BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

WUTC V. AVISTA

DOCKETS UE-140188 & UG-140189

DIRECT TESTIMONY OF JAMES R. DITTMER (JRD-1CT)

ON BEHALF OF PUBLIC COUNSEL

REGARDING REVENUE REQUIREMENT

JULY 22, 2014

REDACTED VERSION

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I. INTRODUCTION

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: I have been retained by the Public Counsel Section of the Washington Attorney General's Office to primarily review, address and respond to Avista's proposal to reflect significant "attrition adjustments" in its recommended revenue requirement for its electric and natural gas operations. Additionally, I am addressing a limited number of more traditional "restating" and "proforma" adjustments to the historic test year ending June 30, 2013.

Q: Please summarize your professional experience.

A: My education and professional experience is summarized in Exhibit No. JRD-8.

Q: What exhibits are you sponsoring in this proceeding?

A: In addition to Exhibit No. JRD-8 that summarizes my educational and professional experience, I am sponsoring the following exhibits:

Exhibit No. JRD-2	Summary of Public Counsel Electric Adjustments
Exhibit No. JRD-3	Summary of Public Counsel Gas Adjustments
Exhibit No. JRD-4C	Response to Staff Data Request No. 92
Exhibit No. JRD-5C	Response to Public Counsel Data Request No. 22 (Attachment A is Confidential)
Exhibit No. JRD-6	Response to Public Counsel Data Request No. 136
Exhibit No. JRD-7	Response to Public Counsel Data Request No. 191

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, including Avista's most recent general rate case (Dockets UE-120436 *et al)*. Most recently, I filed testimony in PacifiCorp's last general rate case – Docket UE-130043.

Q: What is the purpose of your testimony?

A: I oppose Avista's proposal to develop rates by reflecting a very significant attrition adjustment and recommend alternative approaches to improve the timeliness of Avista's recovery of costs being incurred to provide utility service in Washington. Additionally, I propose rejection and/or modifications to a limited number of Avista-proposed "restating" as well as "proforma" adjustments.

II. SUMMARY OF TESTIMONY

Q: Please summarize your primary conclusions and recommendation regarding Avista's proposed attrition adjustments.

A: As previously described, my primary charge and focus in this engagement was to review and respond to Avista's proposed attrition adjustment. As a result of my review and analysis, I am proposing that Avista's attrition adjustments be rejected. As shown by the evidence submitted herein, there are significant challenges to developing the methodology to employ an attrition adjustment that lead me to conclude that an attrition adjustment is not the best tool to address regulatory lag. Moreover, neither conditions precedent to the granting of an attrition adjustment, nor the guidelines to be adhered to when developing an attrition adjustment, have been vetted or established by this Commission. I submit that alternative approaches to addressing regulatory lag, potential earnings erosion, and work load and fatigue experienced by regular rate case participants resulting from frequent filing of general rate case, have not been fully explored and tried.

Accordingly, as an alternative to adoption of an attrition adjustment, as a means to address the noted concerns of regulatory lag, earnings erosion, and "rate case fatigue," I recommend the following mechanisms and approaches:

- End of period – as opposed to the average-of-monthly-averages valuation of major rate base components - should be adopted in this proceeding.
- A post-historic test year adjustment to "update" the valuation of major plant-related rate base components closer to the rate effective date should be adopted.

- Pro forma expense adjustments that capture post-test year increases that can be verified and measured should be adopted.
- Avista should be permitted to undertake up to two Expedited Rate Filings with relatively few constraints and restrictions that should reduce regulatory lag as well as rate case participants' work load.

The post-test year updates to Net Plant Less Deferred Income Taxes adjustments I am recommending are not insignificant. For electric operations the post-test year plant update adjustment, calculated by considering Public Counsel's recommended cost of capital, increases revenue requirements by approximately $9.2 million. For gas operations, the update adjustment increases revenue requirements by approximately $3.6 million.

Q: Did you undertake a comprehensive analysis and review of Avista's claimed revenue deficiency for its Washington jurisdictional electric and gas operations?

A: No. As noted, my primary focus in this engagement was to review and respond to Company's proposed attrition adjustments. While I attempted to broadly review a few other topical areas, resource constraints did not permit a complete or comprehensive review of all issue areas. Public Counsel may subsequently elect to support some of the adjustments of other parties in this proceeding. As a result, I am *not* proposing a comprehensive "bottom line" revenue requirement recommendation on behalf of Public Counsel.

Q: Is Public Counsel presenting a cost of capital recommendation in this proceeding?

A: Yes. Public Counsel has retained Mr. Stephen Hill to present a cost of capital recommendation in this proceeding. The total impact of all Public Counsel recommended adjustments relative to those proposed by Avista in this case, including Mr. Hill's cost of capital recommendation, is $45,386,000 for electric operations and $6,998,000 for gas operations.

Q: In addition to providing the overall base revenue requirement in this case, Avista also provides the "billed revenue change" which incorporates the expiration of rebates associated with the ERM and a BPA Settlement and the addition a proposed REC revenue rebate. Do you address these expiring and new credits?

A: I am aware that Avista has reflected the impact of these expiring and new credits to its total base revenue increase in this case to determine the total net billing revenue change to customer rates. I do not take a position on the expiring rebates and the REC revenue rebate is addressed by Public Counsel witness Lea Fisher.

III. EXHIBIT NOS. JRD-2 AND JRD-3 ORGANIZATION

Q: Please explain how your schedules within Exhibit No. JRD-2 Summary of Public Counsel Electric Adjustments and Exhibit No. JRD-3 Summary of Public Counsel Gas Adjustments are organized.

A: Schedule No. 1 of Exhibit No. JRD-2 and Exhibit No. JRD-3 consist of a Summary of Public Counsel Electric Adjustments and a Summary of Public Counsel Gas Adjustments, respectively. Also shown on each Schedule No. 1 is a listing of every electric and gas adjustment incorporated within Avista's original direct filing. Avista adjustments that I am not supporting, modifying or opposing within this direct testimony have a designation of "PC Neutral in Direct" noted on each Schedule No. 1 for electric and gas operations. As discussed earlier, it is possible that Public Counsel may adopt another party's position regarding Company adjustments that I am not addressing within this testimony. For Company adjustments where Public Counsel is proposing an alternative calculation to that undertaken by the Company, such adjustments have been designated as "PC Modified." There also several Company adjustments that Public Counsel is specifically opposing. Those adjustments have been designated as "PC Oppose."

Public Counsel adjustments that either modify an adjustment originally proposed by Avista, or which are incremental to those proposed by Avista, are summarized on ensuing schedules contained within Exhibit No. JRD-2 or Exhibit No. JRD-3. In my narrative testimony supporting these adjustments, I refer to the schedule number within Exhibit No. JRD-2 or Exhibit No. JRD-3, as well as Public Counsel's adjustment number designation.

IV. HISTORY AND PRECEDENT FOR ADDRESSING REGULATORY LAG AND ADOPTING ATTRITION ADJUSTMENTS

A. Precedent Prior to 2012 Avista General Rate Case.

Q: Please summarize your understanding of this Commission's view on the need for, and criteria for, adoption of attrition adjustments *prior to approval of the*

non-unanimous stipulation in Avista's last general rate case – Dockets UE-120436 et al.

A: Based upon research undertaken when reviewing Avista's 2012 general rate case, I am aware that this Commission, though not in every docket where requested, authorized adoption of attrition adjustments in general rate cases (GRC) undertaken in the early 1980s that had similarities to the attrition adjustment Avista is proposing in the current, as well as within its 2012 GRC, request. Specifically, the first time that I am aware that the UTC allowed an attrition adjustment was in a 1981 general rate case filed by Washington Water Power Company (WWP), Avista's predecessor.[1] Adopting the recommendations of its Staff, the UTC authorized an attrition adjustment in the 1981 WWP proceeding to reflect rate year predicted revenues, expense and rate base levels.

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.

[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: 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 a period of years, the UTC at times accepted, and at times rejected, both its Staff's and other utility companies' proposals to incorporate an attrition adjustment in the development of various Washington regulated utility companies' requests for base rate relief.

Q: When addressing the attrition issue in cases reviewed from the 1980s, did the UTC set forth specific criteria for adoption or rejection of attrition adjustment proposals?

A: The Commission did not set out a specific "test" or formula in the orders addressing attrition requests in the 1980s. However, frequent references were made to the following conditions 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, prior to adoption of the significant implicit attrition adjustment embodied in the non-unanimous stipulation reached in Avista's 2012 GRC, was in a 1986 Pacific Power and Light general rate case order.[2] 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.[3]

Subsequent to the Washington Natural Gas case just cited, I am not aware of any utility requesting a specific attrition adjustment until Avista requested an attrition adjustment in Dockets UE-120436 *et al.*

B. More Recent Precedent for Addressing Regulatory Lag.

Q: Thus far you have summarized this Commission's precedent for addressing regulatory lag and adoption of attrition adjustments that was in place for at least two decades. Please summarize this Commission's more recent actions and statements regarding the need to address regulatory lag.

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

A: While the subject of regulatory lag may have been mentioned or addressed in some manner in a number of GRCs occurring subsequent to the 1986 Pacific Power and Light general rate order mentioned previously, to the best of my knowledge the topic first again became highlighted in a 2011 GRC filed by Puget Sound Energy (PSE).

Specifically, in Dockets UE-111048 and UG-111049, witnesses noted in testimony PSE's inability to earn its authorized rate of return in recent years. In response to PSE claims of alleged attrition and rate requests, the UTC Staff proposed using an Expedited Rate Filing (ERF) as an additional mechanism – beyond GRCs – to assist PSE in addressing its alleged attrition problem. Staff's ERF proposal in the 2011 PSE GRC envisioned that a utility would be permitted to make a rate filing that adhered to cost of capital, restating adjustments and class cost of service rate spreads and rate design adopted by the Commission in its most recent decision addressing such topics. So long as the utility undertook an ERF following principles adopted in the utility's most recent GRC order, the docket could be expected to be processed with very little discovery and on a relatively quick procedural schedule. Inasmuch as there was no specific ERF proposal before it, this Commission made no specific determinations in connection with Staff's proposal in the noted PSE docket, but effectively encouraged the parties to explore regulatory proposals "that might break the current pattern of almost continuous rate cases."[4]

[4] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 & UG-111049, Order 08 ¶ 507 (May 7, 2012).

Q: Please continue by summarizing the next regulatory action occurring in recent history that was designed to address earnings shortfall for regulated Washington energy utilities.

A. On April 2, 2012 - while the 2011 PSE GRC docket was still open and before this Commission issued its decision in that docket - Avista filed a GRC for its electric and gas operations with a significant attrition adjustment. In that docket, the UTC Staff filed testimony that included a recommendation for adoption of a very significant attrition adjustment – similar in some respects to the Company's proposed attrition adjustment. Notwithstanding the inclusion of a very significant attrition adjustment in its calculated revenue requirement for Avista's electric and gas operations, Staff's prefiled direct testimony nonetheless recommended a small electric operations rate *reduction* and a gas operations rate increase that was approximately forty percent (40.0%) of Avista's filed request. Ultimately, Avista, Staff, Northwest Industrial Gas Users (NWIGU), and the Industrial Customers of Northwest Utilities (ICNU) entered into a stipulation in the noted 2012 GRC docket.

Among other things, the multi-party stipulation provided for a first-step increase effective January 1, 2013, and a second-step increase effective January 1, 2014, for Avista's electric and gas operations. The increases were derived via a "black box" settlement wherein the parties did not delineate how such increases had been determined. That stated, it was abundantly obvious that the agreed upon two-step increases for both electric and gas operations included a significant allowance for an attrition adjustment.[5]

The Commission adopted the non-unanimous stipulation over Public Counsel's objection, with certain modifications to the agreement. One modification of some significance was this Commission's designation of the second-step increase as "temporary" with an effective period of only one year.

Q: In approving the non-unanimous stipulation, did this Commission endorse any specific attrition methodologies, approaches or assumptions?

A. No. To the contrary, the Commission's order specifically noted that it was *not* endorsing any specific attrition methodologies, assumptions or inputs.[6]

Q: Did the Commission's order conclude that the general conditions and criteria frequently cited in its orders adopting attrition adjustments in the early 1980s were present in the Avista 2012 GRC?

A: No. The Commission stated that it "intended to clarify the conditions wherein attrition should be considered when setting rates." The Commission noted that the settlement limited its ability to provide that clarity, but that it would "in the near future initiate an inquiry into the appropriate use of attrition analysis in

[5] Staff and Avista acknowledged in testimony supporting the stipulation that consideration had been given to an attrition adjustment. ICNU sponsored testimony supporting the stipulation but stated that from ICNU's perspective the "black box" increase did not consider any attrition adjustment. Public Counsel presented testimony that concluded, given other items agreed to and expressed in the settlement, that the "black box" settlement must have been derived by considering a very significant attrition adjustment. Ultimately this Commission found that the non-unanimous stipulation "was based significantly on attrition." *WUTC v. Avista Corporation.,* Dockets UE-120436 & UG-120437, Order 09 ¶ 70 (December 26, 2012).

[6] *Id.* ¶ 77.

setting rates, including the appropriate methodology to use in preparing attrition studies.[7]

Q: Please continue by discussing the next regulatory action that has recently occurred that was designed to address earnings shortfall for regulated Washington energy utilities.

