used in recent Avista base rate filings vis-à-vis employment of the Aurora model. Retail energy sales revenues were developed by considering billing determinants derived from the Company's 2013 revenue model. The revenue requirement that Avista calculated utilizing a traditionally-developed 2011 historic test year cost of service that considered "restated" and "proformed" operating results was then subtracted from the revenue requirement derived by considering the attrition calculations described above to arrive at Avista's proposed electric operations attrition adjustment of $21.5 million.

Q. Was Dr. Lowry's trend-driven calculation in conjunction with 2013 budgeted sales data the only evidence offered by Avista in support of its attrition adjustment?

A.: No. Ms. Elizabeth Andrews also sponsors four adjustments to incorporate post test-year events and conditions expected to occur through the 2013 rate year. These purportedly serve as a "cross check" to Dr. Lowry's attrition study. The four "cross check" adjustments presented by Ms. Andrews are as follows:

- The annual revenue requirement impact of year-end 2012 planned capital additions *excluding distribution plant associated with connecting new*

customers (i.e., rate base changes attributable to 2012 non-customer-growth related plant additions) as well as related 2012 estimated changes to Accumulated Depreciation and Accumulated Deferred Income Taxes for 2011-ending plant balances.[14]

- The annual revenue *requirement impact of 2013 planned capital additions excluding distribution plant associated with connecting new customers* (i.e., rate base changes attributable to 2013 non-customer-growth related plant additions) as well as related estimated changes to Accumulated Depreciation and Accumulated Deferred Income Taxes for 2011-ending and 2012-ending plant balances. It is noted that for the 2013 Planned Capital Additions "cross check" adjustment rate base was valued using the projected average-of-monthly-average of Plant in Service, Accumulated Depreciation and Accumulated Deferred Income Tax balances – again, all components exclusive of customer-growth-related plant additions.[15]
- The annual revenue requirement impact of estimated "lost margins" calculated to be associated with energy savings attributable to the Company's DSM program.[16]

The annual revenue requirement impact of the three described "cross check" adjustments sponsored by Ms. Andrews, when added to Avista's calculated "traditional" 2011 historic adjusted test year cost of service, summed to within $100,000 of the mostly trend-driven attrition adjusted revenue requirement calculated

[14] Avista Electric Operations Proforma Adjustment 4.00.
[15] Avista Electric Operations Proforma Adjustment 4.01.
[16] Avista Electric Operations Proforma Adjustment 4.02.

by Dr. Lowry. Ms. Andrews therefore posts one additional "cross check' attrition adjustment in the amount of $100,000 to simply force the revenue requirements generated from the sum of the three other "cross check" adjustments to equal the revenue requirement amount calculated by considering Dr. Lowry's attrition adjustment. Again, according to Ms. Andrews and the Company, the three "cross check" adjustments demonstrate the reasonableness and validity of the Company's attrition adjustment sponsored by Dr. Lowry.

Q: Did Dr. Lowry perform an attrition study for Avista's Washington jurisdictional gas operations that was similar or identical to that undertaken on behalf of Avista's jurisdictional electric operations?

A: Initially neither Dr. Lowry nor the Company undertook an attrition study for Avista's Washington jurisdictional gas operations that was similar to the attrition study undertaken for Avista's Washington jurisdictional electric operations. While no similar gas operations' attrition study was initially undertaken, Avista has nonetheless proposed an "Attrition Adjusted Revenue Requirement" for its Washington jurisdictional gas operations in this docket.

Q: How then has Avista developed an "Attrition Adjusted Revenue Requirement" for its Washington gas operations in this docket without developing an attrition study?

A: Avista has proposed an "Attrition Adjusted Revenue Requirement" for its Washington gas operations by calculating two adjustments for Planned Capital Additions for 2012 and Planned Capital Additions for 2013. These are intended to be identical in concept to the two similar "cross check" adjustments that Ms. Andrews

provided for Avista's electric operations. More specifically, Ms. Andrews calculates an "Attrition Adjusted Revenue Requirement" for Avista's Washington gas operations by posting an adjustment to capture the estimated annual revenue requirement impact of 2012 planned gas operations' capital additions. This *excludes distribution plant associated with connecting new customers* (i.e., rate base changes attributable to 2012 non-customer-growth related plant additions). She also captures 2012 estimated changes to Accumulated Depreciation and Accumulated Deferred Income Taxes associated with 2011-ending plant balances.

Ms. Andrews posts an additional adjustment to capture the annual revenue requirement impact of 2013 planned capital gas operations additions *excluding distribution plant associated with connecting new customers* (i.e., rate base changes attributable to 2013 non-customer-growth related plant additions). She also includes estimated changes to Accumulated Depreciation and Accumulated Deferred Income Taxes for 2012-ending plant balances.

In other words, two of the "cross check" type adjustments that purport to further support the electric operations attrition adjustment prepared by Dr. Lowry initially have become the sole basis for Avista's claimed "Attrition Adjusted Revenue Requirement" for its Washington jurisdictional gas operations.

Q: Did Avista subsequently undertake an attrition study for its Washington gas operations that was similar to the one undertaken by Dr. Lowry for the Company's electric operations?

A: Yes. Subsequent to the Company's direct filing made on April 2, 2012, Ms. Elizabeth Andrews undertook an attrition study for Avista's Washington gas operations using the same techniques employed by Dr. Lowry in the electric operations attrition study. Avista made a supplemental filing on May 25, 2012, wherein the results of the noted gas operations attrition study were presented. The results of Ms. Andrews' gas operations attrition study purport to show a need for an attrition adjustment $0.952 million higher than that which was initially developed by only considering the revenue requirements associated with non-revenue producing plant addition budgeted to occur in 2012 and 2013. While the late-filed attrition study purports to justify a higher revenue requirement than that calculated initially by only considering non-growth related budgeted plant additions, Avista has *not* revised its gas operations requested rate relief and continues to base its request on the two noted post test year budgeted plant adjustments.

Q: Did Avista's May 25, 2012, supplemental filing include any other revisions to its original direct filing made on April 2, 2012.

