

Service Date: December 15, 2016

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION, d/b/a
AVISTA UTILITIES,

Respondent.

DOCKETS UE-160228 and
UG-160229 (*Consolidated*)

ORDER 06

FINAL ORDER REJECTING
TARIFF FILING

Synopsis: The Commission rejects the revised tariff sheets Avista Corporation d/b/a Avista Utilities (Avista or Company) filed on February 19, 2016, that would have increased rates for the Company's electric customers by 7.6 percent, raising \$38.6 million in additional revenue for Avista, and that would have increased rates for Avista's natural gas customers by 2.8 percent, raising \$4.4 million in additional revenue for the Company, if approved by the Commission. Avista failed to carry its burden to show that its current rates are not fully sufficient to meet its needs. Under the conditions identified in the Commission's order in Docket UE-150204 and UG-150205, Avista has failed to demonstrate that it requires an attrition adjustment to increase rates effective January 1, 2017. . The record does not support a determination that Avista will experience increased demands for capital expenditures or operating expenses that are beyond the Company's ability to control. Avista's rates accordingly will remain as currently effective.

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SUMMARY

- 1 **PROCEEDINGS:** On February 19, 2016, Avista Corporation, d/b/a Avista Utilities (Avista or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its currently effective Tariffs WN U-28, Electric Service, and Tariff WN U-29, Natural Gas Service. Avista's as-filed tariff revisions, if approved, would increase charges and rates for electric service by approximately \$48.9 million, with a \$38.6 million increase effective January 1, 2017, plus an additional increase of \$10.3 million to become effective January 1, 2018. Avista also proposes to increase rates for natural gas service by approximately \$5.3 million, with a \$4.4 million increase effective January 1, 2017, and a further \$0.9 million increase effective January 1, 2018. The Commission suspended the tariff filings on March 7, 2016, in Order 01, consolidated the two dockets, and determined that it would hold public hearings, as necessary, to determine whether the proposed increases are fair, just, reasonable and sufficient.¹
- 2 **PARTY REPRESENTATIVES:** David J. Meyer, Vice President and Chief Counsel for Regulatory and Governmental Affairs, Spokane, Washington, represents Avista. Lisa W. Gafken, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Division of the Washington State Attorney General's Office (Public Counsel). Jennifer Cameron-Rulkowski, Brett P. Shearer, Andrew O'Connell, and Jeff Roberson, Assistant Attorneys General, Olympia, Washington, represent the Commission's regulatory staff (Staff).²
- 3 Jesse E. Cowell, Davison Van Cleve, P.C., Portland, Oregon, represents the Industrial Customers of Northwest Utilities (ICNU). Chad M. Stokes and Tommy A. Brooks, Cable Huston, Portland, Oregon, represent the Northwest Industrial Gas Users (NWIGU). Ronald L. Roseman, attorney, Seattle, Washington, represents The Energy Project.

¹ The suspension date for the as-filed tariffs is January 21, 2017. Avista requested a January 1, 2017, effective date to allow for a full twelve month rate year followed by a second rate increase for rates effective January 1, 2018, through June 30, 2018.

² In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See*, RCW 34.05.455.

4 **COMMISSION DETERMINATIONS:** The record in this proceeding does not support a determination by the Commission that Avista’s current rates are not fair, just, reasonable, or sufficient. The Commission accordingly rejects the Company’s tariff filing in these dockets. Avista’s rates will remain as determined in Dockets UE-150204 and UG-150205.³

MEMORANDUM

I. Background and Procedural History

5 On February 19, 2016, Avista filed revisions to its currently effective Tariff WN U-28, Electric Service, and Tariff WN U-29, Natural Gas Service. The revenue requirements and rates in its currently effective tariff were established in Dockets UE-150204 and UG-150205, only 44 days prior to the Company’s filing in these dockets.⁴

6 Avista proposes an 18-month rate plan for the period January 1, 2017, through June 30, 2018.⁵ Under Avista’s 18-month proposal, base retail rates would increase on January 1, 2017, and a second-step base rate increase would occur on January 1, 2018, and remain in effect through June 30, 2018. With regard to the proposed January 1, 2018, second-step electric base rate increase in this filing, Avista proposes to offset the bill impact to customers with a rebate of available Energy Recovery Mechanism (ERM) dollars.

7 More specifically, the Company requests authority to increase rates for electric service by approximately \$38.6 million, or 7.6 percent in billed rates, and to increase natural gas rates by \$4.4 million, or 2.8 percent in billed rates effective January 1, 2017. Avista proposes in addition that it be authorized to implement a second rate increase for both electric and natural gas services asking, respectively, for an electric revenue increase of

³ *Washington Utilities & Transportation Comm’n v. Avista Corporation d/b/a Avista Utilities*, Id. (January 6, 2016) (hereafter Dockets UE-150204 and UG-150205, Order 05).

⁴ *Id.*

⁵ Although we describe this as a “rate plan,” Avista would be required to file yet another general rate case by August 1, 2017, to establish rates effective prospectively from July 1, 2018. Thus, this is not a rate plan in the sense of one that breaks the Company’s continuing practice of filing one rate case after another from year to year. Avista’s proposal is not for a stay-out period but rather a means to change the filing cycle of its annual, or near annual, rate cases.

\$10.3 million, or 3.9 percent in billed rates, and for a natural gas revenue increase of \$0.9 million, or 1.0 percent in billed rates effective January 1, 2018, through June 30, 2018.

8 Thus, the Commission having determined revenue requirements for Avista's electric and natural gas services on January 6, 2016,⁶ the Company asserted through its filing in the pending dockets on February 19, 2016, that it would require within a matter of less than 11 months additional increases of \$48.9 million and \$5.3 million for the respective services relative to the adjusted revenue requirements set 44 days earlier.⁷

9 Avista nominally based its revenue requests on a test year from October 1, 2014, through September 30, 2015. The filing included proposals for the following:

- An overall rate of return (ROR) of 7.64 percent.⁸
- A return on equity (ROE) of 9.9 percent.⁹
- A capital structure consisting of 48.5 percent equity and 51.5 percent debt.¹⁰
- An attrition adjustment for both its electric and natural gas operations.

In fact, Avista based its revenue requests in this case on the projected costs and escalated expenses produced by its attrition analyses, plus so-called after-attrition adjustments that capture the estimated costs of large capital projects the Company may complete during 2017 or 2018. Avista presents a modified historical test year with *pro forma* adjustments, further modified by the Company's so-called cross-check study, *only* for purposes of

⁶ See Dockets UE-150204 and UG-150205, Order 05. We note that Order 05 is currently pending appeal in the Thurston County Superior Court.

⁷ The proposed effective date of the as-filed tariff sheets in these dockets was March 21, 2016. The Company recognized, of course, that the Commission would suspend operation of the tariffs within 30 days after they were filed and set the matter for hearing.

⁸ Morris, Exh. SLM-1T at 4:10-11. This would be a 0.35 percent increase relative to the Company's last approved and currently effective ROR.

⁹ *Id.* This would be a 0.4 percent increase relative to the Company's last approved and currently effective ROE.

¹⁰ *Id.* This is unchanged from what the Commission approved in Avista's last prior case, Dockets UE-150204 and UG-150205.

comparison to its modified attrition study results. The Commission expressly rejected the use of Avista's cross-check methodology in the Company's 2015 case.¹¹

- 10 Staff, Public Counsel, The Energy Project,¹² ICNU, and NWIGU¹³ filed response testimony and exhibits opposing the Company's rate and revenue requests on August 18, 2016. On September 19, 2016, the Company filed rebuttal testimony and exhibits, while Staff, ICNU, and Public Counsel filed cross-answering testimony and exhibits on select issues.
- 11 The Commission held public comment hearings in both Spokane and Spokane Valley, Washington, on September 20, 2016, and September 21, 2016, respectively. The Commission and Public Counsel received 73 comments regarding the proposed rate increases from Washington customers, with 71 comments opposing the increases, no comments supporting the increases, and two comments neither supporting nor opposing.¹⁴ The Commission conducted evidentiary hearings at its headquarters in Olympia, Washington, on October 12 - 14, 2016. Altogether, the record includes more than 300 exhibits admitted during the evidentiary hearing. The transcript of this proceeding exceeds 400 pages in length.
- 12 Avista, Staff, Public Counsel, The Energy Project,¹⁵ NWIGU, and ICNU filed post-hearing briefs on November 7, 2016.

¹¹ Dockets UE-150204 and UG-150205, Order 05 ¶ 37 (“Unlike the Company’s cross-check study, the plant additions proposed by other parties are not an estimate, projection, budget forecast, or some similar exercise of judgment – even informed judgment. *We decline to rely on broad budget projections.* The unreliability of the Company’s budget projections is evidenced by the large difference between the Company’s projections for fourth quarter 2014 and the plant additions actually booked in the fourth quarter.”) (emphasis added).

¹² The Energy Project sponsored witness Barbara Alexander jointly with Public Counsel.

¹³ NWIGU sponsors witness Bradley Mullins jointly with ICNU and sponsors separately witness Brian Collins.

¹⁴ Exh. B-6.

¹⁵ Public Counsel and ICNU filed a joint brief on the subject of Avista’s Advanced Metering Infrastructure investments.