A: In early February 2013, PSE filed petitions for electric and gas base rate relief, that became docketed as UE-130137 and UG-130138, utilizing an ERF approach along the lines that Staff had advocated in PSE's 2011 GRC that was described in an earlier answer. With limited testimony and exhibits, and with reflection of the cost of capital, and most - though not all - restating adjustments adopted by this Commission in its 2011 GRC order, PSE proposed to increase its Washington retail electric by approximately $32.1 million and to reduce its gas operations' Washington retail rates by approximately $1.2 million.

PSE's ERF dockets were combined with a decoupling request in Dockets UE-121697 and UG-121705, as well as a separate docket addressing a coal transition purchased power agreement after PSE, Staff and Northwest Energy Coalition (NWEC) reached a multi-party settlement. The multi-party settlement recommended a decoupling mechanism and an ERF increase, as well as a multi-year rate increase plan that relied upon abbreviated calculations fashioned to some extent after the early-1980s-styled attrition adjustments previously approved on occasion by this Commission. The Commission accepted the settlement, with minor modifications. Public Counsel and the Industrial Customers of Northwest

[7] *Id.* ¶ 77.

Utilities (ICNU) challenged the Commission's decision on the attrition adjustment. However, the Commission's decision on the attrition adjustment granted to PSE survived the challenge.

Q: Please continue by summarizing any additional utility applicant regulatory proposals and UTC regulatory decisions wherein the topics of regulatory lag and/or attrition were addressed.

A: In January 2013, PacifiCorp filed a GRC that was designated as Docket UE-130043. PacifiCorp's filing did not include a request for an attrition adjustment. PacifiCorp's revenue requirement calculation started with an historic test year ending June 30, 2012, and was further developed by considering a number of typical "restating" and "proforma" adjustments. Of note, PacifiCorp's proforma adjustments included several requests to include significant plant additions that were projected to be – and in some instances were – closed to Plant in Service during the discovery phase of the docket, as well as other plant additions that were not projected to be closed to Plant in Service until some months following the expected implementation date for revised retail electric rates resulting from the GRC docket. While the PacifiCorp-proposed proforma adjustments made to reflect post-test year plant additions were never described or designated as "attrition adjustments," their proposals were undoubtedly made to address potential earnings deterioration expected as a result of regulatory lag.

Staff and Public Counsel accepted in part, and opposed in part, certain PacifiCorp-proposed proforma adjustments to reflect post-test year plant additions. In turn, this Commission accepted in part, and rejected in part, the various parties' positions regarding inclusion of post-test year plant additions in the development of revenue requirement. When arriving at its decisions on various proforma adjustments to reflect post-test year plant additions, this Commission did not articulate or adhere to specific tests or criteria, instead choosing to rely on informed judgment for each decision being made.

PacifiCorp's prefiled testimony and exhibits did not address nor seek any form or mechanism to achieve expedited rate relief. However, in rejecting certain of PacifiCorp's very forward looking proforma plant adjustments, Staff recommended within concurrently filed testimony that PacifiCorp address perceived exposure to earnings shortfall that might occur as a result of this Commission rejecting a number of PacifiCorp's proposed proforma plant adjustments by making an Expedited Rate Filing along the lines that Staff had first suggested within PSE Docket UE-111048 *et al.* In general, Public Counsel very strongly encouraged the ERF approach to addressing regulatory lag, only offering certain additional conditions and requirements to be adhered to when a utility made such an ERF.

This Commission neither accepted nor rejected Staff and/or Public Counsel's various ERF proposals, stating these decisions were better addressed within a rulemaking docket.[8]

Q: Have the issues of criteria, conditions, filing requirements, procedural schedules or any other elements surrounding rules to address Expedited Rate Filings been vetted within Docket A-130355?

A: Docket A-130355 was established to consider a number of proposed rulemaking changes – including possible rules to address ERFs. As of the time this testimony was to be prepared, very few comments had been filed by parties that even mention ERFs – much less began vetting specific conditions, criteria, filing requirements or procedural schedules to be adhered to if, and when, a utility might choose to undertake an ERF.

Q: Please summarize your observations of recent proposals and recent UTC decisions that focused upon potential mechanisms to address regulatory lag, earnings erosion or attrition.

A: In less than a three year span, the Commission has been presented with widely divergent, non-traditional rate recovery proposals. During this time, this Commission has adopted an attrition adjustment and an ERF proposal. However, each "adoption" was by way of approval of non-unanimous stipulation. And in

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[8] Specifically on the topic of ERF proposals this Commission determined:

> "We find Staff's proposal of an ERF in this proceeding worthy of future consideration but premature in light of the Commission's initiation of Docket A-130355. The ERF concept has its merits to be sure, but we not prepared in this case to embrace it in its nascent form as a substitute for other, more fully developed and familiar approaches to addressing regulatory lag. In this case, we are approving PacifiCorp's use of EOP rate base, an approach the Commission has recognized for many years as an appropriate response to regulatory lag, particularly when associated with chronic under-recovery experience such as that of PacifiCorp during recent periods. We also are taking a more forward approach to allowing pro forma adjustments that capture the costs and benefits of upgraded production assets. This, too, is an approach with which the Commission has

each decision, no specific criteria, condition or methodology was generically approved or endorsed. To the contrary, this Commission has indicated that it would be addressing specific criteria, conditions and/or methodologies surrounding non-traditional rate proposals in future regulatory docket. Accordingly, as of this time this Commission has not stated its expectations or preferences for identifying *when* a non-traditional rate mechanism approach is warranted, and if deemed to be warranted or justified, what is the best non-traditional rate methodology to be undertaken.

V. AVISTA'S ATTRITION ADJUSTMENT 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: Ms. Elizabeth Andrews has developed an attrition adjustment for Avista's Washington jurisdictional electric operations that *increases* the claimed revenue deficiency by approximately $33.7 million above and beyond what Avista calculates using a traditional test year approach that considers "restating" adjustments, its request for an increase in ROE to 10.1 percent, as well as more typical non-power supply "proforma" expense adjustments. The $33.7 million attrition adjustment exceeds the total increase being requested by the Company. The Company's request for increased revenue for electric operations totals $32.3 million, which includes the January 1, 2014 temporary increase of approximately

considerable experience and that has proven to be a useful means to reduce regulatory lag." *WUTC v. PacifiCorp,* Dockets UE-130043, Order 05 ¶ 217 (December 4, 2013).

$14 million and the requested $18.2 million above 2014 rates.[9] Inasmuch as the value of the Company's attrition adjustment exceeds the totality of electric rate relief being requested in this proceeding, it is clear that Avista's own revenue requirement calculations – inclusive of its request for an increase in ROE to 10.1 percent but without consideration of the Company's proposed attrition adjustment – would indicate a reduction from electric rates being collected in 2014 is warranted.

Ms. Andrews' attrition adjustment was developed, in part, by calculating a five-year Compound Growth Rate in Washington jurisdictional electric Net Plant After Deferred Income Taxes,[10] as calculated and presented within Commission Basis Reports prepared for, and filed with, this Commission. The five-year Compound Growth Rate in Washington jurisdictional electric Net Plant After Deferred Income Taxes was then applied to the June 30, 2013 historic test year end-of-period "restated" Net Plant After Deferred Income Taxes valuation that Avista had calculated in the development of its "traditional" adjusted historic test year cost of service presentation. Because Ms. Andrews was attempting to develop projected Net Plant After Deferred Income Taxes for the 2015 "rate effective" period, occurring two years beyond the "restated" June 30, 2013-ending historic test year rate base valuation time frame, the five-year annual historic

[9] On page 10 of Exhibit No. EMA-4, within the column entitled "Prior to 2014 Revenue Subtotal" Avista reflects needed rate relief of $32,254,000. Within the column entitled "Revenue Normalization 2014" Avista reflects $14,054,000 of rate relief that became effective on January 1, 2014. Thus, in the last column entitled "FINAL REV REQ TOTAL" Avista reflected the net increase of $18,201,000 being sought in this proceeding above "temporary" 2014 rates currently being collected.

[10] Net Plant After Deferred Income Taxes was calculated by considering Plant in Service less Accumulated Depreciation and plant-related Accumulated Deferred Income Taxes.

average growth rate was "compounded" for two years to derive Ms. Andrews' proposed 2015 electric operations adjusted Net Plant After Deferred Income Taxes rate base valuation.

Ms. Andrews also developed five-year Compound Growth Rates for expenses grouped into three very large categories. More specifically, Ms. Andrews developed a five-year Compound Growth Rates for operation and maintenance expense--excluding production expenses which were separately addressed in the development of Avista's proposed power supply costs. Additionally, Ms. Andrews developed a five-year Compound Growth Rate for depreciation expense as well as five-year Compound Growth Rate for Taxes Other Than Income Tax expense. While Ms. Andrews developed – utilizing five years of historic experience - an annual Compound Growth Rate for non-power supply operation and maintenance (O&M) expense of 7.86 percent, she nonetheless assumed an annual non-power supply operations and maintenance escalation rate of 4.0 percent. According to Ms. Andrews' testimony, the 4.0 percent escalation rate - rather than the annual Compound Growth Rate derived from five years of historic experience - was applied to "restated" non-power supply O&M expense "to reflect the recent cost-cutting measures implemented by the Company, and the expectation that Avista will manage the growth in these expenses to a lower level in future years."[11]

[11] Exhibit No.EMA-1T, p. 23.

Q: Please continue with your understanding of Ms. Andrews' development of an electric operations attrition adjustment.

A: Ms. Andrews also developed a five-year Compound Growth Rate for miscellaneous Other Revenues that she applied to restated historic test year Other Revenue amounts.[12] However, for development of 2015 "rate year" revenues resulting from traditional retail energy sales, Ms. Andrews employed the Company's current revenue model--or what I understand to be the billing determinants model underlying the Company's 2015 revenue budget.

To summarize, historic test year "restated" expenses other than expense components considered in the development of Avista's power supply cost adjustment, historic test year "restated" Other Revenues, as well as "restated" end-of-period Net Plant After Deferred Income Taxes were all escalated by considering five-year Compound Growth Rate percentages 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 2015 revenue model. The revenue requirement that Avista calculated utilizing a traditionally-developed June 30, 2013-ending historic test year cost of service that considered "restated" and "proformed" operating results was then subtracted

[12] For cost of service components valued at, or annualized to, the end of the historic test year (i.e., June 30, 2013) Avista applied a two-year compounded escalation factor to consider mid-2015 cost levels. For cost of service components that were not annualized to, or valued at, the end of the historic test year, Avista

from the revenue requirement derived by considering the attrition calculations described above to arrive at Avista's proposed electric operations attrition adjustment of approximately $33 million.

Q: Was Ms. Andrews' trend-driven calculations, in conjunction with 2015 budgeted sales data, the only evidence offered by Avista in support of its electric operations attrition adjustment?

A: No. Ms. Andrews also sponsors four adjustments to incorporate post test-year events and conditions expected to occur through the 2015 rate year. These additional proforma adjustments purportedly serve as a "cross check" to Ms. Andrews' attrition study. The four "cross check" adjustments presented by Ms. Andrews include the following:

- The annual revenue requirement impact of planned capital additions from the end of the historic test year through the end of calendar year 2013 *excluding distribution plant associated with connecting new customers*[13] as well as related changes to Accumulated Depreciation and Accumulated Deferred Income Taxes estimated through the end of 2013.[14]
- The annual revenue requirement impact of 2014 planned capital additions *excluding distribution plant associated with connecting new customers* as

applied a two-and-one-half year compounded escalation factor to consider growth from the mid-point of the historic test year (December 31, 2012) through the mid-point of the 2015 rate year (June 30, 2015).

[13] Avista excluded in all of its "cross check" adjustments for post-test year plant additions distribution plant projects constructed to serve new customers.

[14] Avista Electric Operations Proforma Adjustment 4.00.

well as related estimated changes to Accumulated Depreciation and Accumulated Deferred Income Taxes.[15]

- The annual revenue requirement impact of 2015 planned capital additions *excluding distribution plant associated with connecting new customers* as well as related estimated changes to Accumulated Depreciation and Accumulated Deferred Income Taxes.[16] It is noted that for the 2015 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.
- The annual revenue requirement impact of estimated "lost margins" calculated to be associated with energy savings attributable to the Company's DSM program.[17]

The annual revenue requirement impact of the four "cross check" adjustments sponsored by Ms. Andrews, when added to Avista's calculated historic test year Washington retail cost of service adjusted for traditional "restating" and "proforma" expense adjustments, summed to within $61,000 of the mostly trend-driven attrition adjusted revenue requirement calculated by Ms. Andrews. Ms. Andrews therefore posts one additional "cross check" attrition adjustment in the amount of $61,000 to simply force the revenue requirements generated from the

[15] Avista Electric Operations Proforma Adjustment 4.01.
[16] Avista Electric Operations Proforma Adjustment 4.02.
[17] Avista Electric Operations Proforma Adjustment 4.03.

sum of the four other "cross check" adjustments to equal the revenue requirement amount calculated by considering the trend-drive attrition adjustment.[18] Again, according to Ms. Andrews and the Company, the four "cross check" adjustments demonstrate the reasonableness and validity of the Company's trend-drive attrition adjustment.