A: Yes. In addition to supplementing its gas operations original attrition adjustment with a subsequently prepared trend-generated attrition study, Avista also revised its original electric operations' attrition study to reflect use of trending factors that were developed using arithmetic growth factors, as opposed to its original filing which used logarithmic growth factors. The change had the impact of raising Avista's estimated attrition adjustment by a little over $1.0 million. However, as with the supplemental update to its gas operations attrition adjustment, Avista is *not* proposing to raise its requested electric rate relief to reflect the higher attrition

adjustment, purportedly justified by the new method of calculating average escalation rates to apply to 2011 restated electric operating results.

Q: Please summarize Avista's attrition request for its electric and gas operations.

A: For its electric operations, Avista has calculated its attrition related revenue requirement request by considering cost-trend-developed "2011 restated" rate base and expense in combination with its 2013 sales budget. The Company then purports to further justify its actual electric operations attrition adjustment request with three "cross check" adjustments that consider the revenue requirements associated with 2012 budgeted non-revenue producing plant additions, 2013 budgeted non-revenue producing plant additions, and lost electric margins stated to be associated with the Company's electric DSM program.

For its gas operations the Company uses the opposite approach. Specifically, for its gas operations the Company developed its attrition request by calculating the revenue requirement associated with budgeted 2012 and 2013 non-revenue producing plant additions. It then subsequently "cross checked" the reasonableness of its gas operations attrition adjustment developed by considering budgeted plant additions with a multi-year cost-trend-driven study that employed the techniques used by Dr. Lowry for Avista's electric operations.

B. Avista's Proposed Attrition Adjustments Should Be Rejected.

Q: Do you find Avista's electric or gas attrition adjustments necessary or reasonable at this point in time?

A: No. I do not believe either attrition adjustment approach is reasonable for adoption. In support of my recommendation that each attrition adjustment be rejected, I note the following:

- Most conditions which this Commission has seen as a justification for authorizing attrition adjustments are not present today.
- Rates developed in recent Washington base rate proceedings, *without* employment of attrition adjustments, have been stated by Avista to have been reasonable for ratepayers and shareholders and recognized as positive by the ratings industry.
- Employment of attrition adjustments as developed by Avista do not meet this Commission's *current* "known and measurable" codified rule standards
- Historic cost trends, growth rates and investment experience are not always reliable predictors of future events and conditions.
- The Company's mix-and-match approach to developing an attrition adjustment will likely lead to undue confusion, uncertainty and controversy.

Q: Please expand upon your first reason for rejecting the Company's attrition adjustment – namely, that conditions prevalent when attrition adjustments were being granted by this Commission are generally absent today.

A: As previously noted in my discussion of the history of attrition adjustments granted in Washington, several *unfavorable* economic conditions frequently cited within UTC

orders when approving attrition adjustments in the early 1980s are noticeably absent today. In fact, for one item--*high capital costs*--not only does that unfavorable condition not exist today, but capital costs are instead at modern-day lows. Thus, instead of incremental financings for new construction or refinancing of maturing debt securities increasing utilities' cost of service--as was occurring in the early 1980s--today's incremental financings or refinancing invariably lower the utility's overall cost of debt. Further, inflation rates today and in recent years have been in the lower end of the range of inflation experienced over the past several decades--and significantly below the double digit rates experienced in the early 1980s -when this Commission authorized attrition adjustments.

Also noteworthy is the *absence* of deteriorating financial conditions and/or concerns over credit ratings. To the contrary, as already described, both agencies rating Avista's debt securities have raised their ratings for Avista's securities within the past 18 months. Importantly, these rating upgrades occurred prior to Avista's current request for an attrition adjustment.

Q: Please expand upon your second argument that rates established for Avista have been fair to ratepayers and shareholders.

A: In a November 2, 2011, message to employees posted on the Company's electronic newsletter "e.view," President and Chief Executive Officer Mr. Scott Morris described the prior 2011 Washington and Idaho rate settlements as follows:

> We reached settlements in our Idaho and Washington general rate cases during the third quarter, which *we believe provide a fair and*

> *reasonable outcome for our customers and shareholders.*[17] (*emphasis added*)

Also in a December 16, 2011, "e.view" message to employees, senior vice president and president of Avista Utilities Mr. Dennis Vermillion stated the following regarding this Commission's approval of the 2011 multi-party settlement:

> We are pleased the Commission recognized the need for retail rates to reflect increased costs necessary to operate our system.[18] (Response to Public Counsel Data Request No.127, Attachment A)

Finally, included in his message to shareholders in the 2011 Annual Report, Mr. Scott Morris stated:

> The timely recovery of the costs of capital investments remains one of the biggest challenges in today's utility environment. In 2011, we were able to successfully settle rates cases in Washington and Idaho, which *we believe provide a fair and reasonable outcome for our customers and our shareholders.*[19] (*emphasis added*)

Thus, notwithstanding the Company's plea for an immediate and radical change to recent Washington ratemaking principles and approaches, Company management has relayed to its employees and shareholders how recent Washington rate settlements--which were developed without consideration of attrition adjustments such as being proposed within this docket--were fair to Avista ratepayers and common equity owners.

Q: Please elaborate upon your conclusion that Avista's attrition adjustments do not meet the "known and measurable" standards embodied in current codified rule standards.

[17] Avista Response to Public Counsel Data Request No. 127, Attachment A.
[18] *Id.*
[19] Avista 2011 Annual Report to Shareholders, p. 2.

A: The following "known and measurable" criteria are now found within WAC 480-07-510(3), "Workpapers and Accounting Adjustments":

> (e)(iii) "Pro forma adjustments" give effect for the test period to all known and measurable changes that are not offset by other factors. The work papers must identify dollar values and underlying reasons for each proposed pro forma adjustment.

In Avista's last fully litigated base rate case the issue of what types of adjustments would meet the noted "known and measurable" standards set forth in the quoted rule were addressed in considerable detail. In relevant part, the UTC's order concluded:

> First, the adjustment must be known and measurable. The known and measurable concept requires that an 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.[20] It must also be demonstrated (*i.e*., *known)* that the effect of the event will be in place during the 12-month period when rates will likely be in effect.[21] The actual amount of the change must be *measurable. This means the amount cannot be an estimate, a projection, the product of a budget forecast, or some similar exercise of judgment—even informed judgment—concerning future revenue, expense or rate base*. Costs that are documented by actual expenditure, invoice, contract, or other specific obligation usually meet this test**.** *Costs that are the product of forecasts, projections, or budgets generally will not qualify*. There are exceptions, and we will discuss those below.[22]

The "exceptions" to the general requirements that otherwise specifically prohibit use of "forecasts, projections and budgets" were limited to developing power costs. When addressing the topic of using forecasts for developing power supply costs the Commission stated, in relevant part:

[20] This is also known as the "test year," "test period" or "historical test year."
[21] This is also known as the "rate year."
[22] *Washington Utilities & Transportation Commission v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-090134, UG-090135, Order 10, ¶ 45 (emphasis added).