II. Avista's General Rate Case History in the Present Era

- 13 This is Avista's ninth general rate case filed since 2005, and the fourth since 2012 in which it has sought to introduce an attrition adjustment as the basis for, or as a major factor in determining, its revenue requirements. The history of these general rate case proceedings and several earlier cases, beginning with the advent of the Western states energy crisis in 2000-2001, provides important context for our determinations in this proceeding.¹⁶
- 14 The Commission recognized the "extraordinary circumstances" of the western energy crisis in the fall of 2001: unprecedented prices and price volatility in the western wholesale power markets enabled by the federal government's flawed effort to deregulate these markets with too little focus on the potential damage to utilities and their customers when such markets go awry.¹⁷ These circumstances coincided with serious drought conditions in the Pacific Northwest that caused streamflows necessary for hydroelectric generation to drop to near-historic lows regionally and to the worst on record for Avista specifically. Avista, as well as other utilities in the Western United States, quickly experienced severe financial consequences precipitated by this confluence of events. In providing emergency relief to Avista in the fall of 2001, the Commission observed that the circumstances of weather and "the unfortunate consequences of policies implemented outside our state" were matters neither it nor Avista could control.¹⁸ On September 24, 2001, the Commission authorized Avista to initiate a temporary rate increase in the form of a surcharge to all of its electric rate schedules in a uniform amount of 25 percent

¹⁶ The dissent appears to argue that the Majority's discussion of Avista's prior rate cases was offered as evidence bolstering its determination that Avista failed to carry its burden of proof in this case. Dissent ¶ 7. This is incorrect. The full historical narrative based on Commission orders is included to provide context, illustrating the dynamic nature of regulatory ratemaking as the Commission responds to changing circumstances in the economic landscape and the Company's circumstances. The most recent history, concerning Avista's 2012, 2014, and 2015 cases, provides focused discussion of recent applications of law and policy, which the Commission applies to the facts of record in this case that are relevant to its decision.

¹⁷ *In the Matter of Avista Corporation, d/b/a Avista Utilities Request Regarding the Recovery of Power Costs Through the Deferral Mechanism*, Docket No. UE-010395, Sixth Supp. Order ¶¶ 5-6 (September 24, 2001).

¹⁸ *Id.* ¶ 7.

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beginning on October 1, 2001.¹⁹ All revenues collected by Avista under the surcharge were subject to refund.²⁰ Avista was required to file a general rate case no later than December 1, 2001.²¹

- 15 The power cost surcharge approved in Docket UE-010395 was the first of three steps the Commission authorized to help restore Avista's financial integrity that had been seriously undermined by the events of the energy crisis. In Docket UE-011595, filed on December 3, 2001, Avista requested permanent increases in its electric rates. Avista also requested a 12.4 percent interim rate increase, subject to refund, for its electric rates. In a related filing in Docket UE-011514, Avista requested a determination regarding the prudence and recoverability of certain power costs incurred by the Company through September 30, 2001. The Commission conducted joint proceedings in those cases to consider the prudence of Avista's power costs and the Company's request for interim rate relief. Approving and adopting a settlement stipulation among the parties, the Commission found prudent and allowed for recovery in rates \$196,023,342 in deferred power costs, adjusted the accounting treatment previously approved in Docket UE-010395, and provided for a 6.2 percent interim rate increase over base rates for Avista.²²
- 16 The Settlement Stipulation also resolved certain issues pending in Avista's general rate increase request. The remaining issues in Docket UE-011595 were resolved by the

¹⁹ *Id.* ¶ 83. Avista, by its Petition filed on July 18, 2001, had requested the Commission to approve by September 15, 2001, a 36.9 percent surcharge that Avista would collect, subject to refund, pending further proceedings. *Id.* ¶ 2. Staff supported a 32.6 percent surcharge while other parties' recommendations were in the range of 6.1 – 19.1 percent. *Id.* ¶ 63 Table One.

²⁰ Rates made effective "subject to refund" are temporary rates that later may be found to have been excessive at the time approved and charged by a utility. If such a finding is made in subsequent proceedings in which permanent rates are approved, the utility may be required to refund to customers all, or some part of, the temporary rates already collected.

²¹ *In the Matter of Avista Corporation, d/b/a Avista Utilities Request Regarding the Recovery of Power Costs Through the Deferral Mechanism*, Docket No. UE-010395, Sixth Supp. Order ¶¶ 84, 93, 100, 112 (September 24, 2001).

²² *Washington Utilities and Transportation Commission v. Avista Corporation, d/b/a Avista Utilities*, Docket UE-011595, Fourth Supp. Order (March 4, 2002).

Commission's approval and adoption of a subsequent settlement among the parties that provided:

- There would be no incremental increase in customers' rates relative to the rates established following the Commission's Fourth Supplemental Order in 2002 that approved interim rates.
- There would be a reallocation of the revenue increases authorized for, and implemented by, Avista since October 1, 2001, by Commission orders in Dockets UE-010395 (power-cost surcharge), UE-011514 (prudence), and UE-011595 (interim phase).

The Commission also authorized Avista to implement an "Energy Recovery Mechanism" (ERM) that would allow positive or negative adjustments to Avista's rates to account for fluctuations in power costs outside of an authorized band for power-cost recovery in base rates.²³ Thus, Avista embarked, with Commission support provided in a variety of ways, on a path toward recovery from the dire financial straits in which it found itself in the earliest years of the 21st Century.

17 The levels of revenues approved for recovery via electric and natural gas rates in 2001 and 2002 proved sufficient to the Company's needs for several years. Avista filed its next general rate case on March 30, 2005, in Dockets UE-050482 and UG-050483. Avista proposed general rate increases of \$35.8 million, or 11.4 percent, for its electric tariffs and \$2.9 million, or 1.7 percent, for its gas tariffs. On August 12, 2005, Staff filed on behalf of itself, Avista, Northwest Industrial Gas Users, and the Energy Project, a multi-party Settlement Agreement.²⁴ The settlement stipulation proposed that Avista would recover in rates an increase in annual electric revenue of \$22.1 million, approximately 61 percent of the Company's original request, and an increase in annual natural gas revenue of \$968,000, or about 33 percent of what Avista originally requested. The Commission

²³ *Washington Utilities and Transportation Commission v. Avista Corporation, d/b/a Avista Utilities*, Docket UE-011595, Fifth Supp. Order (June 18, 2002).

²⁴ Public Counsel and Industrial Customers of Northwest Utilities opposed the proposed settlement.

approved the settlement with conditions that reduced the electric revenue requirement by approximately \$0.5 million and required a rerun of the Company's power cost model.²⁵

18 Importantly, in the 2005 case, the Commission recognized that Avista was continuing to recover from the serious financial distress it experienced beginning in 2000 and 2001, and the Company was increasing its capital expenditures.²⁶ The Commission observed that Avista experienced record low hydro conditions and unprecedented high wholesale market prices during the referenced period. These required Avista to increase its outstanding debt from \$715 million at December 31, 1999, to \$1,175 million at December 31, 2001, in order to acquire electricity and natural gas to serve its customers.

19 The Commission also related in Order 05 that:

The Company's credit ratings dropped in October 2001 to below investment grade in part due to the significant electric and natural gas deferrals on its books. In 2005, the Company continues to be assessed by the credit rating agencies as below investment grade for unsecured debt. Avista's total electric and natural gas deferral balances as of December 31, 2004, were \$151 million on a system basis, and \$122 million for the Washington jurisdiction.²⁷

Under these circumstances, the Commission relied on what it identified as the "bedrock principle in utility ratemaking . . . that the rate setting body must achieve 'end results' that satisfy the requirements discussed in the preceding paragraph [*i.e.*, paragraph 22].²⁸

²⁵ *Washington Utilities and Transportation Commission v. Avista Corporation, d/b/a Avista Utilities*, Dockets UE-050482 and UG-050483, Order 05 (December 21, 2005).

²⁶ *Id.* ¶¶ 6-8.

²⁷ *Id.*

²⁸ *Id.* ¶ 22. Order 05 ¶ 22 states:

The Commission is charged by statute with the responsibility to regulate in the public interest. In the context of setting rates for electric and natural gas companies, this overarching responsibility is reflected by the Commission's determination, on the basis of substantial evidence, of rates that are fair, just, reasonable and sufficient. The fair, just, reasonable and sufficient standard reflects the balance the Commission is required to strike between providing customers the lowest reasonable rates while providing the utility with rates

In the final analysis, it is the end results, or overall results that matter, not the methods by which they are determined.”²⁹

- 20 The Commission-approved settlement, among other things, provided significant support to Avista by authorizing a hypothetical equity share of 40 percent in the Company’s capital structure when its actual equity share was considerably lower at 27 percent.³⁰ The Commission also approved an “Equity Building Mechanism” that required Avista to increase the utility’s actual equity component to 35 percent by December 31, 2007, and to 38 percent by December 31, 2008.³¹ These increases in the Company’s equity component were to be achieved by growth in retained earnings and reductions in outstanding levels of long-term debt.
- 21 Avista filed its next general rate case a little more than a year later, on April 26, 2007, in Dockets UE-070804 and UG-070805. This filing came shortly after the Commission’s order on February 1, 2007, initiating a pilot decoupling mechanism for natural gas that would allow the Company defer certain costs and revenues in order to improve Avista’s opportunity to recover its fixed costs without being concerned about load loss that might result from increased conservation efforts.
- 22 In its 2007 general rate case, the Company originally requested revenue requirements of \$51.1 million in additional electric revenue and \$4.5 million in additional gas revenue, corresponding to average rate increases of 15.8 percent for electric customers and 2.3 percent for gas customers. The parties negotiated a full Settlement Stipulation³² recommending that the Commission approve \$30.2 million in additional electric revenue

sufficient to cover its prudently incurred costs and an opportunity to recover a return on its investment.²⁸ The allowed return must be adequate to allow the utility to attract required capital at reasonable rates and on reasonable terms for similar companies. Stated differently, rates must be adequate to allow the utility to recover its operating expenses, maintain and service its debt, and attract equity investors by offering equity returns commensurate with what investors expect to achieve in alternative investments of comparable risk.

²⁹ *Id.* ¶ 23.

³⁰ *Id.* ¶ 54.

³¹ *Id.* ¶ 57.