Q: Did Avista employ a similar approach in developing an attrition adjustment for its Washington retail gas operations?

A: Yes, Avista employed a virtually identical approach in developing an attrition adjustment for its Washington gas operations. As with electric operations, Avista relied upon five-year historic Compound Growth Rates experienced for Net Plant After Deferred Income Taxes, O&M expenses excluding purchased gas costs, Taxes Other Than Income, and Other Revenues to be applied to historic test year "restated" balances. Also as with electric operations, Avista employed a lower 4.0 percent O&M escalation rate rather than utilizing the five-year Compound Growth Rate experienced for non-gas cost O&M expense of approximately 7.5 percent. For gas operations, $5.2 million of the total requested increase of $12.1 million is attributable to the Company's attrition adjustment.[19]

Q: Did Avista also present "cross check" adjustments to support its trend-driven attrition adjustment?

A: Yes. However, since Avista's gas operations have a revenue decoupling mechanism in place, no "cross check" adjustment to estimate "lost margins" from

[18] Avista Electric Operations Proforma Adjustment 4.04.
[19] As indicated in Avista's response to Public Counsel Data Request No. 023.

energy efficiency initiatives was presented. As with electric operations, the sum of traditional "restating" and "proforma" expense adjustments, plus the three post-test year "Proforma Cross Check Adjustments" did not exactly equal the trend-driven attrition revenue requirements. Accordingly, Ms. Andrews sponsors one additional gas operations "cross check" revenue requirement adjustment in the amount of $429,000 to simply force the sum of the traditional restating, proforma and the three other "cross check" adjustments to equal Avista's requested trend-drive attrition adjustment.[20]

B. Results Observed Following Implementation of Avista's Existing Attrition-Derived Rates.

Q: Avista's Washington electric and gas operations rates resulting from the stipulation approved in Avista's 2012 GRC became effective on January 1, 2013. As you have noted, the Commission clearly recognized that the stipulated rates had some significant, albeit unstated and unquantified, allowance for an attrition adjustment. What financial results were achieved in 2013 – the first full year in which attrition-derived rates were in effect?

A: Avista has filed Commission Basis Reports (CBR) for its Washington retail electric and gas operations for 2013. As shown on Table 1 below, overall Avista realized returns that are close to returns that were stated to be targeted in the prior case stipulation.

[20] The Company's gas operations adjustment posted for force the sum of restated and proforma adjustment to equal its attrition-derived increase is adjustment 4.03.

Table 1 **Avista Washington Retail Electric and Gas Operations** **Actual Versus Targeted Returns** Source: Response to PC-095-Revised			
Washington Retail Operations	Actual Earned Return on Equity	Targeted Return on Equity in Prior Case Stip	Actual Over/ (Under) Target
- Electric	9.9%	9.8%	0.1%
- Gas	7.2%	9.8%	(1.6%)
- Overall	9.5%	9.8%	(0.3%)

Q: Given regulatory returns earned, can one conclude that the first year of the two-year rate plan achieved the goals of addressing under earnings experienced in recent year?

A: Upon first impression, achievement of returns noted on Table 1 might suggest a "Goldilocks" outcome – with not too much, not too little, but just about the right amount of rate relief. Further, the Company now recommends a net $18.2 million increase over 2014 electric rates – or an amount just slightly higher than the annual increases granted pursuant to the 2012 stipulation for years 2013 and 2014 - with continuing employment of an attrition adjustment fashioned largely after the Company's attrition adjustment presented in its 2012 GRC application. The fact that the Company's 2015 electric operations requested rate relief is somewhat in line with that granted for years 2013 and 2014 might also suggest that the trending approach underlying the Company's attrition adjustment is working and quite precise. However, a closer a look at recent Company decisions to accelerate utility capital expenditures suggests it is appropriate for this Commission to reconsider this approach to developing retail rates.

Q: Please explain.

A: In its current application, as well as within its 2012 GRC application, Avista has consistently indicated that its earnings erosion – or inability to earn its targeted or authorized rate of return - was primarily impacted by its significant utility capital expenditures program. Company witness Mr. Scott Morris states within his direct testimony filed in this proceeding that "[t]he increase in overall costs to serve customers is driven primarily by two major factors: 1) the continuing need to replace and upgrade the facilities and technology we use every day to serve our customers and 2) low revenue growth." In Avista's 2012 proceeding, the Company provided testimony by Mr. Morris, Mr. Kelly Norwood and Dr. Mark Lowry all emphasizing to varying degrees that utilities nationwide generally need – and Avista specifically needs – to replace and upgrade utility infrastructure that was decades old. According to all the noted testimonies, the inability to realize targeted returns was most significantly impacted by the UTC's employment of an historic test year, and more importantly, employment of an historic test year that was developed by valuing rate base by considering an average-of-monthly-averages of the various rate base components. According to Company testimonies, high capital expenditures, in combination with historic test year rate making that employed AMA rate base development, was creating significant regulatory lag that was thwarting Avista's ability to earn its targeted rate of return.

However, in the third quarter of 2013, several months following implementation of new Washington retail rates that were developed by considering a significant attrition adjustment, Avista began *increasing* its capital expenditures program *above that it had presented in the 2012 GRC*. Specifically, as reflected on Table 2 below, a comparison of Avista's utility capital expenditures plans for years 2013 through 2016 as forecasted at the time of its 2012 GRC versus what is being forecasted in the timeframe of the current GRC reveals just how dramatically Avista has increased construction expenditures following implementation of Washington retail rates that embodied a large attrition adjustment.

[Begin Confidential]

Table 2
Capital Expenditures Forecast – 2012 GRC Forecast Versus Current 2014 GRC Forecast ($ millions)

Year	**2012 GRC Forecast[21]**	**Current 2014 GRC Forecast[22](2013 amount shown is actual Cap X)**	**% Increase – Current 2014 GRC Versus 2012 GRC**
2013	[redacted]	[redacted]	[redacted]
2014	[redacted]	[redacted]	[redacted]
2015	[redacted]	[redacted]	[redacted]
2016	[redacted]	[redacted]	[redacted]
Sum Years 2013 thru 2015	[redacted]	[redacted]	[redacted]
Sum Years 2013 thru 2016	[redacted]	[redacted]	[redacted]

[End Confidential]

Thus, while Avista's Washington electric operations marginally exceeded the targeted ROE of 9.8 percent and combined Washington electric and gas

[21] Amounts reflected in this column represent Avista's utility capital expenditures forecast provided in response to data requests from Dockets UE-120436 & UG-120437 (PC_DR_121C Confidential Attachment C.xlsx). Public Counsel refers to PC_DR_121C from the 2012 general rate case with Avista's consent.
[22] Amounts reflected in this column were provided in response to PC Data Request PC_DR_065C Confidential Attachment A. Amount for 2013 reflects Avista's actual 2013 utility capital expenditures. Amounts shown for years 2014 – 2016 reflect Avista's current forecast for utility capital expenditures.

operations marginally fell short of the targeted ROE of 9.8 percent, such return results were realized in 2013 when Avista increased utility capital expenditures by **[Begin Confidential** [redacted] **[End Confidential]** over what had been forecasted in 2012. By way of "cross check" adjustments similar to what Avista presented in this proceeding, Avista's capital budget for calendar year 2013 indirectly supported its attrition adjustment proposed in the 2012 GRC for "rate year 2013."

Q: Would Avista's request for additional rate relief in 2015 in this proceeding be impacted by the significant increase in capital expenditures now forecasted for years 2014 and 2015 versus what Avista was forecasting for years 2014 and 2015 in its 2012 GRC?

A: No, or certainly not directly. It should be remembered that Avista's attrition adjustment for Net Plant After Deferred Income Taxes, Depreciation Expense, Taxes Other Than Income, and Other Revenues is developed by applying the five-year Compound Growth Rate experienced for each noted cost of service component for the period 2007 through 2012. Thus, in theory Avista could have increased its 2013 – 2015 capital expenditures forecast by 40 percent or lowered its 2013 – 2015 capital expenditures forecast by 40 percent from that which it was predicting in 2012 – and its attrition adjustment being presented in the current case would remain exactly the same amount. However, if Avista had not significantly increased its 2013 – 2015 forecast of capital additions from that predicted in the 2012 GRC, the sum of the Company's "Pro Forma Cross Check" adjustments would not have "checked out" or demonstrated the reasonableness of its trend-drive attrition adjustment being recommended in this proceeding. More specifically, as described in earlier testimony, the Company's "Pro Forma Cross Check" adjustments sum to an amount that is almost identical to its attrition adjustment that support its rate request in the current proceeding. Thus, undoubtedly if Avista were to substitute the much lower 2013 – 2015 capital expenditures forecast provided within the 2012 GRC when developing its "Pro Forma Cross Check" adjustments in the instant case, the sum of its "Pro Forma Cross Check" adjustments would have revealed that its current attrition adjustment is significantly overstated.

The other items to appropriately consider when reviewing Avista's request for an electric operations annual increase of $18.2 million in this proceeding is that such increase was calculated by considering 1) a higher return on equity than was stipulated to in the 2012 GRC, and 2) a new methodology for valuing rate base that has the impact of increasing Avista's rate base request in this case compared to what was presented in the 2012 GRC.

Q: Please expand upon why it is appropriate to consider the two noted items when evaluating Avista's attrition request in this proceeding.

A: In the 2012 GRC, this Commission approved the stipulation that specifically embodied a 9.8 percent ROE. In this case Avista is recommending a ROE of 10.1 percent. The impact of the Company's requested increase in ROE, calculated by considering the Company's electric and gas operations rate base request, is to increase the Company's electric and gas operations requested increase by approximately $3.3 million and $.6 million, respectively.

The Company is also requesting, for the first time in this proceeding, to include in rate base valuation pensions/post-retirement benefits liabilities and associated regulatory assets, as well as all Accumulated Deferred Income Tax balances related to such pensions/post-retirement benefits liabilities and regulatory assets.[23] The impact of such new methodology for valuing rate base is to increase Avista's electric and gas operations requested rate relief by approximately $1.6 and $1.0 million, respectively. Thus, but for Avista's request for a higher ROE and a new methodology for valuing rate base, Avista's requested increase – all other items held constant – would be reduced to approximately $13.3 million and $11.1 million for electric and gas operations, respectively. In other words, if such Company proposals are stripped out of the Company's overall request in this proceeding, the "remaining" electric and gas operations increases calculated to be occurring as a result of "cost changes" since the 2012 GRC are less significant.

Q: In an earlier answer you suggested that whether Avista had increased or decreased its capital additions forecast from that provided in the 2012 GRC, its attrition adjustment would remain the same in the instant case even though its "Pro Forma Cross Check" adjustments would no longer support the same attrition adjustment. Is the fact that the Company's "Pro Forma Cross Check" adjustments closely approximate its attrition adjustment request to be expected?

[23] Exhibit No. EMA-1T, pp. 38 and 67.

A: Yes, given the way the Company chose the period to calculate a Compound Growth Rate to be applied to test year "restated" operating results. Specifically, as indicated from the quotation below taken from Ms. Andrews' testimony filed in this proceeding, the Company essentially chose the historic study period that supports its now accelerated capital expansion program underlying its "Pro Forma Cross Check" adjustments:

> The Company chose to use the five-year Compound Growth Rate of 2007-2012. Inspecting the results, it can be seen that the growth in cost categories, such as depreciation expense and net plant, has tended to be higher since 2007. Based on the Company's plan for higher capital expenditures in future years, it is appropriate to use the compound annual growth rates for the 2007-2012 period for rate base and depreciation expenses.[24]

In effect, the Company reflects "Pro Forma Cross Check" adjustments to test the supposed reasonableness of its massive attrition adjustments that are most significantly impacted by trend-driven rate base growth. Yet, the trend period employed to develop the Company's attrition adjustment were specifically chosen to consider "the Company's plan for higher capital expenditures in future years." In effect, the Company's "Pro Forma Cross Check" adjustments provide no independent assessment of the reasonableness of its attrition adjustment. Rather, the Company's cross check adjustments merely demonstrate that Avista very accurately picked an historic trend period that supports the construction program Avista would like to embark upon.

[24] Exhibit No. EMA-1T, p. 23.

Q: Do you know of any other considerations that impact the reasonableness of employing the trend period of 2007 through 2012 to calculate a Compound Growth Rate to apply to Net Plant After Deferred Taxes?

A: Yes. The 2007 through 2012 timeframe includes a period of time when Avista increased its capital budget to catch up for projects that were postponed for calendar years 2000 through 2005. Specifically, in response to a Staff data request, Avista stated the following addressing a question surrounding why general plant in service additions were relatively flat between 2005 and 2006:

> Between 2000 and 2005, Avista was responding to adverse conditions that included a drought and an increase in costs to provide electricity from alternate sources to hydro-generation. This included buying power from external sources. During this time Avista chose a lower capital budget, which would maintain the reliability of our power grid, but postponed some capital investments. From 2006 to 2012, Avista increased its capital budget to address projects that were postponed.[25]

Thus, not only has Avista chosen an historic trend period to match the capital expenditures program it wants to embark upon, the historic trend period it has chosen included to some significant degree “accelerated” capital expenditures to catch up for capital projects that had been postponed for a period of years preceding the historic trend period chosen to calculate the Compound Growth Rate escalator to be applied to test year “restated” values.