> The power cost models used to measure net power costs under average and otherwise expected conditions of load, weather, and market conditions are such a mechanism, allowing for exception to strict application of the above three principles. Power cost models yield expected net power costs by rigorously matching costs and revenues. While these models employ assumptions, estimates, and forecasts as inputs, the modeled results are generally acceptable if the model inputs are reasonable and the modeling is comparable in analytical rigor to what is brought to bear in making normalizing adjustments.[23]

This interpretation of the noted "known and measurable" rules have been affirmed subsequently in two Puget Sound Energy general rate orders, both quoting extensively from the 2009 Avista order.[24]

Avista's various methods of projecting revenues, expense and rate base components that were combined to calculate an attrition adjustment simply do not meet the clear "known and measurable" standards set forth in Avista's 2009 rate order cited above. On the contrary, Avista's attrition adjustments consist exclusively of "projections," "estimates" and "budgets."[25]

Q: Please expand upon your concern that historic cost trends, growth rates and investment experience are not always reliable predictors of future events and conditions.

A: Numerous events can affect utilities' cost and investment experience. Notably and obviously, regulated utilities have a requirement to serve – such that if a utility experiences population growth in its service territory, its construction expenditures

[23] *Id.* ¶ 49.
[24] *Washington Utilities & Transportation Commission v. Puget Sound Energy, Inc.,* Dockets UE-111048, UG-111049, Order 08, ¶¶ 93-101; *Washington Utilities & Transportation Commission v. Puget Sound Energy, Inc.,* Dockets UE-090704, UG-090705, Order 11, ¶¶ 22-33.
[25] I would note that this standard does not appear to have been codified in rule in the early 1980s when attrition adjustments were being adopted.

will be influenced by the need to build and install generation and transmission facilities, as well as distribution lines, meters and services to serve its growing customer base. Thus, periods of relatively high customer growth can be expected to cause relatively high construction requirements.

Costs--both expense and investment--can fluctuate over time merely as a result of higher or lower inflation rates. Thus, even if historic average escalation rates used in creating an attrition adjustment, as Avista proposes in this case, were to meet the current "known and measurable" standard, the regulator must be concerned about whether the inflation underlying the historic cost experience can reasonably be expected to continue in the two years spanning the "restated" historic test year and the first rate effective period.

Breakthroughs in technology can also impact cost trends, as can investments made as an economic trade-off to reduce future operating expenses. For example, in separate testimony filed on this docket on behalf of Public Counsel (Exhibit No. JRD-1T) I discuss Avista's decisions to undertake an investment in a Smart Grid infrastructure improvement. There are many considerations underlying that Company decision, but at least to some degree the decision was made with an assumption that a portion of the investment cost of the Smart Grid project could "earn a return" in the form of avoided future operating costs. An attrition adjustment based upon historical average cost trends, such as proposed by Avista, cannot always be expected to capture the trade-off anticipated when new investment is undertaken to reduce or curb the growth of previous expense levels.

Productivity and efficiency gains can also, at times, be expected to reduce expenses or curb the historic growth rate of expenses. Utilities periodically undertake management audits or review other utilities' "best practices" to determine whether there is simply a better, less duplicative, or more streamlined way of undertaking processes. In particular, advances in technology have created the opportunities for shared data bases, more efficient and expeditious deployment of the utility's internal workforce, and more timely and cost-effective preventive maintenance procedures. In another section of testimony I address a management program initiated by Avista in 2010 that was undertaken with just such an aim of increasing productivity in an attempt to reduce costs and/or curb the growth rate of cost increases. Again, an attrition adjustment based upon historical average cost trends will not always capture the change in cost trajectories that can be expected upon management's identification and implementation of process improvements.

Q: Does employment of cost escalation rates that are based upon many years of results taken from "Commission Basis Reports" create challenges for the rate analyst?

A: Yes. The average escalation rates developed for use in the Company's electric attrition study are derived from multiple years of data that have been "normalized" and adjusted for regulatory actions and intents--as have been presented within the Commission Basis Reports (CBR). However, the calculated average escalation rates are only as good as the underlying "adjusted" and "restated" data contained within the CBRs. In calendar years that were employed as a "test year" in a rate case it may be reasonable to assume that the UTC Staff and intervening parties have reviewed and

modified "restated" amounts as originally presented by the Company in CBRs and deemed them appropriate or reasonable. But for those calendar years which did not also constitute a "test year" in a rate case, there is little reason to conclude that the CBRs for those calendar years received much scrutiny. Indeed, Avista has indicated that it has never received formal discovery from the UTC Staff or other parties to Avista general rate cases regarding its filed CBRs.[26] Further, I submit that no party has adequate time in the context of any given rate case review to audit or revisit in any meaningful detail adjustments posted (or the lack of needed adjustments) in developing CBRs for non-test year reports. Thus, there is a concern that escalation rates can be influenced by data developed within "unaudited" CBRs that are the underpinning of the Company's cost-trended attrition adjustment.

Q: During periods of recession or economic downturn, is it reasonable to expect utilities to more aggressively reduce or control costs?

A: Yes. I am very much aware that there are fundamental differences between utilities selling essential utility services in designated service territories and unregulated companies selling non-essential or perhaps less-essential goods and service in a competitive environment. Utilities have an obligation to provide safe, non-discriminatory utility services within their service territories. Further, in the case of electric service, the production and transmission functions require relatively long lead times in advance of the forecasted need for additional energy resources in order to acquire or construct facilities that require lengthy periods to procure or construct.