³² The full settlement followed, and adopted by reference an earlier partial settlement.

and \$3.3 million in additional gas revenue for Avista. The Commission observed in its order approving the settlement that the amounts settled upon were only slightly higher than the \$29.4 million and \$3.2 million in additional electric and gas revenues, respectively, Staff proposed following its analysis of the Company's case.³³

23 Here, again, the Commission approved approximately 60 percent of what the Company initially requested in increased electric revenue. On the gas side, however, the Commission approved an amount approximately 73 percent of Avista's original request. Significantly, the allowed revenues were determined in part by the Commission's approval of a 10.2 percent return on equity and 46 percent equity in the capital structure, a significant increase even from the 40 percent hypothetical equity component in the prior case.³⁴ This was powerful testament to the success of the Equity Building Mechanism the Commission approved at the end of 2005 and reflected the results of strong regulatory support the Commission gave Avista in ratemaking proceedings following the Company's financial distress, discussed above.

24 Avista's 2007 general rate case marked the beginning of a period, continuing to today, during which the Company has filed a general rate case nearly every year, sometimes within months after completion of the preceding general rate docket. Indeed, three months after the Commission's order in the 2007 general rate case, Avista filed another general rate increase on March 4, 2008, in Dockets UE-080416 and UG-080417.³⁵

25 In Dockets UE-080416 and UG-080417, Avista proposed to implement a general rate increase of \$36.6 million, or 10.3 percent, for electric service and \$6.6 million, or 3.3 percent, for gas service. On July 28, 2008, Avista sought, and was granted leave to file

³³ *Washington Utilities and Transportation Commission v. Avista Corporation, d/b/a Avista Utilities*, Dockets UE-070804 and UG-070805, and UE-070311, Order 05 ¶ 15 (December 19, 2007).

³⁴ In retrospect, it appears the Commission overshot the mark in allowing Avista recovery of revenue determined on the basis of hypothetical equity in its capital structure. The growth in Avista's actual equity component from 27 percent in December 2005 to 46 percent in December 2007 was quite remarkable and evidenced the Company's ability to retain earnings at a rate much higher than anticipated in the Equity Building Mechanism, which targeted 35 percent equity by the end of 2007.

³⁵ *Washington Utilities and Transportation Commission v. Avista Corporation, d/b/a Avista Utilities*, Dockets UE-080416 and UG-080417 and UG-060518 (consolidated), Order 08 (December 29, 2008).

supplemental testimony and exhibits based on updated financial data and power cost inputs which increased its proposed electric revenue requirement of \$11.1 million to \$47.7 million. However, Avista did not seek to revise its tariff filing to increase its “as-filed” revenue requirement.

- 26 On September 16, 2008, Avista, Staff, NWIGU, and The Energy Project filed a Multi-party Settlement Stipulation that would allow Avista to recover in rates an increase in annual electric revenue of \$32.5 million and an increase in annual natural gas revenue of \$4.8 million. The Commission approved the settlement over opposition from ICNU and Public Counsel, focusing again, as in the Company’s 2005 case, on the basic ratemaking principles that the Commission is not bound to follow a specific formula or method when calculating rates, but must, in the final analysis, establish end results that balance both investor and consumer interests to arrive at rates that are fair, just, reasonable, and sufficient.³⁶ The approved settlement allowed Avista to recover approximately 68 percent and 72 percent, respectively, of its updated electric revenue requirement request and its as-filed gas revenue request.
- 27 On January 23, 2009, less than one month after the Commission’s final order in the Company’s 2008 general rate case, Avista filed another general rate case in Dockets UE-090134 and UG-090135. Avista proposed a general rate increase of \$69.8 million, or 16.0 percent, for electric service and \$4.9 million, or 2.4 percent, for gas service.³⁷ Avista also proposed to decrease the then-current Energy Recovery Mechanism surcharge by \$32.4 million, or 7.4 percent, resulting in an overall net increase of 8.6 percent for electric rates. Staff recommended significantly smaller increases in annual revenues: \$20.1 million for annual electric revenue and \$281,000 for annual natural gas revenue. Public Counsel recommended a \$12.8 million *reduction* from then-approved annual electric revenue and

³⁶ *Id.* ¶ 60 (citing *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591,603 (1944), RCW 80.28.010, and 80.28.020).

³⁷ On September 4, 2009, the parties filed a Partial Settlement Stipulation; the Northwest Energy Coalition (NWEC or Coalition) did not join in the proposed settlement, but did not oppose its terms. As a result, the Company revised downward its revenue requirement requests to \$38.61 million for electric and \$3.14 million for natural gas. On rebuttal, filed September 11, 2009, Avista further reduced its asserted revenue deficiencies to \$37.5 million for electric and \$2.8 million for natural gas, taking into account updated cost figures.

a \$431,000 increase for annual natural gas revenue.³⁸ The Commission authorized in its final order an increase in electric revenue of approximately \$12.1 million³⁹ and in gas revenue of approximately \$0.6 million.⁴⁰ In other words, the Commission authorized revenue increases that were approximately 17 percent and 12 percent of what the Company originally requested for electric and natural gas services, respectively.⁴¹

28 On May 16, 2011, Avista filed another general rate case in Dockets UE-110876 and UG-110877. Avista's initial filing requested an electric rate increase of \$38.3 million, or 9.1 percent overall, and a gas rate increase of \$6.2 million or 4.0 percent overall. The parties filed an unopposed settlement⁴² on September 30, 2011, providing an increase in Avista's electric revenue requirement by \$20 million and its natural gas revenue requirement by \$3.75 million. These agreed amounts, which the Commission approved,⁴³ were 52 percent and 60 percent, respectively, of what the Company originally requested.

³⁸ *Washington Utilities and Transportation Commission v. Avista Corporation, d/b/a Avista Utilities*, Dockets UE-090134 and UG-090135, and UG-060518 (consolidated), Order 10 ¶ 4 (December 22, 2008).

³⁹ Order 10 ¶ (The Commission required Avista to rerun its power cost model during the compliance phase. Therefore, “[W]e will determine the Company’s exact revenue deficiency for electric service after its compliance filing. We find a revenue deficiency of \$557,000 for natural gas and authorize Avista to file rates to recover additional revenue in this amount.”)

⁴⁰ *Id.* ¶ 235 (Tables 5 and 6).

⁴¹ On April 30, 2009, Avista filed a petition to consolidate Docket UG-060518, involving its pilot natural gas decoupling mechanism, with the rate case proceeding. Avista asked the Commission to extend the decoupling pilot program beyond its scheduled termination date of June 30, 2009. On May 15, 2009, the Commission consolidated the decoupling issue into the general rate cases,⁴¹ and, on June 30, 2009, granted an interim extension of Avista’s existing pilot decoupling mechanism.⁴¹ The Commission continued the program indefinitely in its final order in the three dockets on December 22, 2009. Dockets UE-090134 and UG-090135, and UG-060518 (consolidated), Order 08.

⁴² The NWEC did not join in the Settlement, but did not oppose its terms. Instead, the NWEC proposed to address separately the issue of decoupling raised in the proceeding. The Commission accepted this proposal and established a separate process to address the decoupling issue in a subsequent hearing.

⁴³ *Washington Utilities & Transportation Comm’n v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-110876 and UG-110877, Order 06 (December 16, 2011).

29 A little more than three months later, on April 2, 2012, Avista filed a general rate case in Dockets UE-120436 and UG-120437. This turned out to be the first in a series of four general rate cases, including the dockets pending here, in which the Company claimed the existence of attrition and the need for an attrition adjustment.⁴⁴ The Commission consolidated Dockets UE-120436 and UG-120437 and set the general rate case for hearing jointly with the second phase of Avista's 2011 general rate case, Dockets UE-110876 and UG-110877, which was then pending specifically to address the issue of electric decoupling for the Company.⁴⁵ Thus, the Commission had simultaneously before it requests to implement two separate ratemaking mechanisms that, designed correctly with appropriate safeguards for ratepayers, would enhance, but not assure, the Company's opportunity to earn fully its authorized return.⁴⁶

⁴⁴ Avista's first proposal to use an attrition adjustment preceded by just one month the culmination of a PSE general rate case in which the Commission had occasion to discuss this ratemaking tool at length. In PSE's 2011/2012 general rate proceeding in Dockets UE-111048 and UG-111049, resolved by final order on May 7, 2012, the Commission discussed favorably the idea of using an attrition adjustment as a means to address the problem of a demonstrated inability of a utility to earn at or near its authorized return over a period of years. *See Washington Utilities & Transportation Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 and UG-111049 (consolidated), Order 08 ¶¶ 483 - 491 (May 7, 2012) (*PSE 2012 GRC*). It appears from the Commission's order in Avista's 2012 general rate case that testimony from Staff in the PSE case inspired, or at least informed, Avista's attrition proposal in early 2012. *Washington Utilities & Transportation Comm'n v. Avista Corporation d/b/a Avista Utilities*, Docket UE-120436 and UG-120437 (consolidated), and UE-110876 and UG-110877 (consolidated), Order 09/14 ¶ 14 n.4 (December 26, 2012) (citing Lowry, Exh. MNL-1T, at 3:9-11). Dr. Lowry, citing to Staff witness Ken Elgin's testimony in PSE Dockets UE-111048 and UG-111049, described the purpose of an attrition adjustment as an "[analysis of] actual historical trends in the growth rates of revenues, expenses, and rate base to estimate the erosion in rate of return caused by disparate growth in these categories." *Id.* ¶ 14 n.4 (citing Lowry, Exh. MNL-1T, at 13:22-24 (citing, in turn, Elgin, Exh. KLE-1T, at 67:6-8, Dockets UE-111048 and UG-111049 (consolidated))).