[25] Quotation taken from Avista’s response to Staff Data Request No. 092 that has been affixed to this testimony in its entirety as Exhibit No. JRD-4C.

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Q: What is the revenue requirement impact of the *increase* in Avista's forecasted capital expenditures program for the 2013 through 2015 time frame that has been implemented since Avista's 2012 GRC?

A: Inasmuch as the forecast for capital expenditures for years 2014 and 2015 was never provided on a utility-operations or state-jurisdictional basis in the 2012 GRC, one cannot know the answer to that question with certainty.[26] However, clearly the impact of increasing its capital expenditures program is causing the purported need for rate relief in this proceeding to be significantly increased. Specifically, as derived from forecasted total company capital expenditures shown on Table 2 above, Avista increased planned expenditures for the 2013 through 2015 time frame by **[Begin Confidential]** [redacted] **[End Confidential]** million since the 2012 GRC.[27] Applying a conservatively low estimate of 12.0 percent to consider return, related federal income taxes, and depreciation to such 2013 - 2015 *increase* in capital expenditures, one can estimate that in excess of **[Begin Confidential]** [redacted] **[End Confidential]** million in total company revenue requirements is associated with Avista's decision to increase its capital expenditures program since the 2012 GRC.[28] Again, since Avista never provided

[26] This conclusion was also confirmed through Avista's response to Public Counsel Data Request No. 201 wherein Avista was requested to recalculate its "cross check" forecasted plant addition adjustments based upon its forecast prior to the recent decision to accelerate its capital expenditures program.
[27] Projected utility capital expenditures for the 2013 – 2015 time frame provided in the 2012 GRC was **[Begin Confidential]** [redacted] **[End Confidential]** million. Avista's forecasted 2014 and 2015, as well as 2013 actual capital expenditures total to **[Begin Confidential]** [redacted] **[End Confidential]** million, resulting in a **[Begin Confidential]** [redacted] **End Confidential**] million increase in forecasted utility capital expenditures for the 2013 – 2015 timeframe from that projected at the time of Avista's 2012 GRC.
[28] Public Counsel is recommending a before-tax cost of capital in this proceeding of 9.7 percent. Adding an assumed composite annual plant depreciation rate of 2.3 percent one can arrive at a "conservatively low estimate of 12.0 percent to consider return, related federal income taxes, and depreciation" associated in capital expenditures. Applying the 12.0 percent factor to the assumed **[Begin Confidential]** [redacted] **[End**

a breakdown of its forecasted capital expenditures program between utility operations and jurisdictions in the 2012 GRC, it cannot be determined how much of the **[Begin Confidential]** [redacted] **End Confidential]** million "total company" increase in revenue requirements resulting from its now accelerated construction program can be attributable to Avista's Washington electric or gas operations. But, given that Avista's Washington electric and gas operations represent approximately two-thirds of Avista's total electric and total gas operations, undoubtedly the majority of the **[Begin Confidential]** [redacted] **End Confidential]** million "total company" revenue requirement increase attributable to Avista's plan to accelerate or expand its capital expenditures program will ultimately be assigned to Avista's Washington electric and gas operations.

Q: Has Avista explained or defended its decision to significantly accelerate its construction program?

A. According to the testimony of Mr. Mark Thies, the three primary drivers of the need to increase Avista's level of capital investment include:

- The business need to fund a greater portion of the departmental requests for new capital investments that in the past have not been funded
- The need to capture investment opportunities and benefits identified by Avista's asset management capabilities, and

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Confidential] million total increase in capital expenditures, one arrives at the estimated annual revenue requirements associated with such increase in capital expenditures of **[Begin Confidential]** [redacted] **[End Confidential]** million – or "in excess of $25 million."

- A continued focus on controlling the increase in operations and maintenance spending through prudent capital investment.

Additionally, according to Mr. Thies' testimony, Avista has chosen to accelerate its capital spending at this particular time to take advantage of near all-time lows in interest rates – and thus avoiding future increases in interest rates and inflation. Finally, Mr. Thies acknowledges that Avista does not currently have a need for new capacity and energy resources that would otherwise put upward pressure on retail rates.[29]

Q: When Avista's Board of Directors considered the accelerated capital expenditures program that the Company has now embarked upon, was it presented with the same considerations that Mr. Thies' testimony describes as being instrumental in the decision to increase capital spending?

A: In response to Public Counsel Data Request No. 22, Avista provided excerpts of the pertinent pages from draft presentations among officers and presentations made to the Board of Directors. The response to Public Counsel Data Request No. 22, as well as Confidential Attachment A to Public Counsel Data Request No. 22, have been affixed to this testimony as Exhibit No. JRD-5C. **[Begin Confidential]** [redacted]

[redacted]

[redacted]

[29] Exhibit No.MIT-1T, pp. 6 and 7.

[redacted]

[End Confidential]

Q: Does the presentation to the Board of Directors contradict any claims or statements made in Mr. Thies' or any other Avista witnesses' testimony regarding the reasons the Company elected to embark upon the accelerated construction program at this particular point in time?

A: Nothing in the presentation directly contradicts any testimonial claims made regarding implementing the accelerated capital expenditures program at this time. **[Begin Confidential]** [redacted] **[End Confidential]**

Q: Are you suggesting that Avista's decision to accelerate its capital expenditures program are imprudent?

A: No. To make such a determination would likely require an extensive and expensive management audit outside the confines of a rate case procedural schedule.

VI. AVISTA'S ATTRITION ADJUSTMENT SHOULD BE REJECTED AND OTHER MECHANISMS TO ADDRESS REGULATORY LAG SHOULD BE ADOPTED

Q: Given your observations, what are your specific recommendations regarding the development of Avista's Washington retail base rates in this proceeding and at least for the short term future?

A: My specific recommendations for the development of Avista's rates in this proceeding, and for the ensuing approximate two year period, include:

- Avista's attrition adjustment proposed for both its electric and gas operations should be rejected.
- However, to address concerns of regulatory lag, potential earnings erosion, and the strain of nearly continuous annual general rate cases, I further recommend:
    - Rates established in this proceeding should be developed by valuing rate base utilizing end-of-test-period balances for Net Plant After Deferred Income Taxes.
    - An adjustment to reflect a post-test year update for growth in Net Plant After Deferred Income Taxes through March 31, 2014 should also be adopted to reduce regulatory lag from the cost measurement period to the rate effective period.
    - Avista should be permitted to file two Expedited Rate Filings before being required to make a GRC filing to further increase base rates. As I shall explain in more detail in ensuing testimony,

there should be relatively few restrictions in the timing of ERFs or test years to be employed so as to allow Avista maximum flexibility in making such filings, which in turn, should permit the Company to minimize regulatory lag and potential earnings erosion.

Q: Are you effectively recommending that this Commission reconsider its willingness to approve attrition adjustments?

A: Yes. I am respectfully requesting that this Commission reconsider its use of attrition adjustments, and instead, utilize a number of tools available to it in its regulatory tool box that have not been fully utilized.

Q: Please expand upon why you believe it is appropriate for this Commission to reconsider its recent actions of adopting an attrition adjustment, and instead, adopt your alternative proposals to address regulatory lag.

A: First, I realize this rate application essentially provides the first report card on the UTC's recent adoption of an attrition adjustment. It is admittedly a relatively short period of time that includes results for only one Washington energy utility. However, Avista's recent earnings experience, and its decision to accelerate its construction program at this time strongly suggest that, but for accelerating its construction program and selectively choosing a trend-period to support its now accelerated construction program, and asking for a higher ROE, Avista could not support maintaining existing 2014 electric operations rates currently in effect – much less support any type of increase in electric rates in 2015 above such existing "temporary" 2014 rates in effect. Such results suggest that it is reasonable for this Commission to reconsider adoption of attrition adjustments in the establishment of base rates at this time.

Second, I submit that ultimately arriving at a one-size-fits-all attrition adjustment approach will be very challenging. Further, notwithstanding this Commission's statement that it intends to address the "appropriate methodology to use in preparing attrition studies,"[30] it is possible that it may ultimately elect to adopt differing approaches to developing attrition adjustments on a case-by-case basis. However, I submit that reserving the ability to decide the methodology to develop an appropriate attrition adjustment for each individual situation will be equally challenging and confusing.

Third, utilization of ERFs along with other mechanisms and procedures have not been fully developed and attempted as a means of addressing the concerns of regulatory lag, potential earnings erosions, and the fatigue being experienced as a result of often annual – or nearly annual - GRCs.

To summarize, I respectfully submit that this Commission moved too quickly and too far to address the noted concerns when it adopted the attrition-based stipulation in the 2012 GRC before exploring and adopting ERFs and other regulatory tools. These alternatives still largely adhere to "historic actual" ratemaking principles, but nonetheless represent a progressive solution that provides serious and significant movements to address the noted concerns of regulatory lag, earnings erosions, and GRC fatigue.

[30] *WUTC v. Avista Corporation d/b/a/ Avista Utilities*, Dockets UE-120436 and UG-120437 (*Consolidated*), Order 09 ¶ 77, December 26, 2012.

Q: Please discuss some of the concerns and challenges that you believe will be faced if the attrition adjustment approach continues to be considered or employed.

A: First, the question arises as to what conditions should be present before an attrition is to be considered. As discussed earlier, to date, no inquiry rulemaking docket, or other process has been undertaken to vet the circumstances deemed necessary to exist before an attrition adjustment would be considered. Thus, at this time Avista is proposing another significant attrition adjustment before this Commission has established the criteria for considering an attrition adjustment.

Q: Beyond concerns addressing the circumstances expected to exist before an attrition adjustment is considered, are there significant challenges to developing the methodology to employ when developing an attrition adjustment?

A: Yes. One need not look any further than Avista's proposal in the instant case to be concerned with the array of options that may arise in developing an "appropriate attrition methodology." First, as noted, Avista chose a recent five-year historic period to develop a Compound Growth Rate to be applied to "restated" test year balances of Net Plant After Deferred Income Taxes to derive the "rate year" rate base valuation. As was previously explained, the five-year historic period that was chosen to match or prove the reasonableness of its current accelerated construction also included an accelerated or "catch up" construction program. Growth in non-power supply O&M expense was first evaluated by Avista by considering actual experience for a recent five-year historic period.

However, instead of applying the approximate eight percent (8.0%) annual growth rate experienced for the recent five-year historic period to non-power supply cost O&M expenses, the Company employed its judgment to adopt a lower four percent (4.0%) annual growth rate that reflected the Company's recent cost cutting measures implemented to manage growth in expenses. Finally, for sales or revenue growth, Avista ignored historic growth over any period, choosing instead to reflect billing determinants from its 2015 revenue forecast.

Thus, in this particular case, Avista has selected a specific historic trend period to purportedly demonstrate the reasonableness of its accelerated construction program, chosen a non-power supply escalation rate to match its cost cutting expectations, and reflected its own 2015 forecast for revenues – to arrive at the "appropriate methodology" to derive an attrition adjustment. The Company's mix-and-match approach to developing its proposed attrition adjustment should reveal the significant challenges this Commission will face when it attempts to provide guidance as to an appropriate methodology in deriving an attrition adjustment.

Q: Please continue by describing in more detail the various processes and procedures you are recommending in this proceeding to address regulatory lag.

A: First, I am recommending that Avista's electric and gas operations rate base valuation for Net Plant After Deferred Income Taxes be established by considering end-of-historic-test year balances. Or more specifically, I am supporting Avista's electric operations Adjustment No. 2.17 and Avista's gas operations Adjustment No. 2.15 – both of which have been proposed to restate Net Plant After Deferred Income Taxes from an AMA rate base valuation to an end of historic test year basis. These adjustments also incorporate the annualization of depreciation expense based upon end of test year Plant in Service value. Public Counsel has endorsed these types of end-of-period (EOP) rate base/depreciation expense adjustment in the last Avista and PacifiCorp GRCs, as well as within the Puget Sound Energy ERF made in early 2013. While adoption of such Company-proposed EOP adjustments might appear to be relatively minor concessions today, it should be remembered that prior to 2012, EOP rate base valuation had typically been rejected by this Commission in favor of AMA valuation. Inasmuch as EOP rate base valuation shortens the period between cost measurement and the rate effective period by approximately six months from that derived with AMA rate base valuation, it represents a significant action to address concerns of regulatory lag.[31]

Second, I am recommending adoption of an "update" adjustment undertaken to value Net Plant After Deferred Income Taxes through March 31, 2014. Additionally, as with the Company's EOP "restating" Adjustment Nos. 2.17 and 2.15 for electric and gas operations, respectively, I am also proposing to adjust depreciation expense by "annualizing" depreciation based upon March 31, 2014 Plant in Service balances. By including Net Plant After Deferred Income Taxes for rate base valuation, and annualizing depreciation based upon March 31,

[31] Under the AMA methodology, rate base is valued at approximately the middle of the historic test year. Thus, by moving from AMA to EOP rate base valuation, regulatory lag associated with the Company's

2014 balances, regulatory lag will have been reduced by nine months from that developed employing EOP historic test year ratemaking principles, and by fifteen months from that developed employing AMA historic ratemaking principles.