That having been stated, it is a fundamental principle that regulation is

[26] Avista Response to Public Counsel Data Request No. 307.

intended to be a surrogate for competition. Just as competition drives unregulated firms to lower costs through achieving efficiencies, economies and strict cost containment, regulation can be similarly expected to put reasonable pressures on utility companies in order to generate efficiencies. Regulatory lag is one such example. While often cited by utilities as a flaw in the system, it is more accurately described as an intrinsic characteristic of regulated ratemaking. It can benefit companies which are over-earning by delaying rate reductions until the conclusion of regulatory review. On the other hand, a "lag" time in recovery of costs creates a clear incentive to the company to operate more efficiently in order to earn its return and replicates the pressure of competition. For this reason, complete elimination of regulatory lag is not necessarily a rational goal of regulation. In this particular case, approving Avista's attrition adjustment may have the effect of removing this surrogate competitive pressure by developing rates, in part, based upon cost escalation factors derived from more robust economic times.[27]

Q: Please expand upon your concern that the Company's mix-and-match approach to developing an attrition adjustment will likely lead to undue confusion, uncertainty and controversy.

A: For a wide array of multi-year historic average escalation rates experienced between the years 2000 and 2011, the Company has selected periods of two different lengths to derive factors to apply to five large buckets of cost of service components. As

[27] This Commission recently noted this beneficial effect of regulatory lag in the 2009 PSE General Rate Case order, observing that some degree of regulatory lag "motivates PSE and the other utilities subject to our jurisdiction to carefully manage their costs and revenues going forward[.]" *WUTC v. Puget Sound Energy,* Dockets UE-090704 and UG-090705, Order 11, at ¶ 23 (April 2 2010).

previously noted, for one of the more significant cost of service components--namely, tariffed energy sales--the Company elected to ignore historic trends, and instead, employed its 2013 budget. On the other hand, while overall capital costs, also a significant cost of service input, have trended continuously and significantly downward in all recent years, the Company has used neither an historic trend nor its 2013 budget as inputs to its electric operations attrition adjustment. Specifically, Avista has assumed that the same capital cost rates it calculates for the historic test year will be funding the rate base additions that Dr. Lowry's attrition study predicts will occur between the 2011 historic test year and the 2013 rate year.

Further, as already described, for electric operations the Company combined historic trended cost data and budgeted billing determinant information to calculate its requested attrition adjustment, but then backed up its requested electric attrition adjustment with a series of "cross check" budgeted 2012 and 2013 plant additions as well as projected DSM-related margin loss adjustments. By contrast, for its gas operations the Company originally calculated its "requested" attrition adjustment by only considering budgeted 2012 and 2013 non-growth related capital additions as well as the associated effects of changes in the Accumulated Depreciation Reserve and Accumulated Deferred Income Taxes. Avista then subsequently provided a "cross check" calculation that develops an attrition adjustment using the same study methodology that the Company used in calculating its "requested" electric operations adjustment. Given the array of Avista approaches undertaken, periods studied, and data considered, I believe the door is flung wide open for any party to propose any number of historic periods and historic cost of service components to combine with

various elements of budgeted information to develop a "better" attrition adjustment. In short, I believe the Company's mix-and-match approach to developing its electric and gas operations attrition adjustments will lead to a great deal of confusion and controversy as to how, if at all, to develop a reasonable attrition adjustment.

Q: Please expand upon the Company's employment of differing historic averages in conjunction with select budgeted data.

A: First, for the Company's electric operations attrition adjustment all cost components were swept into four buckets: Rate Base, Depreciation, Taxes Other Than Income, and all Operations and Maintenance Expense *excluding* those that are separately developed within the Company's Power Supply Proforma Adjustment. Those buckets of "2011 restated" costs were then escalated for two annual periods either using a four-year or an eleven-year historical average of actual year-over-year escalation rates derived from "restated" operating results experienced for years 2000 through 2011.

Revenues reflected in the first rate effective period (i.e., calendar year 2013) were developed in two manners. First, for a small category of "Other Revenues" consisting of miscellaneous receipts for items and services excluding tariffed energy sales, 2011 restated results were escalated for two annual periods using an eleven-year historic average of escalation experienced. However, for tariffed energy sales the Company essentially used its 2013 budget of billing determinants.

Q: What are the major components of rate base?

A: Typically the three single largest components of rate base include gross Plant in Service, Accumulated Depreciation and Accumulated Deferred Income Taxes – with

the latter two major components typically representing large net "deducts" in rate base determination.

Q: Do all three major rate base components tend to grow steadily and in line with inflation being experience in any given measurement period?

A: No. Plant additions can be "lumpy," particularly with regard to a utility's production and transmission plant. Specifically, production facilities are often added in capacity increments that might facilitate serving several years of historic or projected demand and energy requirements. A large production plant addition might be followed by several years wherein no major production capacity additions are constructed. In fact, at times, utilities will experience a net decline in rate base following a major production facility addition as growth in the Accumulated Depreciation Reserve and Accumulated Deferred Income Taxes (i.e., deducts from rate base) outpace immediately ensuing years' construction expenditures. Dr. Lowry's historic-trend-driven methodology for developing an attrition rate base value ignores the fact that, due to the "lumpiness" of major plant additions, past experience is not necessarily a good predictor of future net plant additions.

Q: How were capital costs trended or considered in the Company's electric operations' attrition adjustment development?

A: The Company did not trend or otherwise adjust its requested overall cost of capital when it developed its electric operations attrition adjustment. In other words, it simply assumed that its "restated" 2011 cost of capital would remain in place through the 2013 first rate effective period.

Q: Has there been any discernible trends in capital costs in general, and Avista-specific debt financing costs in recent years?

A: Yes. As noted in previous testimony, long term interest rates have, in general, trended consistently and significantly downward in recent years. This general trend in long term interest rates is also reflected in Avista-specific long term financing costs. As reported within its 2006 CBR, Avista's average interest rate for all long debt outstanding was 7.75%. In its current filing Avista reflects a restated 2011 average interest rate for all long term debt of 5.76% - a nearly 200 basis point decline.

Q: In your earlier answer you indicated that Avista used four-year average historic escalation rates for some cost components and eleven-year average historic escalation rates for other cost components. Was there considerable variation in four-year, eleven-year and other multi-year period averages for the four buckets of costs as well as "Other Revenues"?

A: Yes. Dr. Lowry only briefly discusses the population of multi-year average escalation factors calculated for the noted buckets of costs, as well as his reasoning for focusing upon and ultimately utilizing only four and eleven-year historic averages for noted categories of costs. The entire population of multi-year historic average escalation rates developed from CBRs was affixed as Exhibit No. MNL-3 to Dr. Lowry's direct testimony. On Table 3 below I reflect "high" and "low" multi-year averages of escalation experienced for "Other Revenues" and the four large buckets of cost categories shown on Exhibit No. MNL-3. Also shown on Table 3 below are the escalation rates Avista ultimately chose to utilize in its electric operations attrition

calculation.