⁴⁵ *Washington Utilities & Transportation Comm'n v. Avista Corporation d/b/a Avista Utilities*, Docket UE-120436 and UG-120437 (consolidated), and UE-110876 and UG-110877 (consolidated), Order 03/08 (May 14, 2012).

⁴⁶ These two issues also were before the Commission beginning in October 2012 with PSE's filing in Dockets UE-121697 and UG-121705 seeking approval of electric and natural gas decoupling mechanisms and authority to record accounting entries associated with the mechanisms. PSE amended its petition on March 4, 2013, to include a rate plan proposal. The Commission, recognizing decoupling and the rate plan as parts of a piece with PSE's Expedited Rate Filing (ERF), filed on February 4, 2013, ordered that the decoupling and ERF dockets would

- 30 Avista requested in its 2012 general rate filing an electric rate increase of \$41.0 million, or 9.0 percent, and a gas rate increase of \$10.1 million or 7.0 percent. These revenue requests were based in significant part on an attrition adjustment by which Avista “proposed to cure a perceived revenue deficiency of \$21.6 million”⁴⁷ during the rate year, calendar year 2013. It thus appears Avista’s modified historical test year analysis showed a revenue deficiency of approximately \$20 million to which the Company’s proposed attrition adjustment would be added. In addition, Avista filed tariff Schedule 93, which reflected a proposed one-year Energy Recovery Mechanism (ERM) bill decrease, or rebate, to electric customers of \$13.6 million (about 2.9 percent).
- 31 Staff also performed an attrition study after first making several adjustments to the Company’s initial modified historical test year case. In stark contrast to Avista, Staff’s *pro forma* study resulted in a revenue *surplus* of \$20.378 million for electric operations

be heard jointly. In the ERF proceeding PSE sought to update to May 2013 its rates established in May 2012. The updated rates would establish the starting point for operation of decoupling and the rate plan.

The Commission first discussed the idea of an ERF, again at Staff’s suggestion, in its final order in the 2012 PSE case, immediately following its discussion of attrition. *See supra* n.44; *see also PSE 2012 GRC*, Order 08 ¶¶ 492 - 507. PSE filed its ERF “in response to the Commission’s statement in its *PSE 2012 GRC* Order that the Commission would give ‘fair consideration’ to proposals ‘that might break the current pattern of almost continuous rate cases,’” with specific reference to the Commission’s observation in ¶ 507 of its *PSE 2012 GRC* Order that:

This pattern of one general rate case filing following quickly after the resolution of another is overtaxing the resources of all participants and is wearying to the ratepayers who are confronted with increase after increase. This situation does not well serve the public interest and we encourage the development of thoughtful solutions.

In the Matter of the Petition of Puget Sound Energy and NW Energy Coalition For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms, Dockets UE-121697 and UG-121705 (consolidated) (Decoupling) and *Washington Utilities and Transportation Commission v. Puget Sound Energy*, Dockets UE-130137 and UG-130138 (consolidated) (ERF), Order 07 - Final Order Granting Decoupling Petition and Final Order Authorizing ERF Rates ¶ 4 (June 25, 2013) (*Decoupling and ERF Dockets*, Order 07) (citing *PSE 2012 GRC*, Order 08 ¶ 507).

⁴⁷ *Washington Utilities & Transportation Comm’n v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-120436 and UG-120437 (consolidated), and UE-110876 and UG-110877 (consolidated), Order 09/14 ¶ 14 (December 26, 2012).

and a revenue deficiency of \$1.135 million for natural gas operations. Staff, however, assumed the revenue surplus would not be sustained through the rate period. Staff found attrition in the amount of \$19.066 million that, combined with its revenue surplus projection of \$20.378 million, resulted in an attrition-adjusted *surplus* of \$1.312 million for electric service. As to natural gas, Staff determined attrition of \$2.837 million. Added to Avista's *pro forma* revenue deficiency of \$1.135 million shown by Staff's modified historical test year analysis, this resulted in an attrition-adjusted revenue deficiency of \$3.972 million for natural gas service.⁴⁸ Public Counsel and ICNU opposed all of the proposed attrition adjustments.

32 On October 19, 2012, all parties except Public Counsel and NWECA⁴⁹ filed a settlement stipulation addressing the Company's revenue requirement, cost of capital, the ERM structure, rate spread and rate design, as well as several other issues. The Commission described the settlement as a "black box," meaning that the settling parties agreed to firm end-result numbers without indicating which parties' adjustments or issues were included in the final numbers.⁵⁰ Even so, the settling parties agreed to:

- Revenue Requirements for 2013 and 2014 (both electric and natural gas).⁵¹
- Cost of Capital, Capital Structure and Rate of Return.
- Depreciation Rates Based on the Depreciation Study by Avista.
- ERM Rate Adjustment Trigger.
- Power Supply Revenues and Expenses.
- Renewable Energy Credit Revenue Deferral to Customers.
- An agreement not to advocate for electric decoupling prior to January 1, 2015.
- Rate Spread and Rate Design (both electric and natural gas).⁵²

⁴⁸ *Id.* ¶ 16.

⁴⁹ NWECA did not oppose the Settlement but initially wanted to reserve its right to pursue further litigation of the electric decoupling issue.

⁵⁰ Order 09/14 ¶ 28.

⁵¹ The settling parties did not agree to a specific attrition adjustment but stated in this connection that "their respective litigation positions" were taken into account in reaching their agreement. Order 09/14 Appendix A ¶ 8.

⁵² Order 09/14 ¶ 29.

33 The settling parties agreed to a two-step rate increase: the first rate increase became effective with service on and after January 1, 2013, and the second increase began on January 1, 2014. This two-year rate increase was projected to produce an additional \$13.650 million (3.0 percent on average) in revenue for Avista from electric ratepayers in the first year and \$14.038 million (3.0 percent on average) in the second year.⁵³ The Company's natural gas customers would pay \$5.300 million in additional rates (3.7 percent on average) for the first year and \$1.400 million in additional rates (0.9 percent on average) in the second year.⁵⁴

34 Despite the settlement's disavowal of express reliance on the Company's or Staff's attrition adjustments, the Commission made clear in Order 09/14 its understanding that Staff and Avista relied heavily on the existence of attrition to justify both the 2013 and 2014 rate increases proposed in the settlement.⁵⁵ The Commission states in its order that:

In the context of this Settlement, [as opposed to the context of a litigated rate case], we have not had the opportunity either to articulate the appropriate standards by which to assess a proposed attrition adjustment nor evaluate thoroughly the evidence in support of such an adjustment.⁵⁶

35 The Commission found "sufficient evidence in both Staff and the Company's attrition analyses to demonstrate that, based on the 2011 test year data, Avista will experience some level of attrition in 2013."⁵⁷ Finding "much of the attrition . . . based on continued capital investment by Avista," the Commission observed that while Avista had "put forth its 2013 capital construction plan," the Commission deem[ed] it desirable to monitor the Company's progress in achieving its plan for capital expenditures.⁵⁸ The Commission also stated that while the record included attrition studies for 2013, there was no such evidence for 2014 and "trending data offered in support of the proposed rate increase for

⁵³ Exh. 5 ¶¶ 4 and 5.

⁵⁴ Order 09/14 ¶ 30.

⁵⁵ *Id.* ¶¶ 53, 69.

⁵⁶ *Id.* ¶ 70

⁵⁷ *Id.*

⁵⁸ *Id.* ¶ 71.

2014 [was] substantially less precise than we would require in a fully-litigated rate case.”⁵⁹ Finally, in this connection, the Commission said:

The trending data supplied by Avista, wherein the Company pledged to continue its multi-year capital expenditure program for both 2013 and 2014, forms a cornerstone of our approval of the two-step rate increases. As Public Counsel rightly points out, we do not have a detailed capital expenditure plan for 2014 before us. Given that a detailed capital expenditure plan for 2014 may not be available until well into the third quarter of 2013, we require Avista to file such an updated capital expenditure plan on or before September 30, 2013. This filing should also describe the Company’s actual expenditures in 2013 compared to the projected amounts. In addition, we require that the Company provide updates on changes in meeting the calendar year 2014 capital expenditure plan and the Company’s progress in making such improvements on June 1, September 1, and December 1, 2014, respectively, for the previous quarters. Should Avista’s representations in this proceeding regarding the necessity of such expenditures prove unsupported as compared to the Company’s actual expenditures, the Commission may exercise our statutory authority and reopen this proceeding.⁶⁰

36 Thus, the Commission conditionally approved the settlement, including escalation factors, but made clear that it was “not endorsing the specific attrition methodologies, assumptions, or inputs used in this case.”⁶¹ The Commission said it intended “to clarify the conditions wherein attrition should be considered when setting rates” and would “in the near future initiate an inquiry into the appropriate use of attrition analysis in setting rates, including the appropriate methodology to use in preparing attrition studies.”⁶²

⁵⁹ *Id.* ¶ 72.

⁶⁰ *Id.* ¶ 72 (internal citation omitted).

⁶¹ *Id.* ¶ 77.