Third, I am recommending that Avista be permitted to file, with limited constraints, two ERFs before being required to make a new GRC filing. Without limitations as to what test year to employ, or when it should make such filings, the Company retains maximum flexibility so as to minimize regulatory lag following incurrence of any significant cost increase that cannot otherwise reasonably be expected to be offset by revenue growth.

Q: Why do you view your various proposals to be superior to adoption of an attrition adjustment?

A: Each of my individual proposals, and cumulatively all the proposals together, significantly reduce regulatory lag. Further, by relying upon actual incurred and verifiable costs, the subjectivity, ambiguities and confusion that appears likely to be experienced when an attrition adjustment is employed will be avoided. By utilizing procedures and methodologies that rely upon "actual" investment and expense levels, as well as actual recent sales volumes, many controversies surrounding adoption of attrition adjustments are avoided while regulatory lag is reasonably minimized.

Some additional Staff and intervenor resources can be expected to be deployed to review a utility's ERF. However, so long as the filing is made strictly

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capital expenditures program is reduced by approximately six months.

compliant with past ratemaking principles adopted, and so long as filing requirements are established that minimize the requirements for discovery, such resource and time requirements should be very modest relative to processing a full GRC application.

Q: In previous answers you have frequently characterized your various proposals as "reducing" or "minimizing" regulatory lag. Could your various proposals completely eliminate regulatory lag?

A: It may not be possible in all situations to completely eliminate regulatory lag. However, given the great deal of flexibility being recommended for undertaking ERFs and the next GRC, I would expect any earnings erosion due to regulatory lag to be modest.

Q: Why would you expect earnings erosion resulting from regulatory lag under your various proposals to be modest?

A: Impacts from plant closings or significant expense increases are frequently "lumpy," and the times of their exact incurrence are frequently knowable in advance, or in some instances partially controllable by utility management. For instance, closing a major plant addition, or perhaps a number of plant additions, is known fairly precisely months in advance of completing construction. Thus, the timing of an ERF can be made to minimize the period time between "cost incurrence" and the rate effective period. Similarly, granting annual cost of living and other wage increases typically occur at a particular point in the year. Thus, once again, the timing of an ERF can be planned to minimize regulatory lag for scenarios where growth in revenues does not appear to be fully offsetting growth in cost to serve.

Another fact to remember is that, notwithstanding frequent GRCs in recent years in Washington, growth in cost to serve (return on investment plus expense recovery) does not always exceed growth in revenues for all years or for all months of a given calendar year. For instance, last year I participated in a GRC in Nevada wherein a regulated electric utility filed for a rate reduction and in which the Public Utilities Commission of Nevada ordered an even larger rate reduction than the utility had recommended.[32] Further, even for utilities that have been experiencing a need for annual, or nearly annual, base rate relief, such utilities sometime experience months within a given twelve month period where Net Plant After Deferred Income Taxes declines for a period of time before again resuming a year-over-year increase. Such partial year reduction in rate base valuation sometimes occurs as seasonal construction additions slow while growth in the Accumulated Depreciation Reserve and Accumulated Deferred Income Taxes continue – thus resulting in a rate base decline for a portion of a given twelve month period. With maximum flexibility to file ERFs, Avista as well as other Washington utilities could time such filings to capture the EOP rate base valuation at peak before any mid-annual-period decline that might occur, and

[32] In Docket No. 13-06002 Sierra Pacific Power Company filed for an electric operations rate reduction of $9.4 million, and by order issued on December 16, 2013 the PUCN reduced rates by $37.1 million. The application was required to be made pursuant to statute. In the absence of the statutory requirement to make a filing, it is highly unlikely that Sierra Pacific Power Company would have filed for a rate change at a time that it was experiencing electric operations over earnings.

effectively minimize, if not eliminate earnings erosion resulting from disproportionate rate base growth.

Finally, I am aware that this Commission, as well as commissions around the country, sometimes considers utility applications to obtain an accounting authority order (AAO) to defer for future recovery costs that would otherwise be immediately charged to operations. While I am not encouraging use of AAOs to address regulatory lag, it should be recognized that such mechanism is an option for a utility to request, and for this Commission to consider authorizing, when the utility is facing a unique and significant cost event that might create earnings erosions even with the flexible ERF plans being recommended herein.

Q: In prior periods, has this Commission as well as the Staff ascribed to the theory that a degree of regulatory lag provides incentives for regulated utilities to invest and operate efficiently?

A: Yes. In PSE GRC Dockets UE-111048 and UG-111049, Mr. Ken Elgin appearing on behalf of Staff first advocated in direct testimony employment of an ERF as an appropriate mechanism to address regulatory lag and earnings erosions. In such testimony Mr. Elgin also included the following conclusions regarding regulatory lag:

> **Q: Are the effects of attrition and regulatory lag always "bad"?**
>
> A: No. Regulatory lag should inspire utility managers to control costs aggressively to achieve the lowest reasonable cost of service, which is a good thing for both the utility and its rate payers. Attrition caused by increasing construction budgets also should inspire utility management to carefully evaluate capital budgets and approve only those projects absolutely necessary. I mentioned this earlier in my testimony when discussing the Commission's

> decision to reject future test periods based on budgets. This incentive also is consistent with the *Bluefield* and *Hope* standards regarding efficiency and our statutes governing the obligation of a public service company to keep its facilities safe, adequate and efficient.[33] Finally, the Commission has recognized that historical test periods and regulatory lag are self-regulating mechanisms that provide the proper incentive for utilities to control costs. [34]

Further, in a 2009 GRC order, this Commission observed that some degree of regulatory lag "motivates PSE and other utilities subject to our jurisdiction to carefully manage their costs and revenues moving forward."[35]

In summary, the cumulative impact of the various rate proposals I am recommending should significantly minimize regulatory lag, though it may not totally eliminate regulatory lag in each situation or scenario. But, for reasons recently discussed by Staff as well as this Commission itself – with which I fully agree – exposure to a degree of regulatory lag can "provide the proper incentive for utilities to control costs."

VII. PROPOSED CONDITIONS TO BE IMPOSED WHEN AN EXPEDITED RATE FILING IS UNDERTAKEN

Q: You recommend that Avista be authorized to undertake Expedited Rate Filings to address regulatory lag. Please summarize the major conditions you are recommending as necessary for an appropriate ERF filing.

[33] RCW 80.28.010(2).
[34] Dockets UE-111048 and UG-111049; Exhibit No. KLE-1T, p. 70.
[35] *WUTC v. Puget Sound Energy*, Dockets UE-090704 and UG-090705, Order 11, at ¶ 23 (April 2 2010).

A: I am recommending that the following conditions and/or filing requirements be adopted for any ERF mechanism to be approved for Avista:

- Avista should be required to calculate and post *all restating* adjustments adopted by the WUTC in its last general rate case order prior to the ERF proceeding. The calculation and posting of all restating adjustments should be a filing requirement of any ERF application, and the filing should be made with all supporting spreadsheet files provided at the time of the filing. Further, the ERF should be developed by including the ROE authorized by the Commission in this GRC. Finally, rates should also be developed by adhering to class cost of service and rate design principle adopted by the Commission in this GRC.
- Avista should be required to provide evidence that a reasonable effort has been undertaken to identify, quantify, and eliminate from the ERF test year cost of service material abnormal, non-operating and non-recurring transactions.
- Revenue relief to be granted through the ERF process should be limited to no more than three percent above existing base rates.
- Avista should be permitted to file an ERF utilizing a non-calendar test year with no restriction as to the earliest date that such filing could be made.

- Avista should be permitted to undertake two ERF filings before being required to make a GRC filing to further increase base rates. During any ERF proceeding the Company would be prohibited from filing a general rate case.

I would note that the conditions set forth above are consistent with Public Counsel's recommendations regarding ERFs in the most recent PacifiCorp GRC – Docket UE-130043.

Q: Please continue by explaining the need for your first condition when undertaking an ERF application – namely, that Avista should be required to calculate and post *all* restating adjustments adopted by the WUTC in its last general rate case order.

A: The need for, and propriety of, such requirement should be obvious. In the context of an expedited rate proceeding, a goal should be to arrive at a relatively simple and non-controversial cost of service presentation that adheres to past Commission precedent regarding allowable costs for rate recovery. As such, it is equitable, and indeed necessary, to consider restating adjustments.

Basically, the "exchange" that occurs with an ERF application is that the utility receives very accelerated review and implementation of requested rate relief while Staff and interested intervenor parties can expect a "clean" filing that reflects no new theories, arguments or approaches in developing rates, but rather, reflects *all* and *only previously UTC approved* restating adjustments. The utility may not necessarily agree with restating adjustments adopted in the previous

GRC, but nonetheless would be expected to post *all* such adjustments in exchange for accelerated rate relief with presumed limited need for discovery. Conversely, of course, Staff and intervening parties may also not agree with all previously approved restating adjustments. But again for purposes of processing an ERF, would forego the right to suggest new arguments in opposition to restating adjustments most recently approved in a GRC order, and would forego the right to suggest or recommend new restating adjustments. To be clear, all parties would always be permitted to oppose previously approved restating adjustments or propose new restating adjustments in the context of Avista's next GRC. However, such positions just could not be advocated in the context of an ERF application.

Q: Could a negotiated general rate case settlement create concern or confusion in a subsequent ERF proceeding?

A: Yes. In a black box settlement, or a settlement that was reached without delineating how the various parties or the Commission arrived at the agreed upon increase, there will not be a trail as to what restating adjustments were considered in the settlement. Similarly, there may or may not be a stated cost of capital, and there may not be a trail as to which jurisdictional or class cost of service allocation factors or procedures were envisioned with the settlement. Accordingly, it is imperative that, at a minimum, any negotiated settlement set forth elements as to what cost of capital, what jurisdictional allocations, and what restating adjustments were assumed in arriving at the settlement increase. Without such findings set forth, it is difficult to envision how any number of controversies could be handled expeditiously or avoided within an ERF proceeding.

Q: Please continue by discussing the need for your second condition that with any ERF application Avista should be required to provide evidence that a reasonable effort has been undertaken to identify, quantify, and eliminate from the ERF test year cost of service material, abnormal and non-recurring transactions.

A: This recommendation represents a filing requirement intended to streamline and assist in expediting the review process. It is intended to provide at least modest assurances that the ERF test year has been appropriately adjusted to reflect normal and ongoing conditions.

Q: Are Commission Basis Reports required to eliminate material abnormal and non-recurring events or items?

A: Yes. As required by WAC 480-100-257 (1) (b), a Commission Basis Report (CBR), which is intended to become the underlying ratemaking vehicle in the ERF process, must include:

> Results of operations adjusted for any material out-of-period, nonoperating, nonrecurring, and extraordinary items or any other item that materially distorts reporting period earnings and rate base.

Thus, any utility making a CBR filing is already expected to eliminate material extraordinary and nonrecurring events and transaction. Therefore, my second recommended ERF condition is simply a filing requirement that would have Avista provide evidence demonstrating that it had undertaken a review, search or audit to identify and quantify for removal of any material out-of-period, non-operating, nonrecurring and extraordinary items when preparing its CBR. Since the identification and quantification tasks are already a CBR requirement, the filing requirement embodied in my second condition should represent a fairly modest effort on the utility's part to simply provide documentation of the processes and exercises undertaken in such identification and quantification effort that would significantly assist in the Staff and intervenors' ERF review efforts.

Q: Please expand upon your third condition that rate relief to be granted through the ERF process should be limited to no more than three percent above existing rates

A: The Commission's rule at WAC 480-07-510 defines a general rate proceeding as a proceeding in which the amount requested would increase a utility's gross annual revenue by three percent or more. Pursuant to the noted rule, when a utility requests an increase in rates of three percent or more through a general rate case it must meet detailed filing requirement. My proposed condition that ERFs be limited to situations wherein a utility is requesting no more than three percent is consistent with WAC 480-07-510, and effectively simply equates to a recommendation that the noted rule remain enforce.

Q: Please state the reasons – beyond merely compliance with WAC 480-07-510 - why an ERF should be limited to three percent.

A: Very simply, the ERF process is a unique process designed specifically to accommodate a shorter and less thorough review. It is intended to address regulatory lag, fairly continuous under earnings, as well as rising rate case costs and rate case fatigue that are a fall out of annual or nearly-annual full blown general rate case reviews. While there may be benefits of the ERF process to consumers as well as utility applicants, implementation of an ERF does nonetheless represent a concession from the consumers' perspective because the typical scrutiny afforded a general rate application is relaxed and diminished. In light of such a concession, I believe it is reasonable that the ERF process be limited to addressing less significant needs for rate relief, or more specifically, that the ERF process should limit the applicant's increases to no more than three percent of existing base rates.

An expedited rate proceeding, by its very nature, is intended to be a limited update of costs with an accelerated review period. If the ERF were to raise rates by three percent or more, by rule, it would constitute a general rate case which would require substantial additional evidence and a comprehensive review by the Commission of earnings, revenues and expenses, including a determination of rate of return, before increasing rates. These requirements are essential to the Commission's duty to regulate utilities in the public interest.

Q: Please expand upon your recommendation that Avista should be permitted to make an ERF utilizing a non-calendar test year, with no restriction as to the earliest date that such filing could be made.