Table 3

Historic Average Escalation Factors Considered and Ultimately Used in the Development of Avista's Electric Operations Attrition Adjustment

	Highest Average		Lowest Average		Used in Adj't	
Cost Category	**%**	**No. of Years**	**%**	**No. of Years**	**%**	**No. of Years**
Depreciation	16.42%	11	5.36%	9	7.15%	4
Taxes Other	10.17%	2	3.31%	9	4.04%	11
Other Operating Expense – Exld. Power Supply	7.20%	4	4.63%	11	4.63%	11
Rate Base	6.48%	3	4.46%	9	6.09%	4
Other Revenues	18.74%	2	(17.91%)	8	0.41%	11

As can be observed from the data shown on Table 3 above, a wide array of periods and escalation rates could be selected under the attrition adjustment approach advocated by Avista. Depending upon the periods and rates ultimately chosen, a broad range of possible attrition adjustments could be calculated, each with its own defenders and detractors.

Q: Could not the Commission avoid this problem simply by using the lowest average escalation factors to determine an attrition adjustment?

A: I believe such approach would be arbitrary – and would have the impact of creating an incentive for parties to simply derive the most extreme escalation factors (both high and low) that could be credibly defended. More importantly, for the reasons discussed elsewhere in my testimony, I believe concerns over regulatory lag can be addressed more rationally and reliably by employment of more recent "actual" data in

the rate setting formula – and thus avoiding all the subjectivity created under the Company proposed trend-adjusted development of cost of service components.

Q: Please summarize your concerns regarding the Company's approach to developing its electric and gas operations attrition adjustments.

A. My description of the Company's various approaches to developing attrition adjustments clearly shows the Company's use of a mix-and-match collection of budgeted and historic information, and employment of differing historic periods to develop trended cost information, when historic cost escalation rates were determined to be preferable for use over budgeted data. This is likely to result in widely varying attrition adjustment outcomes that ultimately incorporate a great deal of subjective judgment. As a result, they do not provide a basis for establishing just and reasonable rates. Given the absence of the most compelling conditions that supported the award of attrition adjustments by this Commission in the early 1980s, as well as a very real concern over the variety, subjectivity, and reliability of data and approaches employed, I strongly recommend that Avista's electric and gas operations attrition adjustments be rejected.

V. PROPOSED ALTERNATIVE APPROACH TO ADDRESSING REGULATORY LAG

Q: In your testimony thus far you have set forth your reasons for opposing the Company's proposed attrition adjustments. Are there more reasonable ways to address regulatory lag than the attrition adjustment proposals being sponsored by Avista?

A: Yes. In particular I note that Avista stresses that the earnings attrition it claims to have experienced with regard to its Washington jurisdictional operations is largely associated with rapid rate base growth. This factor has been observed by this Commission as one contributing justification for previously allowing attrition adjustments, albeit generally in conjunction with observations of high inflation, rising capital costs, and concerns over utilities' financial integrity during periods of extensive financings. Avista appears to argue that this factor is a justification for its requested adjustment in this case.

Specifically, Avista argues that there is a considerable time lag between the time it makes investments in needed plant additions until the time that it can fully reflect the return and depreciation expense associated with such incremental investment in the development of base rates. On that front, I note that the precedent in Washington is to employ an average-of-monthly-averages of historic test year investments in the development of jurisdictional rate base. My review of prior Avista rate orders and rate settlements leads me to believe that there are exceptions made to strict adherence to cutting off the measurement of all rate base investment at the end of the historic test year. Rather, some post test year adjustments are made to pick up a particular and significant plant addition, or subset of significant plant additions. To some considerable degree this addresses concerns of regulatory lag.

Nonetheless, the fact remains that for the more normal, ongoing plant investments, there is a gap between cost incurrence/commercial operation of new plant additions and the time that such related costs can be fully reflected in base rate development. This can result in many cases in approximately a one-year period

between the *end* of the historic test year and the date when new rates generated from utilizing such historic test year investment go into effect. Use of the noted average-of-monthly-averages rate base methodology effectively may stretch the period from investment cost incurrence (i.e., approximately the middle of the historic test year) until the effective date of new base rates to approximately 18 months. Thus, for "ongoing" or more routine plant investments, there may be approximately 18 months between investment in incremental rate base and the time that rates reflecting such costs go into effect.

One method of addressing the concern with regulatory lag regarding recovery of investment cost is to employ a *test year end* measurement of major rate base components. This approach has been adopted in a number of other jurisdictions. This rate base development procedure has the effect of shortening the regulatory lag period for recovery of return and depreciation on new plant investment by approximately six months. Under the *test-year-end* approach to developing rates, depreciation expense associated with test-year-end plant investment is "annualized," as are any related operations and maintenance expense as well as property tax expenses directly and exclusively associated with year-end plant investment. Importantly, since test-year-end plant in service balances facilitate the provision of service to new customers added throughout the historic test year, it is also reasonable and indeed equitable to "annualize" revenues or margins associated with test-year-end numbers of customers rather than only normalizing test year sales for weather and/or other aberrations in sales experienced within the historic test year. When revenues are "annualized" for test year growth, the intent is to reflect the revenues or margins

that can be expected on an annual basis from customers taking service at test year end as if all those customers had taken service throughout the historic test year.

Q: Does employment of a year-end rate base approach, which addresses to some extent concerns of regulatory lag, avoid some of the concerns you described earlier with an attrition adjustment like that proposed by Avista?

A: Yes. By relying upon "actual" data for cost of service development, the ambiguities and subjectivity of picking and choosing historical periods to analyze and consider for developing cost escalation factors, as well as the mixing and matching of budgeted versus historic-escalated data, is avoided. The year-end test year approach relies upon employment of "actual" and "verifiable" data. To the extent Avista is experiencing elevated levels of capital expenditures, these will be more timely recovered in rates by this approach. The benefit of this method is that "actual" expenditures will be reflected in the adjustment, as opposed to those which are simply estimated, budgeted, or projected.