⁶² *Id.* Independent of any such inquiry, the Commission brought additional clarity to its intentions regarding the conditions in which attrition should be considered when setting rates in its final order in PSE’s decoupling and ERF dockets that came approximately seven months after its December 26, 2012, Order 9/14. See *Decoupling and ERF Dockets*, Order 07 (June 25, 2013). Briefly, in Order 07, the Commission implemented three “innovative ratemaking mechanisms that, together, fulfill[ed] the Commission’s policy goal of breaking the recent pattern of almost continuous rate cases.” In this connection, Order 07 quotes PSE 2012 GRC Order ¶ 507. See

- 37 Early in the second year of the two year rate plan, Avista filed another general rate case on February 4, 2014, in Dockets UE-140188 and UG-140189 proposing to increase revenue for electric service by approximately \$18.2 million or 3.8 percent⁶³ and to increase revenue for natural gas service by approximately \$12.1 million, or 8.1 percent.⁶⁴ Despite being filed at the beginning of the second year of a two-year rate plan approved with the Commission's express recognition of the Company's claims of attrition and allowing increased revenues at levels intended to ameliorate claimed earnings deficiencies, Avista's request for increased revenues in the 2014 filing again turned on claims of attrition.
- 38 Ultimately, the Commission approved and adopted a settlement the parties filed on August 18, 2014, reflecting increases of approximately \$11.9 million in electric rates⁶⁵ and \$8.5 million in natural gas rates. Order 05 recognized the Company's updated power supply impacts and the Commission's decision in approving the settlement to double the Settlement's proposed increase in LIRAP funding, resulting in final electric and natural gas revenues of \$12.1 million and \$8.9 million respectively. Thus, the settlement amounts

supra n.44. The three mechanisms included the ERF update, full decoupling, and a multi-year rate plan with escalation factors based on trending analyses results adjusted downward to yield "stretch goals" that would require improved efficiency in operations and cost cutting, if PSE was to earn its authorized return. The Commission concluded that:

The use of fixed annual escalation factors to adjust PSE's rates is a viable approach to reduce the impacts of regulatory lag and attrition during a multi-year general rate case stay-out period. The escalation factors provide PSE an improved opportunity to earn its authorized return, but are set at levels that will requires PSE to improve the efficiency of its operations if it is to actually earn its authorized return. This is a critically important consideration underlying our approval of the rate plan.

Decoupling and ERF Dockets, Order 07 ¶ 171.

⁶³ The overall electric increase Avista proposed is 5.5 percent, including the above-mentioned 3.8 percent base rate increase, a Renewable Energy Credit Revenue Mechanism rebate of 1.1 percent, and the expiration of two rebates currently received by electric customers totaling 2.8 percent, effective January 1, 2015.

⁶⁴ *Washington Utilities & Transportation Comm'n v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-140188 and UG-140189 (consolidated), Order 05 (November 25, 2014).

⁶⁵ *Id.* ¶¶ 17-18. The settlement reflects a net electric rate increase impact, including offsets from various credits and refunds detailed in the settlement agreement and discussed in Order 05.

represent approximately 66 percent and 74 percent of the Company's original requests for increased electric and natural gas revenues, respectively.⁶⁶

39 Importantly, the settlement in Avista's 2014 case approved decoupling mechanisms for both electric and natural gas rates for a five-year term. As discussed elsewhere, decoupling allows for the utility's recovery of the fixed costs it incurs independent of the amounts of electricity and natural gas it sells.⁶⁷ Decoupling removes the so-called "throughput incentive" and is intended to promote more aggressive pursuit of cost-effective conservation. Thus, generally, the utility is assured recovery of a significant part of its fixed costs without regard to load growth, or even load loss. The decoupling approval included a requirement for a third-party evaluation to "address decoupling's effect on revenues, its impact on conservation, the extent to which the allowed revenues are recovering their allocated cost of service by customer class, and the extent to which fixed costs are recovered in fixed charges for the customer classes excluded from the decoupling mechanisms."⁶⁸

40 The Commission recognized in Order 05, as it has in other orders, that full decoupling improves significantly a utility company's opportunity to realize its authorized return or even to over earn relative to its authorized ROR. Thus, the decoupling mechanisms approved in Order 05 included an earnings test. If volumetric rates produced a surplus of revenue (*i.e.*, sales revenue is above the product of the number of customers in the rate year times the revenue per customer), all of the surplus would be returned to the customers. In addition, if Avista's achieved ROR, as determined in the Company's annual Commission Basis Report, exceeded 7.32 percent, the rebate to customers would

⁶⁶ *Id.* ¶ 20, Revised Table A.

⁶⁷ See, e.g., *In re WUTC Investigation into Energy Conservation Incentives*, Docket U-100522, Report and Policy Statement on Regulatory Mechanisms, including Decoupling, To Encourage Utilities To Meet or Exceed Their Conservation Targets (Nov. 4, 2010) (Decoupling Policy Statement).

⁶⁸ Dockets UE-140188 and UG-140189, Order 05 ¶ 5. The electric schedules omitted from the decoupling mechanism include Extra Large General Service (Schedule 25) and Street and Area Lighting (Schedules 41-48). Appendix 2 to Settlement at 3. The natural gas schedules omitted from the decoupling mechanism include Large General Service – Firm (Schedule 112), High Annual Load Factor Large General Service – Firm (Schedule 122), Interruptible Service (Schedule 132), and Transportation Service for Customer-owned Gas (Schedule 146).

be increased by half the revenue causing the excess ROR.⁶⁹ Indeed, under the earnings test mechanism the Commission adopted, Avista essentially was guaranteed to recover a significant portion of its fixed costs. This is because if the decoupling mechanisms produced a revenue deficit (*i.e.*, sales revenue is below the product of the number of customers in the rate year times the revenue per customer) and Avista's ROR was less than 7.32 percent, a bill surcharge would be applied to customer bills to recover the full deficit amount. However, should that condition arise, to the extent Avista's ROR was greater than 7.32 percent, the surcharge on customer bills would be decreased by half the revenue causing the excess ROR.⁷⁰

41 Order 05 discusses that Avista claimed in its as-filed case to be experiencing attrition and included in its prefiled evidence an attrition study, which the Company used to derive its revenue deficiency. Staff adopted a similar trending method to identify projected expense levels, which Staff proposed the Commission use to set rates.

42 According to Order 05, Public Counsel "strongly opposed the trending methodology used by Avista and Commission Staff, arguing that, although it appears the trending approach used in the prior case "...is working and [is] quite precise," upon closer examination, the apparent precision is not due to the trending."⁷¹ Public Counsel suggested that the attrition study results were due, rather, to the Company's decisions to accelerate capital expenditures before the end of the test period.⁷² ICNU also opposed the use of attrition studies to set revenue requirements, pointing out that the proposed methodology had not been approved by the Commission and that the Company failed to satisfy the burden necessary to justify a departure by the Commission from its normal practice of setting revenue requirements using a modified historical test period approach.⁷³

⁶⁹ *Id.* ¶ 23. The 7.32 percent ROR baseline was an agreed amount. We note, however, that Avista's as-filed case included a ROR of 7.71 percent with a ROE of 10.1 percent and 49 percent equity in the capital structure. All else being equal, the agreed 7.32 percent ROR reflects a 9.71 percent ROE. This compares to the agreed 9.8 percent ROE and 47 percent common equity that produced a 7.64 percent ROR under the parties' settlement in Dockets UE-120436 and UG-120437.

⁷⁰ *Id.* ¶ 24.

⁷¹ *Id.* ¶ 48.

⁷² *Id.*

⁷³ *Id.*

43 Under the circumstances, the Commission said in Order 05 that:

Since the parties do not agree that an attrition adjustment is included within the Settlement or whether an attrition adjustment is appropriate at all, we do not deliberate on the merits of any position on the issue presented in this case. The settling parties do, however, recommend that the Commission establish a separate forum to discuss attrition and other general rate making policy issues. Clearly there is a consensus among the parties regarding the need for a formalized discussion of attrition along with other possible ratemaking mechanisms that may address attrition's effects on earnings.⁷⁴

Avista agreed to provided semi-annual reporting of 2014 and 2015 capital expenditures with actual data by expenditure request, in the categories provided in its *pro forma* "cross check" plant adjustments. In furtherance of this commitment, the settling parties agreed to meet no later than January 31, 2015, to establish any additional details of the capital reporting requirements.⁷⁵

44 The Commission directed Staff to open an investigatory docket for the purpose of convening a forum to address attrition consistent with the settlement. The Commission stated that the forum should be inclusive and open to participation by the broader community of Commission-regulated utility companies and interested consumer groups.⁷⁶

45 Less than three months after the Commission's order in Avista's 2014 general rate case, the Company filed on February 9, 2015, yet another general rate case. In Dockets UE-150204 and UG-150205 Avista asked for revenue increases of \$33.2 million for electric

⁷⁴ *Id.* ¶ 49 (internal citations omitted).

⁷⁵ *Id.* ¶ 50.

⁷⁶ *Id.* ¶ 51. The Commission initiated the forum by notice served on February 5, 2015, in Docket U-150040.

service and \$12 million for natural gas service.⁷⁷ Once again, Avista's filing was based on its attrition analyses.

46 In response to the filing, Staff agreed that because Avista's growth in net plant investment and operating expenses were outpacing its growth in revenue, the Commission *could* allow an attrition adjustment. Staff's witness, Mr. McGuire, testified that to the extent the Company was experiencing attrition it predominantly was due to large capital investments in distribution plant.⁷⁸ Mr. McGuire questioned, however, whether Avista had justified its level of capital investment. In addition, Staff found serious flaws in the Company's attrition analyses. Mr. McGuire testified that:

[A]lthough the Company refers to its case as an "attrition" case, it is in reality a re-branded future test year case. Rather than perform an objective trending analysis to ascertain prevailing rates of growth in the business, Avista developed future test year results for both a) net plant and b) depreciation/amortization, and then circularly calculates its "attrition" growth rates to reproduce those future test year results.⁷⁹

Mr. McGuire found it "worth emphasizing" that the Company rejected its own expert witness's growth rates, which indicated the need for far less revenue than what the Company sought through its filing, in favor of "using speculative future test year" data.⁸⁰

47 Staff performed its own attrition study. Mr. McGuire used the 2009-2014 time period as the basis of his analysis rather than the Company's proposed 2007-2014 time period.⁸¹ At hearing he acknowledged that the 2007-2014 time period closely represented the attrition the Company is likely to experience from 2014 to 2016, and that there was very little difference between his original time period and the Company's.⁸² Mr. McGuire also

⁷⁷ *Washington Utilities & Transportation Comm'n v. Avista Corporation d/b/a Avista Utilities*, Dockets UE-150204 and UG-150205, Order 05 (January 6, 2016).