A: Such conditions will provide Avista considerable latitude in the timing of any ERF so as to minimize regulatory lag, and correspondingly, most efficiently address the potential for earnings erosions. While from the ratepayers' perspective this could be viewed as a considerable "concession," I nonetheless believe it is reasonable so long as other conditions I am recommending be applied to the ERF are concurrently adopted. To address the Commission's stated policy goal of breaking the recent pattern of almost continuous rate cases and to explore innovative ways to address a utility's potential earnings erosion, Public Counsel is amenable to the relatively new conventions of 1) end-of-test-year rate base valuation, and 2) Expedited Rate Filings, combined with 3) allowing utilities maximum flexibility in the selection of ERF test years to employ and the timing of ERFs. These concessions have been supported with the condition that rates continue to be established – whether in GRCs or ERFs – utilizing historic test years and actual-incurred and verifiable cost elements properly matched or synchronized with attendant revenue levels to a similar or identical point in time. As evidenced by my recommendations, while continuing to recommend adherence to only considering historic costs in the rate setting process, I am correspondingly recommending processes and procedures that are designed to significantly shorten the time span between cost measurement in the ratemaking process and the effective date of new rates being developed in the various rate setting processes.

Q: Please expand upon your final condition that Avista be permitted to file two ERFs, but that to further increase base rates beyond two ERFs, it should be required to undertake a GRC filing.

A: While my recommended ERF process would result in limitations as to what the utility applicant could include in its rate request, as well as the maximum amount of the request, the process nonetheless will be abbreviated, or expedited, thus limiting Staff and Intervenors' ability to review the utility's practices, procedures and investment decisions more intensively, such as occurs within GRC application reviews. Thus, some limitation as to the number of ERFs to be filed before a more detailed GRC review is undertaken is reasonable and critical. I believe the condition of limiting ERFs to two before requiring a utility to undertake a GRC, when viewed in conjunction with the conditions that a utility should be permitted to file non-calendar ERF test years without a minimum time restriction between ERFs, is balanced and reasonable.

VIII. ADJUSTMENTS RELATED TO PUBLIC COUNSEL'S POSITION REGARDING ATTRITION AND REGULATORY LAG

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, I am opposing the following electric operations proforma adjustments proposed by Avista:

Adjustment Number	Adjustment Description
4.01	Planned Capital Additions 2014 EOP
4.02	Planned Capital Additions 2015 AMA
4.03	DSM (proforma lost margins)
4.04	Reconcile Pro Forma to Attrition

Company electric adjustments 4.01 and 4.02 calculate the revenue requirements associated with budgeted 2014 and 2015 plant additions *other than* distribution plant additions directly associated with customer growth. Adjustment 4.03 estimates annual lost margins attributable to Demand Side Management initiatives. Adjustment 4.04 is merely a "plug" adjustment to force the sum of the Company's "Pro Forma Cross Check" adjustment numbers 4.00, 4.01, 4.02 and 4.03 as well as the Company's various other restating and pro forma expense adjustments to equal the total electric attrition adjustment sponsored by Ms. Andrews.

For gas operations, on behalf of Public Counsel I am opposing the following adjustments proposed by Avista:

Adjustment Number	Adjustment Description
4.01	Planned Capital Additions 2014 EOP
4.02	Planned Capital Additions 2015 AMA
4.03	Reconcile Pro Forma to Attrition

As with Avista's electric operations, Company gas adjustment numbers 4.01 and 4.02 calculate the revenue requirements associated with budgeted 2014 and 2015 plant additions *other than* distribution plant additions directly associated with customer growth. Adjustment 4.03 is merely a "plug" adjustment to force the sum of the "cross check" adjustment numbers 4.00, 4.01, 4.02 and 4.02 as well as the Company's various other restating and pro forma expense adjustments to equal the total gas attrition adjustment sponsored by Ms. Andrews.

Q: Please identify the adjustments included within Exhibit No. JRD-2 and Exhibit No. JRD-3 that relate to Public Counsel's position regarding attrition and regulatory lag.

A: The following Public Counsel adjustments are proposed to reflect consideration and measurement of cost of service component changes that were experienced post-test year and closer to the rate effective date.

Table 3
Identification of Public Counsel Post-Test Year Adjustments Offered to Address Concerns of Regulatory Lag

Adjustment No.	Adjustment Description	Exhibit/Schedule Reference
PC-E.2.10 A	Revenue Normalization	Exhibit No. JRD-2, Sch. No. 3
PC-E.3.02	Proforma Non-Labor Expense	Exhibit No. JRD-2, Sch. No. 4
PC-E.3.04	Proforma Employee Benefits Expense	Exhibit No. JRD-2, Sch. No. 5
PC-E.3.05	Proforma Insurance Expense	Exhibit No. JRD-2, Sch. No. 6
PC-E.3.06	Property Tax	Exhibit No. JRD-2, Sch. No. 7
PC-E.4.00 A	Actual Capital Additions March 31, 2014	Exhibit No. JRD-2, Sch. No. 8
PC-G.2.10	Revenue Normalization	Exhibit No. JRD-3, Sch. No. 3
PC-G.3.00	Proforma Non-Labor Expense	Exhibit No. JRD-3, Sch. No. 4
PC-G.3.02	Proforma Employee Benefits Expense	Exhibit No. JRD-3, Sch. No. 5
PC-G.3.03	Proforma Insurance Expense	Exhibit No. JRD-3, Sch. No. 6
PC-G 3.04	Proforma Property Tax	Exhibit No. JRD-3, Sch. No. 7
PC-G 4.00A	Actual Capital Additions March 31, 2014	Exhibit No. JRD-3, Sch. No. 8

Q: Please continue by discussing the adjustments you are proposing for revenue normalization for electric and gas operations.

A: Electric operations Adjustment No. PC-E.2.10 A and gas operations Adjustment No. PC-G.210 A are proposed to reflect annualized net margins resulting from customer growth from the historic test year ending June 30, 2013 through March 31, 2014 – which is the date through which I am proposing to update actual electric and gas operations Plant in Service less Accumulated Depreciation and Accumulated Deferred Income Taxes.

By way of background, I am specifically *supporting* the Company's electric operations Restating Adjustment No. 2.17 and gas operations Restating Adjustment No. 2.15 in consideration of "regulatory lag" and earnings attrition concerns. The Company's electric operations Restating Adjustment No. 2.17 reflects rate base values at June 30, 2013 rather than the historic test year average-of-monthly average balance shown in the starting point Results of Operations presentation. Restating Adjustment No. 2.17 reflects "annualized" depreciation expense associated with such historic test-year end Plant in Service values. Similarly, the Company's gas operations Restating Adjustment No. 2.15 reflects rate base values at June 30, 2013 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.

Additionally, I am specifically supporting the Company's electric operations "Pro Forma Cross Check" Adjustment No. 4.00 Planned Capital Additions Through December 2013 EOP and the Company's gas operations "Pro Forma Cross Check" Adjustment No. 4.00 Planned Capital Additions Through

December 2013 EOP.[36] Further, I am also proposing one additional rate base adjustment for electric and gas operations to reflect actual Net Plant After Deferred Federal Income Taxes balances at March 31, 2014, as well as a corollary income statement adjustment to reflect "annualized" depreciation expense calculated based on March 31, 2014 actual Washington jurisdiction electric and gas operations Plant in Service.

Q: Why do you characterize your acceptance of the noted Company-proposed electric and gas operations restating adjustment numbers 2.17 and 2.15, respectively, as responsive to concerns of earnings attrition and regulatory lag?

A: As previously described in my testimony, valuing rate base employing the Average of Monthly Averages of test year balances of Net Plant After Deferred Income Taxes effectively establishes the rate base valuation in approximately the middle of the historic test year – or in this case, approximately December 31, 2012. Thus, by establishing the rate base valuation for Net Plant After Deferred Income Taxes at June 30, 2013 – or the end of the historic test year, regulatory lag for this cost of service component is reduced by approximately six months.

Q: Please continue your explanation of the electric and gas operations revenue normalization adjustments you are proposing.

[36] As noted elsewhere in testimony, I am proposing an adjustment to update Net Plant After Deferred Income Taxes for actual balances at March 31, 2013. Thus, while I am accepting herein an "estimate" of end-of-2013 balances, any variance between originally-estimated and actual December 31, 2013 balances is effectively eliminated with the update adjustment I propose to reflect March 31, 2014 balances.

A: First, regardless of the test year mechanism employed, an axiom adhered to by regulators is that test year revenues should be measured or calibrated with test year rate base valuation. In cases using AMA rate base valuation, it is unnecessary, and indeed it would be inequitable, to annualize revenues or margins for growth in customers that typically occurred *within and throughout* a given historic test year. However, when test-year-end rate base valuation is employed, it is reasonable and 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 Adjustment 2.10 to normalize test year revenues for electric and gas operations, as well as to adjust revenues for the impact of the January 1, 2013 rate increase that was only in effect for one-half of the historic test year. I do not take exception to the Company's electric and gas operations adjustment calculated to normalize revenues for historic test year weather aberrations as well as to annualize the impact of the January 1, 2013 rate increase granted. However, 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. Additionally, inasmuch as I am updating rate base valuation for Net Plant After Deferred Income Taxes through March 31, 2014, it is also consistent and equitable to annualize margins associated with customer growth through March 31, 2014 so that test year revenues are property matched with the March 31, 2014 updated Net Plant After Deferred Income Taxes valuation. Accordingly, while I have accepted and support the Company's electric and gas operations restating Adjustment No. 2.10 as presented, I also propose a "PC Incremental" adjustment to electric and gas operations to reflect margins associated with customer growth through March 31, 2014. Specifically, Public Counsel's incremental adjustments designated as PC-E.2.10 A and PC-G.210 A are proposed to reflect annualized electric and gas operations margin growth associated with customers added from the historic test year through March 31, 2014. Also reflected as a partial offset to margin growth are corollary adjustments to reflect associated increases in uncollectible accounts expense, WUTC Fees expense, and Washington Excise Taxes. Each noted corollary expense adjustment was calculated in a manner consistent with that proposed by the Company when developing its "Revenue Growth" adjustment, posted as an element of its attrition adjustment, and as reflected on page 4, column (J), of Exhibit No. EMA-2 and Exhibit No. EMA-3 for electric and gas operations, respectively.

Q: Please state how the adjustment to capture growth in customer margins through March 31, 2014 was calculated.

A: As reflected on Schedule No. 3 of Exhibit No. JRD-2 and Exhibit No. JRD-3, I calculated an adjustment to recognize growth in margins from the end of the historic test year through March 31, 2014, by prorating the portion of growth in margins that Avista predicts to occur from the June 2013-ending test year through the 2015 rate year to reflect growth that can be expected to have occurred by March 31, 2014.

Q: Why did you undertake a revenue growth adjustment that relies, in part, upon the Company's 2015 margin forecast?

A. First, in theory the annualization of revenues for customers taking service at the end of a particular month would appear to be straight forward, and consist of the following steps:

- No. of Customer Taking Service at Period End by Rate Class
- Normalized Annual Billing Determinants per Customer by Times Rate Class
- Times Currently Effective Tariff Rates
- Annualized Revenues by Rate Class Associated With Period Equals End Number of Customers

However, two events are occurring with Avista's customer base that cause what should be expected to be a straightforward calculation to be somewhat challenging. First, Avista appears to have some degree of seasonal customers. By "seasonal customers," I am referring to customers who only take service for a portion of the year – or perhaps only one or a few of all the seasons, but completely disconnect their home or business from the utility's distribution system for the remainder of the year. When "seasonality" is experienced, the customer counts, while generally increasing year over year, for certain months of the year actually decline before once again resuming upward growth. Thus, if one were to annualize revenues based upon a high or low month of seasonally-connected customers, the revenue annualization result would likely be somewhat over or under stated, respectively.

Second, some degree of migration between rate classes is occurring. As a result, it is difficult to estimate or calculate annualized billing determinants for customers who have migrated sometime during the historic period being analyzed. The two events noted to be occurring with Avista's customer base combine to make estimating revenues associated with March 31, 2013 number of customers challenging. Accordingly, I undertook a calculation as reflected on Schedule No. 3 of Exhibit No. JRD-2 and Exhibit No. JRD-3 that I believe is reasonable, if not conservative, in deriving an adjustment required to estimate margin growth associated with growth in numbers of customers and usage from the end of the test year through March 31, 2014.

Q: Why do you believe the revenue adjustments you have calculated conservatively estimate margin growth from test year end through March 31, 2014?

A: On Table 4 below, I reflect the percentage growth in customers and normalized sales/throughput occurring between the test year ending June 30, 2013, and the twelve months ending March 31, 2014, for electric and gas operations. Table 4 also reflects the revenue growth that I employed in developing my revenue annualization adjustment found on Schedule 3 of Exhibits JRD-2 and JRD-3, which was based upon a proration of revenue growth predicted by the Company to occur between the test year and the 2015 rate year.