While, to my knowledge, the Commission has not previously adopted this approach, I would invite this Commission to consider employment of a test-year-end valuation of rate base as a reasonable alternative to the Company's multi-faceted attrition proposal in this case. Again, for the reasons stated, I do not believe it is reasonable to authorize an attrition adjustment as proposed by Avista in this case. That stated, I believe that changing the current Washington precedent of employing an average-of-monthly-averages approach to valuing rate base will address some of the Company's "regulatory lag" concerns.

Q: Are there other ratemaking approaches to consider, beyond valuing rate base under the test-year-end approach described, that alleviate regulatory lag and yet avoid many of the noted problems and ambiguities associated with the Company's attrition adjustment?

A: Yes, another approach employed by at least two regulatory jurisdictions, Missouri and Nevada, addresses concerns over regulatory lag in the recovery of costs associated with new investment. These states allow for updating of actual plant in service balances to some period several months beyond the end of the historic test year.

The Public Utilities Commission of Nevada, pursuant to statute, allows updating for Plant in Service, Accumulated Depreciation, Accumulated Deferred Income Taxes as well as other singularly significant rate base investments. At the Missouri Public Service Commission, to the best of my knowledge, every major regulated energy utility employs a test year end rate base updated for "actual" rate base component values some number of months beyond the end of the historic test year, pursuant to a commission precedent that has been followed for over 30 years..

In both jurisdictions, the plant/rate base update period is confined to a period wherein each commission's staff and intervening parties can utilize, and at least to some modest extent "audit," actual data to be employed in the development of their adjusted test year cost of service recommendation. Because the utility applicant must file months in advance of the responsive filings prepared by the commission staff and intervenor witnesses, the utilities in each noted jurisdiction will initially file some combination of "actual" and "budgeted" information to capture expected changes in

plant/rate base investment through the post-test year cutoff update period. However, the utility applicant at some later point in the procedure will update information initially filed relying in part upon budgeted plant information with all actual data as reported for public financial statement purposes at the agreed upon rate base cutoff point in time.

Importantly, each noted jurisdiction that provides for an update for actual plant/rate base components to some point in time a few months beyond the end of the historic test period, also require attendant annualization, both of costs resulting from new plant investment as well as revenues or margins expected to be received from customers taking service at the end of the update cutoff period. Thus, the intent is to properly "match" revenues, investment and expenses to a period closer to the time that new rates resulting from the rate case will go into effect.

Q: If this Commission has a significant concern regarding regulatory lag that Avista might be experiencing, do you believe the update-for-post-test-year actual rate base experience, along with an attendant offset in the form of post test year revenue growth, offers advantages to the Company's mix-and-match development of its attrition adjustment?

A: Very much so. As noted, simply reflecting a test-year-end approach to valuing rate base along with attendant annualizing of income statement adjustments eliminates six months of regulatory lag. Allowing for updates for major rate base components, along with attendant "annualizing" income statement adjustments, can reduce regulatory lag by several more months. Importantly, measurably reducing regulatory lag under the "update" approach suggested is accomplished by considering only

actual experience or investment that can, at least to some degree, be verified within the rate case audit schedule. I find that employment of actual data obtained closer to the rate effective date a preferred approach for addressing regulatory lag than going down the path of attempting an attrition adjustment through a mix-and-match approach of using historic trends along with some budgeted data.

VI. SPECFIC ADJUSTMENTS

A. Positions And Adjustments Advocated By Public Counsel Northwest Industrial Gas Users And The Industrial Customers Of Northwest Utilities That Are Responsive To Avista's Attrition Proposals [Exhibit No. JRD-2, Schedule No. 3, PC E 2.12/Schedule No. 23, PC E 3.06 and Exhibit No. JRD-3, Schedule No. 2, PC G 2.01/Schedule No. 18, PC G 3.04].

Q: Are you sponsoring specific adjustments that are intended to be responsive to Avista's request for attrition adjustments in this proceeding?

A. Yes. However, I would first note that I am specifically opposing the Company's electric and gas operations attrition adjustments. Therefore, on behalf of Public Counsel and ICNU, I am opposing the following electric operations proforma

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adjustments proposed by Avista:

Adjustment Number	Adjustment Description
4.00	Planned Capital Additions 2012
4.01	Planned Capital Additions 2013
4.02	DSM (proforma lost margins)
4.03	Other

Company electric adjustments 4.00 and 4.01 calculate the revenue requirements associated with budgeted 2012 and 2013 plant additions *other than* distribution plant additions directly associated with customer growth. Adjustment 4.02, as previously described, estimates annual lost margins attributable to Demand Side Management initiatives. Adjustment 4.03 is merely a "plug" adjustment to force the sum of the "cross check" adjustment numbers 4.0, 4.01 and 4.02 to equal the total electric attrition adjustment sponsored by Dr. Lowry. At this point I would note and emphasize that I am opposing the Company's electric adjustment 4.02, in part, because it is merely one "cross check" adjustments employed to reconcile to Dr. Lowry's attrition adjustment. However, in later section of testimony I discuss why such adjustment should be rejected in the event the Commission was to evaluate the merits of this adjustment on its own – or outside of the context as partial support for Dr. Lowry's attrition adjustment.

For gas operations, on behalf of Public Counsel and NWIGU I am opposing

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the following adjustments proposed by Avista:

Adjustment Number	Adjustment Description
4.00	Planned Capital Additions 2012
4.01	Planned Capital Additions 2013

As previously described, Avista's attrition proposal for its gas operations was initially supported exclusively by its proposed reflection of gas adjustment numbers 4.00 and 4.01, and did not include any support through an historic cost-trended attrition adjustment such as was prepared by Dr. Lowry for Avista's Washington jurisdictional electric operations. While the Company subsequently undertook an historic cost-trended attrition study for gas operations that was similar to that which supports it electric operations attrition adjustment and presented such study results in a May 25, 2012, supplemental filing, it nonetheless continues to make its attrition request on the basis of the noted adjustment numbers 4.00 and 4.01.

While I am specifically opposing the noted Company-proposed electric and gas operations attrition adjustments, I am specifically *supporting* the Company's electric operations Restating Adjustment No. 3.07 and gas operations Restating Adjustment No. 3.06 in consideration of the Company's "regulatory lag" and earnings attrition concerns. The Company's electric operations Restating Adjustment No. 3.07 reflects rate base values at December 31, 2011 rather than the test year average-of-monthly average balance shown in the starting point Results of Operations presentation, and also reflects "annualized" depreciation expense associated with such test-year-end Plant in Service values. Similarly, the Company's gas operations

Restating Adjustment No. 3.06 reflects rate base values at December 31, 2011 rather than the test year average-of-monthly average balance shown in the starting point Results of Operations presentation, and also reflects "annualized" depreciation expense associated with such test year end Plant in Service values.