⁷⁸ *Id.* ¶ 74 (citing McGuire, Exh. CRM-1T at 20:11-16).

⁷⁹ *Id.* ¶ 75 (citing McGuire, Exh. CRM-1T at 45:6-19).

⁸⁰ *Id.*

⁸¹ *Id.* ¶ 76.

⁸² *Id.* (citing McGuire, TR 462:10-463:18; 481:9-15).

replaced the Company's budget estimates for the fourth quarter of 2014 with booked actuals from the Company's Commission Basis Report (CBR).⁸³ Further, Mr. McGuire rejected the Company's use of a Compounding Growth Factor and instead used least-squares linear and quadratic regression for calculating growth trends.⁸⁴ With these changes and additional departures from Avista's attrition analyses, Staff's attrition study at the time it filed responsive testimony produced an attrition allowance of \$14.7 million for the electric revenue requirement and \$5.4 million for the natural gas revenue requirement.⁸⁵ Thus, Staff proposed attrition adjustments that were less than half of what the Company requested in its as-filed case.

48 Significantly, Order 05 relates that:

Mr. McGuire notes that Avista's growth in net plant investment is driven largely by growth in distribution plant. While he does not dispute the prudence of any individual distribution plant investments presented in this case, Mr. McGuire questions the need for the Company to "invest heavily" in distribution plant because the Company has not provided evidence supporting the need to maintain or improve reliability. He raises this issue as a policy matter, questioning whether it is appropriate to continue authorizing significant increases in distribution system capital investments year after year, for the purposes of enhancing system reliability absent a demonstration by the Company of quantifiable benefits to ratepayers.

Staff witness Mr. David Gomez argues that Avista has not demonstrated that its growth in capital spending is just and reasonable and results in facilities that are both efficient and adequate. He proposes that the Commission require expanded capital reporting for Avista, to justify its increased capital spending and demonstrate how this spending benefits ratepayers. Avista is currently required to file semi-annual reports of its

⁸³ *Id.* ¶ 77 (citing McGuire, Exh. CRM-1T at 48:13-18). This is somewhat analogous to using a modified CBR to update rates as occurred in PSE's ERF dockets, noted earlier.

⁸⁴ *Id.* ¶ 77 (citing McGuire, Exh. CRM-1T at 50:6-9).

⁸⁵ *Id.* ¶ 80 (citing McGuire, Exh. CRM-1T at 8:16-17; 43:14-17).

capital expenditures, CWIP balances, and transfers to plant as a condition of the Settlement in its last GRC.

Further, Staff witness Mr. Cebulko argues that the information obtained through Avista's annual electric service reliability report, its Voice of the Customer survey and the J.D. Power Customer Satisfaction Index is inadequate for Staff to determine whether Avista provides reliable electric service. Mr. Cebulko reports that Staff is developing an econometric model that takes into account service territory attributes such as population density, number of line miles, average age of distribution infrastructure and weather severity to determine "meaningful, company-specific [reliability] benchmarks" for Avista. Staff recommends that the Commission order this study, and that it be expanded to include benchmarks for reliability, distribution O&M, and distribution net plant in service for all utilities.

On brief, Staff argues that the Company has provided a narrative of its budgeting process, but does not explain why its budgets are growing at an increasing rate, or demonstrate that these increased costs are required to maintain or improve reliability. Staff argues that the Company's case for incurring ever-increasing costs to replace aging infrastructure for reliability purposes is "vague and unpersuasive."⁸⁶

49 Public Counsel challenged the idea that Avista required an attrition adjustment for either electric or gas revenue requirements and suggested alternatives, such as using end-of-period rate base for gas operations to address the Company's consistent earnings below its authorized return.⁸⁷ ICNU argued Avista's electric operations were not suffering from attrition and, in point of fact, the Company was "over earning" on the electric side of its business.⁸⁸ ICNU opposed any attrition adjustment in determining electric revenue requirements and argued Avista is in a pattern of overspending. ICNU quoted the Company's response to a data request where it specifically acknowledges that the "CPG

⁸⁶ *Id.* ¶¶ 81-84 (internal citations omitted).

⁸⁷ *Id.* ¶85.

⁸⁸ *Id.* ¶ 86

[Capital Planning Group] approves or declines [capital expenditure] requests based on managing a total budget amount.”⁸⁹ NWIGU also opposed the use of attrition to set Avista’s rates in Washington.⁹⁰

50 On rebuttal, Avista abandoned the attrition study filed in its direct testimony and instead adopted Staff’s proposed attrition study and methodologies, with several changes. The Commission discussed in Order 05 that: “[a]though Avista largely adopts Staff’s attrition study methodology, Staff’s Brief cautions the Commission against immoderate dependence on that analysis as a basis for actually authorizing any attrition adjustment.”⁹¹ The Commission noted, too, that “that the evidence presented indicates that Avista has, at least with respect to its electric operations, either earned at or above its approved rate of return in 2013 and 2014, and may possibly do so in 2015.”⁹² For this and other reasons, Public Counsel and ICNU opposed any attrition adjustment for electric rates, contending instead that Avista’s over-earning during the test year [should] have a direct bearing on Commission consideration of the necessity of any attrition adjustment.⁹³

51 With these considerations in mind, the Commission addressed three fundamental questions Avista’s case presented in connection with attrition:

- The appropriate criteria for determining whether an attrition adjustment is warranted.
- The appropriate methodology for an attrition study.
- Whether Avista has met its burden of proof to justify granting an attrition adjustment for both electric and natural gas rates.

52 With respect to the first question, the Commission determined that:

[I]t is not necessary to require a finding of extraordinary circumstances to justify granting an attrition adjustment. An attrition adjustment is yet

⁸⁹ *Id.* ¶ 87 (quoting ICNU Brief ¶ 10 (citations omitted)).

⁹⁰ *Id.* ¶ 88.

⁹¹ *Id.* ¶ 104.

⁹² *Id.* ¶ 105 (citing McGuire, TR. 441:19-24; Norwood, Exh. KON-5).

⁹³ *Id.* ¶ 105.

another tool in our regulatory “toolbox” for utility ratemaking. However, *we do require that utilities requesting an attrition adjustment demonstrate that the cause of the mismatch between revenues, rate base and expenses is not within the utility’s control. Without such a standard, a utility could plan for a level of expenditures that would exceed revenues and rate base recovery, creating the need for an attrition adjustment.*⁹⁴

Thus, the Commission rejected a criterion upon which earlier Commissions relied when considering attrition adjustments, but unequivocally emphasized a second criterion, namely that the record must demonstrate persuasively that any claimed attrition is a result of circumstances that are beyond the ability of the Company to control.

53 Turning to the second question, the Commission found “Staff’s approach, as adjusted and corrected by the Company,” provided “the most appropriate methodology *in this docket.*”⁹⁵ The Commission determined more generally that:

Because an attrition study is an additional tool to use in conjunction with a modified historical test year, *the appropriate methodology begins with development of a modified historical test year with pro forma plant additions*, even subsequent to a test year. An attrition study is based on the resulting projected earnings and revenue requirements, and the attrition adjustment is added only if the study shows a mismatch of earnings and expenditures.⁹⁶

In addition, “[a]llowing an attrition adjustment based on a utility’s budgeted capital spending, portrayed in its testimony as a “cross-check,” is contrary to this ratemaking methodology, given its uncertain and speculative nature.”⁹⁷

54 On the question of burden of proof, the Commission again emphasized that when claiming attrition resulting from increased capital investments in non-revenue generating

⁹⁴ *Id.* ¶ 110 (emphasis added).

⁹⁵ *Id.* ¶ 111 (emphasis added).

⁹⁶ *Id.* ¶ 111 (emphasis added).

⁹⁷ *Id.* ¶ 112.

distribution plant in an environment of low load growth “it is necessary for Avista, and any other utility seeking an attrition adjustment, to demonstrate that its need to invest in non-revenue generating plant, particularly distribution plant, is so necessary and immediate as to be beyond its control.”⁹⁸ Stated differently, “faced with little or no load growth, and hence revenue growth, for the foreseeable future, can Avista demonstrate the *need for such investments, and the benefit to its customers* of its increased level of capital investments, beyond its expected revenues?”⁹⁹

55 The Commission observed in this connection in Order 05 that:

Several parties urge us to firmly reject what they describe as Avista’s attempt to capture future capital spending and incorporate it into an attrition adjustment. They contend that Commission authorization of this approach would enable the Company to follow a plan of capital over-spending that would be consciously pursued in order to increase shareholder earnings. As ICNU points out, such an approach is nothing new to the realm of utility regulation and is widely documented and commonly referred to as the Averch-Johnson Effect.¹⁰⁰

Acknowledging Avista’s contention that it is operating in a challenging environment in which low load and revenue growth is outpaced by capital investment requirements and changes in operating expense levels, the Commission also recognized there is risk to the Company’s ratepayers that by embracing an attrition adjustment Avista may be allowed to manage its capital expenditures without regard to rate impact, effective cost control,

⁹⁸ *Id.* ¶ 116.

⁹⁹ *Id.* ¶ 116 (emphasis added).