Table 4
Comparison of Percentage Growth in Normalized Sales and Numbers of Customers from Test Year End Through March 31, 2014 *Versus* the Percentage Growth Assumed in the Public Counsel's Revenue Annualization Adjustment

	Electric Operations	Gas Operations
Percentage Growth in Total Number of Customers – Test Year Average Versus Average for 12 Months Ending March 31, 2014	0.72%	0.59%
Percentage Growth in Total Number of Customers – Test Year End Versus Customers Taking Service at March 31, 2014	1.35%	1.34%
Percentage Growth in Total Number of kWh sales (electric operations) or Mcf Throughput (gas operations)	1.55%	4.85%
Growth Factor Employed With Revenue Annualization Adjustment Found on Schedule No. 3 of Exhibits JRD-2 and JRD-3	0.62%	0.65%

As can be observed from growth percentages shown on Table 4, the factors I have applied to test year base revenues to derive annualized revenues associated with growth from the test year through March 31, 2014, is significantly below actual growth in normalized sales/throughput volumes experienced between the test year and the twelve months ending March 31, 2014. The growth factor utilized in my adjustments is also in line with the growth in average number of customers experienced from the test year through the twelve months ending March 31, 2014, and significantly below the growth in number of customers actually taking service at June 30, 2013 through March 31, 2014. That stated, I believe the more significant percentage growth in numbers of customers taking service at test year end versus March 31, 2014, has been influenced by the "seasonality" of customers taking service for only portions of any given twelve month period – as described above.

In any event, given that the growth factors I employed in my revenue annualization adjustments are considerably lower than the percentage growth in normalized sales/throughput volumes experienced between June 30, 2013 and March 31, 2014, and very much in line with growth in average numbers of customers served for the twelve months ending June 30, 2013 and March 31, 2014, I conclude that the growth factors I have employed are not only reasonable, but in all likelihood, conservatively calculated.

Q: Have you calculated attended increases in expenses that would accompany increases in throughputs and revenues calculated on Schedule No. 3 of Exhibit No. JRD-2 and Exhibit No. JRD-3?

A: Yes. I have calculated attendant increases in power supply costs for electric operations, and attendant increases in purchased gas costs for gas operations. Additionally, I have adjusted uncollectible accounts expense, WUTC fees, and revenue taxes for the growth in revenues calculated. Each accompanying expense increase was consistently calculated utilizing ratios or percentages that the Company employed when it calculated growth in revenues from the test year through the 2015 rate year.

Q: Please continue by discussing the next electric and gas operations adjustments you are sponsoring intended to address regulatory lag.

A: Avista proposes a number of "Pro Forma" expense adjustments that were undertaken to estimate 2015 levels of expense. Specifically, Avista proposes the following electric and gas pro forma expense adjustments to capture 2015 levels for certain relatively large categories of expense:

Table 5
Pro Forma Adjustments Proposed by Avista
To Reflect Expected 2015 Expense Levels

Adjustment Description	**Electric Adj't No.**	**Gas Adj't No.**
Labor Non-Executive Expense	3.02	3.00
Employee Benefits Expense	3.04	3.02
Insurance Expense	3.05	3.03
Property Tax Expense	3.06	3.04

Based upon my experience with Washington energy utility GRC applications *preceding* the 2012 Avista GRC application, I believe the noted pro forma expense adjustments are similar to pro forma expense adjustments traditionally proposed by utility applicants. However, I would note two differences between the pro forma expense adjustments *traditionally* proposed by utility applicants prior to the 2012 Avista GRC and Avista's proposal in the instant case. First, Avista has reached and estimated expense price changes all the way through the entire 2015 rate year. This, I believe, is further outside the test year than energy utilities typically proposed or that this Commission typically accepted with regard to pro forma non-power supply expense adjustments.

Second, while Avista proposes the noted pro forma expense adjustments, like the other "Pro Forma Cross Check" adjustments that Avista offers for budgeted post-test year plant in service growth, the revenue requirement impact of the noted pro forma expense adjustments are effectively replaced – or superseded – by the Company's attrition adjustment. In other word, regardless of whether one might conclude that such Company-proposed pro forma expense adjustments are significantly over or understated, from the Company's perspective its rate request remains fully intact and justified. More specifically, per the Company's request in this case, even if a party or this Commission were to conclude that a Company-proposed pro forma expense adjustment were significantly overstated, the Company's request would remain identical. The only value that would change, again according to the Company's position, is the "plug" Adjustment Nos. 4.04 and 4.03 for electric and gas operations, respectively, so that the sum of the various Company-proposed traditional restating and pro forma adjustments would always exactly equal the Company's attrition-adjusted revenue increase request.

Q: Please state which elements of the Company's pro forma expense adjustments you are accepting and which elements you are proposing to modify or reject.

A: I am proposing to modify the Company's electric operations Pro Forma Adjustment 3.02 and the Company's gas operations Pro Forma Adjustment 3.00. Each of the noted Company adjustments reflect wage increases for non-executive employees expected to occur through 2015 – or the first year rates resulting from these dockets are expected to be in effect. The impact of the modifications to the noted Company proposed electric and gas operations wage changes are reflected within adjustments I have designated as PC-E 3.02 and PC-G 3.00.

When calculating its proposed pro forma level of non-executive labor expense, Avista annualized the impact of wage increases granted in the first quarter of 2014 and also calculated the impact of 2015 *expected* wage increases for those months of 2015 that such increases are predicted to be in effect. I have accepted that portion of Avista's payroll adjustment that captures the annualized impact of the increases that became effective in March 2014. However, I have eliminated, or excluded, the predicted 2015 wage increases when calculating proforma non-executive labor expense in adjustments PC-E 3.02 and PC-G 3.00.

Q: Why have you eliminated the 2015 wage increases included within the Company's development of pro forma non-executive labor expense?

A: The union and non-union 2015 increases are planned increases that do not meet the "known and measurable" standard promulgated by WUTC rules. Further, such estimated increases are predicted to occur well beyond the historic test year ending June 30, 2013. Inclusion of such estimated increases occurring so far beyond the end of the historic test year creates a test year mismatch of revenues, expenses, and rate base – and should therefore be excluded. Conversely, the wage increases effective in March 2014, which I have accepted and included in the development of revised non-executive labor adjustments I am proposing, are properly synchronized with the rate base valuation cutoff date that I am reflecting, as well as the incremental Public Counsel adjustments undertaken to reflect margin growth associated with customer growth through the same point in time (PC-E.2.10 A and PC-G 2.10).

Q: What is the revenue requirement impact of adjustments PC-E 3.02 and PC-G 3.00?

A: As shown on Schedule No. 2 of Exhibit No. JRD-2 and Exhibit No. JRD-3, the revenue requirement impact is $950,000 and $262,000 for electric and gas operations, respectively.

Q: The Company also proposes pro forma electric and gas operations adjustments for "Executive Labor." Are you proposing revisions to the Company's Executive Labor adjustments to eliminate anticipated 2015 increases?

A: No, such revisions were not necessary regarding the Company's pro forma expense adjustments for "Executive Labor." While the Company does propose pro forma "Executive Labor" Adjustment Nos. 3.03 and 3.01 for electric and gas operations, respectively, such adjustment only capture slight shifts in the allocation of executive labor between utility and non-utility operations.[37] The Company did not include any estimate for 2015 executive wage increases within the noted adjustments and accordingly, no revision to eliminate 2015-estimated wage increases for executives was required.

Q: Please continue by discussing your next proposed modification to Avista-proposed pro forma expense adjustments.

A: I am proposing modifications to Company Adjustment Nos. 3.04 and 3.02 for electric and gas operations, respectively. Avista's Adjustment Nos. 3.04 (electric) and 3.02 (gas) were calculated by considering 2014 actuarial experience for employee health and medical benefits, as well as actuarially estimated 2015 pensions and post-retirement medical benefits (PRMB) expense. I am proposing to modify the noted employee benefits expense adjustments to only reflect actuarially determined pensions and PRMB costs for 2014 that the Company is currently recording. The revenue requirement value of Adjustment PC-E.-3.02 for electric operations is $2,361,000 and the revenue requirement value of Adjustment PC-G.3.02 for gas operations is $653,000.

Q: Does the entire difference in revenue requirements between yours and the Company's employee benefits adjustment stem from your proposed reflection of *2014* actuarially determined pension and PRMB expense versus the Company's reflection of *2015* actuarially estimated pension and PRMB expense?

A: No. Beyond just conceptually opposing the Company's proposed reflection of another 2015 estimate of expense levels, I note that the Company has received revised actuarial estimates for pensions and PRMB expense for 2014 and 2015 that are significantly lower than estimates that the Company was relying upon when originally preparing Company Adjustment Nos. 3.04 and 3.02 for electric and gas operations, respectively.[38] Thus, the fairly large differences in revenue requirements stated above attributable to these employee benefits adjustments is

[37] I am taking no position with regard to the Company proposed proforma shift in executive salaries between utility and non-utility operations. Accordingly, on Exhibit Nos. JRD-2 and JRD-3, the Company adjustments for Pro Forma Executive Labor are designated as "PC Neutral."
[38] Avista's response to Public Counsel Data Request No. 213.

due in part to my proposed rejection of the Company's reflection of 2015 estimates for pensions and PRMB expense, but also due in large part to the lower estimates for pensions and PRMB expense that Avista has been presented subsequent to preparing its initial pro formal employee benefits expense adjustment.

In response to Public Counsel Data Request No. 213, Avista provided the revised 2014 and 2015 pension and PRMB cost estimates and also indicated its intentions to revise its Company Adjustment Nos. 3.04 and 3.02 for electric and gas operations, respectively, to reflect new estimates being provided for 2015. Thus, while the true revenue requirement difference between Public Counsel and Avista for these employee benefits adjustments will be less than that stated above once Avista's revises its revenue requirement schedules, a difference will nonetheless continue to exist inasmuch as Avista continues to support reflection of a 2015 estimate.[39]

Q: Please continue by discussing your next proposed modification to a pro forma expense adjustment as calculated by Avista.

A: Avista proposes proforma adjustment 3.05 and 3.03 for electric and gas operations, respectively, to reflect 2015 estimated increases for General Liability and Directors and Officers Liability insurance expense. Avista estimated that 2014 insurance premiums would be increased by 10.0 percent in 2015 and that

[39] While the revenue requirement difference attributable to employee benefits expense differences will change whenever Avista updates its schedules, Avista actual requested rate relief is not expected to change. Specifically, it is anticipated that any change in pro forma employee benefits expense will be accompanied

2014 Directors and Officers Liability insurance expense would be increased by 5.0 percent in 2015. I am opposing reflection of the 2015 estimated increases as they are not "known and measurable," and because to reach that far beyond the end of the historic test period creates a test year mismatch in the measurement of annualized/normalized revenues and expense, and the cutoff measurement date for rate base valuation. Accordingly, with adjustment PC-E.3.05 and PC-G 3.03, I propose pro forma insurance expense levels revised to eliminate the 2015 estimated increases being proposed by Avista. The revenue requirement impact of adjustment PC-E 3.05 is $445,000 and the revenue requirement impact of adjustment PC-G 3.03 is $119,000.

Q: Please continue with your next recommended modification to Company-proposed pro forma expense adjustments.

A: Avista estimated 2015 property tax expense for electric and gas operations by considering budgeted Plant in Service balances at December 31, 2014 – or effectively what Avista would consider the start of the first "rate year." Avista also provided an estimate of 2014 property tax expense for both its electric and gas operations. I have accepted Avista's estimate of 2014 property tax expense that was calculated by considering end of 2013 Plant in Service balances. My revised pro forma adjustment for insurance expense has been designated as PC-E 3.06 and PC-G 3.04 for electric and gas operations, respectively. The revenue requirement impact of electric operations pro forma property tax expense as

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by an equal offsetting change in the "plug" adjustment Avista posts to always force the sum of restating and pro forma adjustment to equal its attrition request.

shown on adjustment PC-E 3.06 is $1,130,000 and the revenue requirement impact of gas operations pro forma property tax expense as shown on PC-G 3.04 is $201,000.

Q: You have discussed your proposed revisions to four Avista-proposed pro forma expense adjustments wherein you effectively remove 2015 estimated cost increases as calculated by Avista. Does your removal and opposition to the Company-proposed reflection of 2015 estimated increases automatically translate to some form of "disallowance," or significantly expose Avista to under recovery of such costs?

A: Not at all. First, the magnitude of 2015 estimated expense increases is not known or fully measurable at this time. Second, even if the Avista-estimated increases are experienced in 2015, they may be "offset" by events such as customer margin growth beyond March 2014 (i.e., the cutoff reflected in Public Counsel's revenue normalization adjustments), or any other cost cutting measures that could be invoked by the Company. Finally, rates can be reset on an accelerated timeline and within a non-controversial ERF proceeding – so long as Avista makes such filing following this Commission's most recent precedent for Avista. In short, rejection of Avista's estimated 2015 increases in expense does not automatically translate to a "disallowance" or under recovery of costs because those costs can be timely recovered once they are known and measurable.

IX. REVISIONS TO AVISTA-PROPOSED FEDERAL INCOME TAX RESTATING ADJUSTMENT [Exhibit No. JRD-2, Schedule No. 2, Adjustment PC-E. 2.06 and Exhibit No. JRD-3, Schedule No. 2, Adjustment PC-G.2.06]]

Q: Are you proposing revisions to any of Avista's test year restating adjustments?

A: My review of Avista's restating adjustments was limited. That stated, I am proposing one revision to Avista's adjustment calculated to restate federal income tax expense that is applicable to both electric and gas operations, as well as one other revision to Avista's federal income tax expense adjustment that is only applicable to electric operations.

Q: Please discuss and describe the one revision you are proposing to Avista's federal income tax expense restating adjustment that is applicable to both electric and gas operations.