Q: Why do you characterize your acceptance of the noted Company-proposed electric and gas operations "Restating Adjustments" as responsive to concerns of earnings attrition and regulatory lag?

A: My understanding is that the UTC has never accepted test-year-end valuation of rate base and annualization of depreciation expense based upon test-year-end Plant in Service values--as is being proposed by the Company in the noted Restating Adjustments. However, consideration of this approach in this case is a reasonable response to concerns of regulatory lag and earnings attrition in this proceeding, to the extent justified by Avista's current levels of capital expenditure.

I would note and emphasize at this point that my support of the noted Company-proposed 2011 "test year end" Restating Adjustments is contingent upon acceptance of modifications to the Company's restating or proforma adjustment for revenues and property taxes that I am proposing.[28] The modification to the two noted Company adjustments will partially offset the revenue requirements associated with the Company-proposed test-year-end rate base/depreciation expense Restating Adjustments that I am conditionally supporting. Employment of a year-end approach to valuing rate base requires the noted adjustments to properly "match" both revenues

[28] Specifically, acceptance of the test year-end rate base valuation is contingent upon acceptance of revenue adjustments PC E 2.12 and PC G 2.06 as well as property tax adjustments PC E 3.06 and PC G 3.04.

to be derived from all customers taking service at test year end, as well as to include only property tax expense calculated to be associated with such year-end rate base valuations.

Q: Please describe the modifications to the two Company-proposed adjustments that you propose.

A: First, as described in previous testimony, when test-year-end rate base valuation is employed, it is reasonable and indeed consistent to "annualize" revenues or margins from customers taking service at test year end. Annualization of revenues associated with year-end numbers of customers being served properly "matches" revenues with test-year-end rate base investment. The Company developed its Restating Adjustments 2.12 and 2.01 to "normalize" test year revenues for electric and gas operations, respectively. However, the noted Company revenue adjustments only modified test year recorded revenues to reflect normal weather conditions as well as current rates in effect. If test-year-end valuation of rate base is to be adopted, it is also essential to "annualize" revenues associated with test-year-end numbers of customers. Accordingly, I have modified Company electric Restating Adjustment No. 2.12 and gas Restating Adjustment No. 2.01 to incorporate additional margins that would be expected to be realized if new customers who have only taken service for a *portion* of the historic test year had taken utility service throughout the *entire* historic test year.

Additionally, Company's proforma property tax expense Adjustment Nos. 3.06 and 3.04 for electric and gas operations, respectively, should be modified as I am proposing within adjustments PC E 3.06 and PC G 3.04. When developing its

proposed proforma electric and gas operations proforma property tax expense the Company considered and included budgeted plant additions expected to occur throughout 2012. However, since the rate base/Plant in Service cutoff period that I am proposing is December 31, 2011, it is consistent and necessary to synchronize the property tax expense calculation with December 31, 2011, *actual* Plant in Service valuation rather than the Company-proposed linkage to December 31, 2012, *budgeted* Plant in Service valuation. Accordingly, I submit that adoption of the Company-proposed Restating Adjustments to reflect test-year-end rate base valuation/depreciation annualization should also be contingent upon adoption of the modified property tax expense adjustments I am sponsoring that reflect property tax expense expected to be incurred with 2011 test-year-end *actual* plant valuations.

Q: Have the modifications that you are proposing to adjustments for revenues and property tax expense originally developed by Avista been incorporated within exhibits attached to testimony that is being separately filed on behalf of Public Counsel?

A: Yes. In Table 4 I show the exhibit number, schedule reference, adjustment number and adjustment descriptions that capture the modifications to Company adjustments that I am proposing, as reflected in revenue requirement exhibits supporting my separate revenue requirement testimony on behalf of Public Counsel, identified as Exhibit No. JRD-1T.

Table 4 **Identification of Adjustments in Separately Filed Testimony** **Related to Public Counsel, ICNU and NWIGU Positions Regarding Attrition**		
Adjustment No.	Adjustment Description	Exhibit/Schedule Reference
PC E.2.12	Revenue Normalization	Exhibit No. JRD-2, Sch. No. 3
PC E.3.06	Property Tax	Exhibit No. JRD-2, Sch. No.23
PC G.2.01	Revenue Normalization	Exhibit No. JRD-3, Sch. No. 2
PC G 3.04	Property Tax	Exhibit No. JRD-3, Sch. No.18

Q: Previously you indicated that, in addition to reflecting a test-year-end rate base valuation as a response to regulatory lag, it would also be reasonable to update Plant in Service, Accumulated Depreciation and Accumulated Deferred Income Tax balances to capture more post-test-year "actual" data. Are you therefore also proposing an additional proforma adjustment, or a series of related proforma adjustments, to pick up the impact of post-test year "actual" rate base component changes now available?

A: No. I briefly discussed with Company revenue requirement witness Ms. Elizabeth Andrews the possibility of obtaining updated Washington jurisdictional rate base investment for the latest reporting period available--in an effort to understand the impact of updating the cost of service model for last known actual information available prior to the time that intervenor parties were required to file direct testimony and exhibits in this proceeding. I was informed that, due to the seasonality of the Company's construction program, actual financial information available at that time (for the period ending June 30, 2012) would show a decline in rate base from that

which existed during the historic test year. In other words, growth in the Accumulated Depreciation Reserve and Accumulated Deferred Income Taxes outpaced construction expenditures during the first half of calendar 2012, due to seasonally slow construction activity occurring during the winter season. Thus, while I believe an "update" for last known actual rate base investment, accompanied by at least partially "offsetting" growth in revenue margins to a comparable point in time, is a more reasonable method of addressing regulatory lag than is the Company's attrition adjustment approach, it would be expected to have little impact if updates through June 30, 2012 were to be undertaken. Accordingly, I have made no such calculations and am not proposing a post-test-year "update" adjustment in this proceeding. Nonetheless, the "update" approach could remain a viable option in future Avista base rate proceedings to address concerns of regulatory lag. Such updates would be particularly effective in responding to regulatory lag if timed such that the update "cutoff" period would coincide with the end of the most active construction season.