¹⁰⁰ *Id.* ¶ 117 (citing Mullins, Exh. BGM-1CT at 13:5-11, who, in turn, cites Harvey Averch & Leland L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 Am. Econ. Rev. 996, 1052 (1962)).

demonstrated benefit, or actual need, and only in reference to its own budgeted targets.¹⁰¹
The Commission continued that:

Simply stated, we are concerned about authorizing a practice that simply projects future levels of expense and capital expenditures that may, as multiple commenters point out, “become a ‘self-fulfilling prophecy’ where there is an incentive for rates of capital expenditure to be driven by an effort to match earlier projections.”¹⁰²

56 Despite its expressed concerns, the Commission found the evidence supported, in part, attrition adjustments for natural gas and electric services. As to natural gas service, the Commission found that “the Company has reasonably demonstrated that it is making significant investments in non-revenue generating plant for the purposes of safety and reliability, to comply with explicit regulatory requirements and in accordance with prior Commission orders.”¹⁰³ The Commission identified specifically the Company’s pipe replacement program for “gas pipe and facilities that have been determined to have a high risk of failure, such as Aldyl-A and steel, which are at the end of their useful lives or have failed.”¹⁰⁴ Observing both that it had procedures in place to review and approve this program biennially, and that it expressly “recognized these activities as a priority,”¹⁰⁵ the Commission accepted “that Avista has established that the need for its capital investments in natural gas operations are beyond its control.”¹⁰⁶ The Commission granted

¹⁰¹ The Commission noted: “Additionally, Avista benefits from a full electric and natural gas decoupling mechanism, starting in January 2015, which removes the link between the Company’s distribution revenues and its volumetric rates.” *Id.* ¶ 119 n 173.

¹⁰² *Id.* ¶ 119 (citing *Investigation of Possible Ratemaking Mechanisms to Address Utility Earnings Attrition*, Docket U-150040, Public Counsel’s Comments, ¶ 40 (Mar. 27, 2015) (quoting the testimony of David C. Gomez in Avista’s 2014 GRC, Dockets UE-140148/UG-140149).

¹⁰³ *Id.* ¶ 121.

¹⁰⁴ *Id.*

¹⁰⁵ See *In the Matter of the Policy of the Washington Utilities and Transportation Commission Related to Replacing Pipeline Facilities with an Elevated Risk of Failure*, Docket UG-120715, Commission Policy on Accelerated Replacement of Pipeline Facilities with Elevated Risk ¶ 37 (Dec. 31, 2012). (Pipeline Replacement Policy Statement).

¹⁰⁶ Dockets UE-150204 and UG-150205, Order 05 ¶ 121.

an attrition adjustment of approximately \$6.8 million for Avista's natural gas operations, resulting in an overall increase in revenue requirement of \$10.8 million.¹⁰⁷

57 In terms of electric operations, the Commission found unpersuasive the evidence filed to support the Company's claims about investment in distribution plant. The Commission cited to evidence from several Staff witnesses demonstrating that the Company failed to explain fully the relationships among the Company's business cases, asset management program and total net plant investment.¹⁰⁸ Order 05 states that "the evidence lacks detailed description of how the Company prioritizes its capital investments in electric distribution plant, or performance criteria to track the need or impacts of those investments."¹⁰⁹ Order 05 quotes ICNU's brief to the effect that:

In practice, the Company has ensured that actual capital expenditures match and then exceed original forecasts on an annual basis. This is accomplished via end-of-year expenditure ramping. The CPG [Capital Planning Group] "has a list of shovel-ready work that can be activated in November *should there be any available funds.*" That is, the Company has designed a program to guarantee full capital spending rather than preserving cost controls. This late-year ramping is apparent in the record, given both actual expenditures in 2014 and forecast expenditures in 2015. Such evidence speaks powerfully to a Company whose spending practices need to be carefully reined in, rather than fueled, *carte blanche*, through the grant of an "undistributed increase" to revenue in the form of an attrition adjustment.¹¹⁰

Order 05 states in addition that the record was incomplete with respect to whether investments being made in electric infrastructure were "driven by, or at least guided by, a specific plan to address ... safety or reliability shortcomings."¹¹¹ Indeed, Order 05 states that the evidence Avista presented in this regard "provides minimal explanation of the

¹⁰⁷ *Id.* ¶ 124.

¹⁰⁸ *Id.* ¶ 126.

¹⁰⁹ *Id.* ¶ 126.

¹¹⁰ *Id.* ¶ 126 (quoting ICNU Brief ¶ 12).

¹¹¹ *Id.* ¶ 127.

projects' relationship to overall reliability, safety, or service quality benefits."¹¹²

Summing up, the Commission said in Order 05 that the "evidence does not convince us that Avista's projected electric distribution investments are entirely outside of its control, or required for the safe and efficient operation of its system."¹¹³

58 Order 05 also points out that "the record shows that Avista's electric operations are currently financially healthy and the Company has actually earned near or above authorized levels for its Washington electric operations for the past two years."¹¹⁴ While this clearly militated strongly against any argument that the Company has been suffering year-over-year attrition, the Commission nevertheless expressed its concerns that the result under Staff's modified historical test year *pro forma* analysis would be a reduction in electric revenue requirement of more than \$20 million and that other parties advocated "even more severe reductions based solely on a modified test year analysis with known and measurable *pro forma* adjustments." Although reductions of the magnitude advocated could be appropriate in some circumstances, under the circumstances of the case, including a period of low load growth to which the Company apparently has not yet had an adequate opportunity to adjust, the Commission concluded that such reductions would produce end results that would be inappropriate.¹¹⁵ Thus, all things considered, the

¹¹² *Id.* ¶ 127.

¹¹³ *Id.* ¶ 127.

¹¹⁴ *Id.* ¶ 131.

¹¹⁵ *Id.* ¶ 132. The Commission here relied on the seminal authority found in *Bluefield Water Works & Imp. Co. v. Public Serv. Comm'n*, 262 U.S. 679, 692, 43 S.Ct. 675, 67 L.Ed. 1176 (1923) (*Bluefield*); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 88 L. Ed. 333 (1944) (*Hope*); *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 791–92, 88 S. Ct. 1344, 1372–73, 20 L. Ed. 2d 312 (1968) (*Permian Basin*); *People's Organization for Washington Energy Resources v. Washington Utilities & Transportation Comm'n*, 104 Wn.2d 798, 811–12, 711 P.2d 319 (1985) (*POWER*). We note that the dissent in this proceeding relies on *Hope* and *Bluefield*. We have no need to offer detailed analysis of the propriety of the dissent's use of these cases to justify the somewhat singular approach to ratemaking it reflects, but we do observe that whatever else these cases and related authorities stand for, they do not support ratemaking decisions that fail to follow the dictates of our statutes, such as the threshold requirement in RCW 80.28.020. We continue to rely on the modified historical test year approach to pro form rates into the rate effective period and insist on this analysis as a starting point in every case. Only if the results of such analysis, considering all relevant evidence, demonstrate a revenue deficiency, do we take the next step to determine whether this is due to circumstances beyond the Company's ability to control. If so, the Commission can consider an attrition

Commission granted “a modified attrition adjustment for electric operations,” while emphasizing that the Commission shared “Staff’s frustration about continuing to authorize recovery for [the Company’s] significant capital investments, absent a complete demonstration by the Company of quantifiable benefits to ratepayers.”¹¹⁶ This resulted in an approximate \$8.1 million *reduction* in the overall revenue requirement for Avista’s electric service based upon the results of a modified historical test year with known and measurable *pro forma* adjustments, including an attrition adjustment.¹¹⁷

III. Avista’s 2016 General Rate Case

59 Avista filed this general rate case on February 19, 2016, six weeks after the Commission’s entry and service of its final order, Order 05, in Dockets UE-150204 and UG-150205. Given that it typically requires months to prepare a general rate case for filing, it appears Avista had very little time and, hence, opportunity to take into account the direction the Commission gave in Order 05. Indeed, whether because of the timing of its filing or for other reasons, the Company fails to present the evidence identified in Order 05 as being critical to demonstrating the basis for an attrition adjustment.¹¹⁸ We discuss the full significance of this failure below.

60 RCW 80.28.020, which governs the Commission’s authority to set just, reasonable, and compensatory rates, provides that:

Whenever the commission shall find, after a hearing had upon its own motion, or upon complaint, that the rates or charges demanded, exacted, charged or collected by any gas company, electrical company, ... for gas [or] electricity..., or in connection therewith, ... are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in any wise in violation

adjustment, among other available ratemaking tools, to improve the Company’s opportunity to earn its full return.

¹¹⁶ *Id.* ¶ 141.

¹¹⁷ *Id.* ¶ 140.

¹¹⁸ The guidance the Commission gave in Order 05 is particularly significant considering that this was the first time in nearly 25 years that the Commission expressly approved an attrition adjustment. *See Id.* ¶¶ 50-51 for a discussion of the history of the Commission’s use of attrition adjustments, and ¶¶ 52-66 for a discussion of the Commission’s contemporary experience with the subject.

of the provisions of the law, or that such rates or charges are insufficient to yield a reasonable compensation for the service rendered, the commission shall determine the just, reasonable, or sufficient rates, charges, regulations, practices or contracts to be thereafter observed and in force, and shall fix the same by order.

That is, the Commission must first determine the question whether the Company's existing rates "are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in any wise in violation of the provisions of the law, or that such rates or charges are insufficient to yield a reasonable compensation for the service rendered." If, and only if, the Commission determines the answer to this threshold question is "yes," does the Commission have the authority, and the obligation, to determine revised rates that meet the fair, just, reasonable, and sufficient standard.

61 With respect to these required showings, RCW 80.04.130 (4) states:

At any hearing involving any change in any schedule, classification, rule, or regulation the effect of which is to increase any rate, charge, rental, or toll theretofore charged, the burden of proof to show that such increase is just and reasonable shall be upon the public service company.