A. I am proposing that Avista's electric and gas operations federal income tax restating expense adjustment be modified to reflect a recurring permanent book/tax difference that is available to Avista to consistently reduce current federal income tax expense. Specifically, I am proposing that the permanent book/tax difference referred to as the "Employee Stock Ownership Plan Dividend Deduction" be included in the calculation of restated current federal income tax expense.

Q: What is a "permanent" book/tax difference?

A: A "permanent" book/tax difference can occur or arise whenever either: 1) a transaction is recognized for "book" or "financial statement" earnings presentation purposes that is *never* recognized for purposes of calculating federal taxable income or 2) a transaction is recognized for purposes of calculating federal taxable income that is *never* recognized for "book" or "financial statement" earnings presentation purposes. An example of a permanent book/tax difference that many individual tax payers can relate to is the receipt of interest on municipal bonds that most definitely represents income to an individual bond holder that is never considered income for purposes of calculating federal taxable income.

Q: What events or transactions give rise to the permanent book/tax difference you have referred to as the Employee Stock Ownership Plan Dividend Deduction (ESOP dividend deduction)?

A: Avista employees are permitted to purchase Company stock within their 401-K employee benefits plan. Dividends paid on common stock issued by a corporate tax payer are never recorded as an "expense" for financial statement earnings presentation, and are *normally never* deducted for purposes of calculating corporate federal taxable income. The exception to the "normal" situation wherein dividends paid on corporate common stock are *not deductible* for purposes of calculating corporate federal taxable income occurs when dividends are paid on common stocks held within the employees' 401-K plan. When dividends are paid on common stock held in the employees' 401-K plan, such dividends become tax deductible to the corporate tax payer even though such dividend payments are never reflected as an "expense" for financial statement earning development. Thus, dividends paid on common stock held in employees'

401-K plan create, or result in, a permanent book/tax difference that on a regular, consistent and ongoing basis reduces Avista's corporate federal taxable income and attendant corporate federal current income tax expense.

Q: How has Avista treated or reflected the ESOP dividend deduction in the calculation of current federal income tax expense reflected for retail cost of service development?

A: Avista has designated the ESOP dividend deduction as a "non-operating" or "non-utility deduction." As such, Avista does not allocate or assign any portion of the ESOP dividend deduction to utility operations. The outcome of such position is that this permanent ongoing federal tax deduction – and attendant savings – are allocated 100 percent to shareholders.

Q: Why does Avista assign 100 percent of this permanent tax deduction to shareholders?

A: This question was posed as elements of Public Counsel Data Request No. 191 which dealt exclusively with the topic of the ESOP dividend deduction. In subparts (g) and (h) to Public Counsel Data Request No. 191 Avista was asked:

> (g) To the extent not fully addressed in response to other subparts of this request, please state/describe all reason why this permanent difference is designated as a "non-operating" difference.
>
> (h) To the extent not fully addressed in response to other subparts of this request, please state/describe all reason why this permanent difference should not be allocated/assigned at least in part to utility operations.

The Company's complete response to inquiries set forth with in subparts (g) and (h) of Public Counsel Data Request No. 191 stated:

> (g) The federal tax deduction is associated with a common stock dividend distribution to an employee shareholder for shares held in a non-utility trust, and is not included in utility rate base [SIC]. Common stock dividends are not specific components of utility income or the associated revenue requirement.
>
> (h) Company contributions to the employee 401-k plan are properly accounted for as employee benefit costs and included in financial and regulatory accounting as recoverable costs of utility service. Costs of common equity, however, are recovered through the cost of common equity component of the authorized rates of return approved by the utility commissions where the company serves. As noted in the response to (g) above, company common stock dividends issued to shares are held in a separate trust, wherein employees maintain ownership, among other options, of company stock for their individual use, and is not a component of utility cost of service; it is a component of the authorized rate of return.

I have also attached as Exhibit No. JRD-7 the Company's complete response to all components of Public Counsel Data Request No. 191.

Q: Do you find the Company's arguments for allocating 100 percent of this permanent tax deduction to shareholders persuasive?

A: No. First, the Company's 401-K Plan is an employee benefit – with any associated expense being routinely, and to my knowledge, without exception fully included in the development of Washington retail electric and gas base rates. Second, I take strong exception to Avista's statement that dividends issued for shares held in the 401-K trust accounts are "not a component of utility cost of service." As this Commission knows very well, a return on common equity is always included in the development of a regulated utility's weighted overall cost of capital – and rates are always developed by including an allowance for return on rate base that is calculated by multiplying the utility's overall cost of capital times its rate base investment. While dividends are typically not separately set forth as a component of the return on equity (ROE), under the discounted cash flow (DCF) methodology that I understand this Commission regularly adheres to in the setting of ROE, dividends along with expected growth in earnings form the basis of establishing the targeted or desired ROE. Thus, to suggest or imply that dividends paid on shares of common stock – whether held in a 401-K trust account or any other type of financial account – are not included as a component of a utility's cost of service is disingenuous.

Q: Is the payment of common stock dividends mandatory?

A: No. While it is true that common stock dividends are issued at the discretion of the utility's Board of Directors, they are typically consistently paid – with the cutting or elimination of a utility common stock dividend being a very infrequent occurrence. Further, as noted in the Company's response to subpart (f) of Public Counsel Data Request No. 191 (Exhibit No. JRD-7), Avista experienced constant to slightly-increasing ESOP dividend deductions for years 2010 through 2013 and estimates identical deductions for years 2014 and 2015. Thus, to suggest that such deduction is not reasonably known and measurable, even though it is technically "discretionary," is also unsupportable.

Q: Can a credible argument be made that somehow Avista's shareholders, rather than its ratepayers, are entitled to savings resulting from this permanent book/tax deduction that Avista routinely takes on its corporate federal income tax return?

A: No. Avista's rates have been, and almost certainly will continue to be, established by considering a targeted ROE that includes an ongoing dividend component. If the savings from permanent ESOP dividend deduction is assigned to shareholders – as Avista proposes – rates will be established with a targeted ROE that does not consider all tax savings available to Avista. In short, the Company effectively argues by its rate treatment proposed for the ESOP dividend deduction, that shareholders should be entitled to a targeted ROE *plus additional earnings* generated by savings resulting from the ESOP dividend deduction that is not being considered in Washington rate development. If Avista were to reduce its otherwise-requested targeted ROE for tax savings achieved by virtue of the ESOP dividend deduction, I would agree that ratepayers should not be entitled to such tax savings. However, Avista proposes no such reduction to its otherwise-requested ROE for tax savings being realized from taking the ESOP dividend deduction.

Q: Please discuss how you have revised Avista's restating adjustments for corporate federal income to reflect savings generated from the ESOP dividend deduction.

A: My revisions to the Company's restating corporate federal income tax expense adjustments are found on adjustments PC-E 2.06 and PC-G 2.06. As reflected within footnote (1) found on each adjustment schedule, I started with a "total Avista" ESOP dividend deduction of $1,484,424 million – an amount actually expected to be deducted by Avista for tax year 2013, and virtually identical to the $1.5 million predicted by Avista to be taken for tax years 2014 and 2015. I allocated 98.8 percent of the total $1.5 million deduction to Avista's utility operations – consistent with Avista's allocation of total corporate employee benefits to utility operations. I then allocated the total utility ESOP divided deduction to Washington electric and gas operations on the basis of Washington O&M labor to total utility O&M labor for all Avista utility jurisdictions. The impact of the noted revisions attributable to reflecting tax savings generated by the ESOP dividend deduction is to reduce Washington electric operations revenue requirements by $386,000 and reduce Washington gas operations revenue requirements by $107,000.

Q: Please continue by discussing your final revision to electric operations restated federal corporate income tax expense.

A: My next adjustments revises test year federal income tax expense to reflect the actual Domestic Production Activities Deduction (DPAD) now expected to be taken for the 2013 tax year. When calculating "recorded" current income tax expense for the historic test year ending June 30, 2012, the Company utilized a total Company DPAD estimate of $3,000,000 that was considerably lower than the DPAD amount that was actually claimed for calendar year 2012 or the amount now calculated and expected to be taken when filing its 2013 corporate income tax return. Thus, the impact of my revision to Avista's electric operations restating adjustment as reflected on PC-E 2.06 is to lower test year federal income tax expense to reflect the larger DPAD expected to be taken for tax year 2013.

Q: Why is it appropriate to reflect the noted revision to the Company's proposed test year DPAD included within its electric operations restating adjustment for test year corporate federal income tax expense?

A: In response to Public Counsel Data Request No. 98 Avista provided the following DPAD deductions for years 2011, 2012 and 2013:

2011 Actual	$6,296,845
2012 Actual	$4,009,808
2013 Estimated	$5,650,000

It is unclear why the Company elected to reflect a lower DPAD than was actually taken for 2012, much lower than what it claimed for 2011, and also much lower than the amount it now calculates to be taken for calendar year 2013. In any event, the "unadjusted" DPAD included in the Company's income tax restating adjustment is clearly unsupportable and in need of upward revision. I am recommending inclusion of the DPAD expected to be taken in 2013 as I believe reflection of the estimated 2013 DPAD in development of the Company's electric operations is better synchronized with adjusted test year operating results, and probably represents a conservative estimate of the DPAD to be taken during the rate effective period.

Q: Please explain your last conclusion regarding the reasonableness of the DPAD amount you are proposing to include in electric operations revenue requirements.

A: The Domestic Production Activities Deduction is basically a function of the taxable income resulting from the utility's production operations. Further, the taxable income derived from a utility's production operations is primarily a function of, or significantly impacted by, its before-tax equity return. With a growing production function rate base resulting in a larger targeted before-tax equity return in this proceeding, it logically follows that prospectively the DPAD can be expected to grow from historic levels. That stated, I am aware that the "production function's taxable income" is not solely a product of the production function's before-tax targeted return on equity, but also includes incorporation of book/tax timing differences that can fluctuate – sometimes significantly – from year to year. In general, however, with an increasing production function rate base and resultant growing targeted production function before-tax equity return, it follows that over time the DPAD should be growing. Accordingly, I conclude that reflecting the DPAD expected to be taken for 2013 is not only reasonably associated with adjusted test year rate base valuation (that pursuant to Public Counsel's update adjustment will be reflected at March 31, 2014 valuations), but also probably represents a conservative estimate of the DPAD to be taken during the rate effective period. As shown on Schedule No. 1 of Exhibit No. JRD-2, the revenue requirement of adjustment PC-E.2.18 is $515,000.

X. CONCLUSION

Q: Please summarize Public Counsel's 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 adjustment for both electric and natural gas operations are as follows:

- I am recommending that the Company's attrition adjustments be rejected in this docket. However, in recognition of a need to address regulatory lag, potential earnings erosion, and fatigue resulting from nearly annual GRC filings, I am recommending that 1) rates established in this GRC be developed by including post-test year updated rate base values, and 2) Avista be permitted to undertake two ERFs with relatively few restrictions as to test years to be employed or filing intervals before base rates are again established with a comprehensive GRC filing.
- My reasons for rejection of the Company's proposed attrition adjustment include:
    - No guidance or directive has yet been given by this Commission as to what conditions should exist before an attrition adjustment is to be considered. Further, no guidance or directive has been given as to how an attrition should be properly constructed.
    - The Company's mix-and-match approach to developing its proposed attrition adjustment in the current, as well as the prior, GRC suggest developing a properly constructed attrition adjustment will likely prove difficult, controversial and confusing. Specifically, in developing its proposed attrition adjustment the Company has: 1)

selected an historic trend period that supports the very recently accelerated construction program it is electing to embark upon, 2) used Company budgets to develop “rate year” margins or revenues, and 3) used judgment to develop its proposed O&M expense escalator.

  - Avista’s recent decision to significantly accelerate its construction program shortly following implementation of rates that were primarily developed by reflecting a very significant attrition adjustment suggest it is reasonable to question whether the granting of an attrition adjustment has resulted in the unintended consequence of promoting utility investment – rather than inspiring utility managers to control costs aggressively to achieve the lowest reasonable cost of service - as the Staff recently argued should be expected when a degree of regulatory lag is experienced.
  - A number of other options that continue to rely upon historic test year ratemaking conventions – including utilization of ERFs – have not been fully explored or tested as a means of addressing regulatory lag, earnings erosions, or the fatigue attendant to undertaking frequent GRC reviews.

- The various means for addressing regulatory lag that I am proposing, that adhere to reflecting “known and measurable” changes and utilization of historic test year mechanisms, include:

- Developing major rate base components by including EOP rather than AMA valuations.
- Reflecting pro forma adjustments that reflect post-test year prices and conditions, but nonetheless are restricted to "known and measurable" events or conditions.
- When possible and practical, reflecting post-test year updates for Net Plant After Deferred Income Taxes values available closer to the rate effective date, albeit with corollary adjustments to update for known "offsets" for items such as revenue growth to a similar cutoff point in time.
- Authority to file up to two ERFs with few limitations or restrictions regarding test years to employ or minimum intervals between filings.

In summary, I respectfully request that the Commission revisit its willingness to grant a significant attrition adjustment, and instead, adopt the various other approaches and mechanisms I have recommended herein as a means of combatting regulatory lag, potential earnings erosions and rate case fatigue.

Q: Does this conclude your direct testimony?

A: Yes, it does.