B. Response To Avista's Electric Adjustment 4.02 Addressing Estimated Lost Margins Attributable To DSM Initiatives.

Q: Please state your understanding of Avista's electric operations adjustment 4.02.

A: Avista's electric operations adjustment 4.02 purports to calculate lost margins estimated to be realized through 2013 that are a direct result of the Company's Demand Side Management initiatives. Technically the Company is not proposing that this adjustment be included in the calculation of the electric operations revenue deficiency. Rather, Avista offers up electric adjustment 4.02 as one of the "cross

check" adjustments that purportedly show the reasonableness of Dr. Lowry's attrition study for Avista's Washington jurisdictional electric operations.

Q: Do you have any comments to offer addressing the Company's electric operations "cross check" adjustment 4.02?

A: Yes. As stated, I recognize that the Company is technically not asking for adoption of its "cross check" adjustment 4.02. However, in the event the Company changes its position regarding the adjustment, and/or the Commission is persuaded to consider it as an alternative to Dr. Lowry's attrition adjustment, I would offer a few comments.

I would recommend rejection of Avista's electric adjustment 4.02, even if the Commission rejects Dr. Lowry's electric attrition study. This adjustment attempts to measure one, and only one, cause or element affecting electric utility sales. It is wholly unreasonable to select only one driver of changing sales volumes from the list of events that influence energy consumption, while making none of the other adjustments that would be needed to account for the other variables that influence sales. Further, assuming one were to conclude that conservation resulting from DSM programs was occurring exactly as estimated within Avista's electric conservation adjustment, such adjustment would still not be proper and would not meet the "known and measurable" criteria of WAC 480-07-510(3) inasmuch as it fails to consider "offsets" in the form of increasing usage per customer from other events and conditions that clearly appear to be occurring.

Q: What other events or elements, beyond DSM measures, influence or impact electric sales?

A: There are a multitude of other factors that influence kWh sales levels. These include:

- The number of customers being served by the utility.
- The average usage per customer being served, which in turn can be impacted by:
  - Selected end-uses of the customer, such as heat, water heat, air conditioning and other appliance choices.
  - Home/building sizes and changes in building codes.
  - Economic conditions
  - Price elasticity
  - Replacement of equipment/appliances with newer and more efficient devices.
  - Additional appliances/devices such as extra televisions, refrigerators, freezers, etc.

Q: What amount of kWh sales does the Company's adjustment 4.02 predict to be "lost" or foregone as a result of its DSM initiatives?

A: Avista's adjustment predicts approximately 95 million kWh sales to be "lost" as a result of DSM initiatives. It predicts reduced sales for all rate classes except the Street & Area Lights and Special Contract Schedules.

Q: Have the rate classes for which Avista is projecting lost sales with its adjustment 4.02, in fact, been experiencing reduced sales in recent years?

A: Generally no. On Exhibit No. JRD-9 I show total actual sales, total weather normalized sales, and annual weather normalized kWh usage per customer for each

electric class, and the sum of those classes, for which Avista proposes an adjustment to reflect reduced or "lost' sales attributable to its DM initiatives. As can be observed from Exhibit No. JRD-9, total actual sales and total weather normalized sales for the sum of all noted classes were essentially flat between 2008 and 2009. Further, and more importantly, overall weather normalized annual *usage per customer* for all affected classes combined increased in 2010 and 2011. There was a reduction in weather normalized annual usage per customer for the sum of the noted customer classes between 2008 and 2009. However, the reduction in normalized usage per customer between 2008 and 2009 occurred in all the classes *other than* Residential – which would suggest that the decline in usage per customer between those two noted years can be largely attributable to the Great Recession which was peaking in the first half of 2009.

The data shown on Exhibit No. JRD-9 does reflect reduced normalized annual usage per customer for some customer classes in some year-to-year comparisons. However, again, overall normalized usage per customer in the aggregate for the noted classes has increased between years 2009/2010 and again between years 2010/2011.

Q: Does the data indicate that the electric conservation measures are failing?

A: No. The fundamental problem with the Company's adjustment is that it is unreasonable to focus upon only the utility-sponsored DSM impacts affecting sales, while completely ignoring all other sales-impacting variables and the fact that overall electric sales have <u>not</u> been declining. While I have not studied what elements or events are influencing Avista's electric usage per customer, it would not surprise me to find that increases in usage per customers resulting from more/larger high

definition televisions, more computers – and more computers staying on close to 24/7, as well as simply the continuing purchase and usage of additional electrical appliances, has caused electric usage per customer to remain relatively flat *notwithstanding some kWh savings successes with electric conservation programs.* In effect, I believe the Company's electric adjustment 4.02 attempts to adjust one element of usage per customer while ignoring equal and offsetting elements of usage per customer that appear – for whatever undefined reasons – to be increasing. Accordingly, I submit that the Company's lost margin adjustment 4.02 should be rejected.

VII. CONCLUSION

Q: Please summarize the Public Counsel, ICNU and NWIGU position regarding the issues surrounding the Company's request for attrition adjustments.

A: My major conclusions and recommendations regarding the Company's claim of "regulatory lag" and its request for an "attrition adjustments" are as follows:

- The Company's attrition adjustments should be rejected inasmuch as conditions which might justify such unique rate treatment do not exist today for either the electric or natural gas operations. By the Company's own characterizations, recent UTC rate treatment, which did not include attrition adjustments, has been fair. In addition, the Company's attrition adjustments do not meet this Commission's codified "known and measurable" rules.
- As a means to address regulatory lag, valuation of major rate base components at test year end would be reasonable in this proceeding. However, adoption of test year end rate base valuation must be contingent upon adoption of partially

offsetting adjustments that properly match test year growth in revenues and restrict property tax expense development to only considering test year end plant valuations.

- Prospectively, "updating" of major rate base components for actual growth that can be verified, at least to some extent during the discovery/audit phase of a base rate proceeding, would be preferable to any form of attrition allowance or attrition adjustment as is being proposed by Avista in this proceeding. If "updating" for verified actual net rate base growth is to be undertaken, it should only be adopted if partially-offsetting adjustments for revenue growth and operational savings expected to be realized from post-test year Plant in Service additions are also calculated and considered in the rate setting formula.

Q: Does this conclude your testimony?

A. Yes, it does.