Avista, in this case, has failed to carry its burden to show that its existing rates "are unjust, unreasonable, [or] insufficient to yield a reasonable compensation for the service rendered." Indeed, as we discuss below, the evidence points to the opposite conclusion.¹¹⁹

¹¹⁹ The dissent states: "I believe Avista has adequately carried its burden in justifying need for additional revenue based on a thorough and comprehensive attrition analysis." Dissent ¶ 1. However, two paragraphs later, the dissent says: "I believe Staff's overall approach is well grounded in both theory and fact and should be approved *while Avista's specific proposal should be rejected.*" Dissent ¶ 3 (emphasis added). This appears to relate back to the dissent's further statement in paragraph 1 that: "I believe that *Staff is the only party* that has responded with a legitimate attrition analysis which complements its modified historical test year approach and results in a reasonable revenue requirement." Dissent ¶ 1 (emphasis added). This discussion misses the mark for two reasons. First, Staff does not bear the burden of proof. Avista bears the burden to prove the existence of attrition, but failed to follow the Commission's prior direction that the starting point for such an analysis is a *pro forma* study following the modified historical test year approach upon which the Commission continues to rely.

62 First, Avista ignores the Commission's direction in its final order in the 2015 case that:

Because an attrition study is an additional tool to use in conjunction with a modified historical test year, *the appropriate methodology begins with development of a modified historical test year with pro forma plant additions*, even subsequent to a test year. *An attrition study is based on the resulting projected earnings and revenue requirements, and the attrition adjustment is added only if the study shows a mismatch of earnings and expenditures.*¹²⁰

Avista did not follow this “appropriate methodology” and instead begins with the Company's attrition study. Indeed, insofar as its revenue requirements case is concerned, Avista's case begins and ends with its attrition study, albeit with results adjusted upward for certain capital investments that may occur during the rate period, which the Company describes as “after-attrition adjustments.” That is, the Company's revenue requirements base case depends entirely on the independent results of its attrition study that relies on trends in costs indicated by regression analysis performed on data from 2007 to 2015 plus additional capital costs it contends are not captured by its trending of costs from prior

Second, and more important, is the fact that statistical trending analyses, such as those Avista and Staff performed, do not demonstrate the *existence* of attrition in the rate year and the need for an attrition adjustment. This is why the Commission requires parties to begin any revenue requirements analysis with a pro forma study using the modified historical test year approach. If the *pro forma* study demonstrates a mismatch in the rate year between revenues, rate base and expenses that is not within the utility's control, then there is evidence of attrition. Other evidence, such as a history of chronic under earning, also may suggest the existence of attrition. If the existence of attrition is confirmed considering such evidence, then a trending analysis or “attrition study” can provide useful information upon which to base an attrition adjustment or grant alternative forms of relief.

In point of fact, as discussed in this Order, Staff's traditional *pro forma* study shows a revenue sufficiency in the rate year for both electric and natural gas operations, while the existence of attrition depends on the existence of a revenue deficiency. Moreover, as the dissent acknowledges, “There is evidence of Avista over-earning over the past several years, especially on electric operations” and concludes: “I am persuaded that, on a combined basis for the 2013-2016 period, that Avista has come fairly close to earning its authorized ROE of 9.5 percent.” Dissent ¶ 32. Nor does the evidence show that Avista faces capital investments or expenses that are beyond its ability to control. These facts, among others discussed in this Order, persuade us that Avista has failed to make the required threshold showing that its current rates are unjust, unfair, unreasonable, or insufficient as required under RCW 80.28.020.

¹²⁰ *Id.* ¶ 111.

years. Avista would have the Commission rely on its attrition analyses with after-attrition adjustments rather than analyses grounded in a careful *pro forma* study based on a modified historical test year approach. This simply ignores the Commission’s discussion of “appropriate methodology,” quoted above.

63 Avista did present an analysis it describes as a modified historical test year *pro forma* study, but the results are adjusted to account for the Company’s so-called cross-check analyses, which are based on budget projections. The Commission expressly rejected the use of cross-check studies in the Company’s 2015 case.¹²¹ For this reason, Avista’s *pro forma* results cannot be relied upon to demonstrate a revenue deficiency. In any event, Avista presented these results only for purpose of comparison to its attrition study results. Avista’s nominal *pro forma* results are not evidence that the Company is experiencing attrition and do not demonstrate a failure of the modified historical test year relationships to hold into the rate year.

64 Staff and ICNU also undertook and presented *pro forma* results of operations (*i.e.*, revenue requirements) based on their separate analyses of the modified historical test year. Despite results that suggest Avista does not suffer from attrition at this time, Staff and ICNU nevertheless performed trending analyses, albeit with different methods and results relative to each other and to Avista, and proposed “attrition adjustments” for the Commission’s consideration. Table One shows the outcomes of the parties’ respective efforts.

¹²¹ *Id.* ¶ 37; *see supra* ¶ 10 n.12.

TABLE ONE
Dockets UE-160228 and UG-160229
Pro Forma and Attrition Study Revenue Increases
(\$ Millions)

Party	Electric			Gas		
	Pro Forma	Attrition	Revenue Requirement	Pro Forma	Attrition	Revenue Requirement
Avista	\$11.8	\$48.9 ((\$38.5 in 2017 plus \$10.3 in 2018))	\$48.9 ((\$38.5 in 2017 plus \$10.3 in 2018))	(\$1.2)	\$5.3 ((\$4.4 in 2017 plus \$0.9 in 2018))	\$5.3 ((\$4.4 in 2017 plus \$0.9 in 2018))
Staff	(\$0.4) ¹²²	\$26.0 (18 months)	\$25.6 (18 months)	(\$3.3)	\$2.1 (18 months)	(\$1.2) (18 months)
ICNU	(\$8.1)	(\$3.2)	(\$4.9)	(\$4.1)	(\$4.7)	(\$0.6)

65 As shown in Table One, Avista’s *pro forma* analyses, although flawed as discussed above, purport to show a modest revenue deficiency for electric service, \$11.8 million, and a slight revenue sufficiency, (\$1.2 million), for natural gas service. Even were we to ignore Avista’s inappropriate adjustment of its *pro forma* results considering its cross-check studies, the *pro forma* results portrayed in Table One showing the Company’s revenue requirements for 2017 and the first half of 2018 do not in themselves demonstrate that Avista is experiencing attrition. That is, even if we could accept Avista’s stated results for electric service, Commission orders in the Company’s rate cases over the past 10 years suggest it is unlikely that we would simply adopt Avista’s *pro forma* results in a litigated case.¹²³ This is particularly indicated by Staff’s and

¹²² Staff’s response testimony showed *pro forma* electric results of (\$4.5 million) and *pro forma* gas results of (\$3.3 million). Staff, on brief, states its *pro forma* results and attrition adjustment have changed due to Staff’s acceptance of Avista’s *pro forma* property tax adjustment, which is no longer in dispute, and Staff’s modification of its position on the Montana Riverbed lease expense. Staff Brief ¶ 1 n.2. Based on the text of its brief, Staff now calculates revenue requirements of \$25,570,000 for electric and \$2,143,000 for gas. Staff Brief ¶ 1. From its attrition study, Staff derives an “attrition adjustment” of \$26,005,000. It is unclear whether this is electric only or electric and gas combined.

¹²³ On average, over the past decade of Avista rate cases, the Commission has approved about 43 percent of the Company’ as-filed requests for increased revenue for electric service and about 67

ICNU's results that show small to modest revenue sufficiencies for both electric and natural gas service. The parties' respective results, all taken at face value and considered together, show that finding a revenue sufficiency for electric operations would be at least equally likely as finding a revenue deficiency. The results of all parties' analyses in the case of gas operations are definitive; a revenue sufficiency is indicated in each party's *pro forma* analysis.

66 Second, as we consider whether Avista has carried its burden to show the existence of attrition, we are mindful that chronic under earnings were the touchstone that sparked the Commission's positive reaction to Staff's suggestion in PSE's 2011 general rate case that attrition adjustments could be used in response to such a situation if the results were caused by circumstances beyond a utility's ability to control.¹²⁴ It was this factor, coupled with the pattern of annual rate filings by investor-owned utilities in Washington that prompted the Commission to reopen the door to attrition as a ratemaking tool after a nearly twenty-five year long hiatus in its use. The absence of a showing of chronic under earnings in this case and, indeed, undisputed evidence that the Company continues to earn at, near, or even in excess of, its authorized return, thus militates against the use of an attrition adjustment in this case.

percent of its as-filed requests for increased revenue for gas service. *See infra* ¶ 72. We note, too, that there is a 40 basis point spread between Avista's currently approved ROE of 9.5 percent and the 9.9 percent ROE Avista assumes for purposes of its *pro forma* analysis. In addition, there is testimony in this record that a ROE as low as 9.1 percent might be appropriate today. Each 10 basis points represents about \$1,000,000 in electric revenue.

¹²⁴ In its final order in PSE's 2011 general rate case, the Commission said:

[A]n attrition adjustment is one among several possible responses the Commission could make to address a demonstrated trend of under earning due to circumstances beyond the Company's ability to control. This form of adjustment was available to utilities during the early 1980's in an environment of exceptional inflation and high interest rates; it is equally available today if shown to be a needed response to the challenges posed by PSE's current intensive capital investment program to replace aging infrastructure.

WUTC v. Puget Sound Energy, Dockets UE-111048 and UG-111049, Order 08 ¶ 489 (May 7, 2012).

67 Avista, to its credit, candidly acknowledges in its brief that the Company earned at or near its authorized return during 2013, 2014, 2015, and that this continues into 2016. Avista's brief states that:

For 2013-2015, Avista's normalized Returns On Equity (ROE) for its Washington electric and natural gas operations show that it somewhat over-earned for its electric operations and under-earned for its natural gas operations during the three year period, although its earned ROE for its Washington utility operations as a whole were quite close to the authorized ROE.

[A] similar result has been observed thus far in 2016 for Avista's electric and natural gas operations. After examining the electric and natural gas earnings sharing deferrals for Washington operations for the first six months of 2016, the results, when translated into equivalent ROEs, yield an estimated electric ROE for 2016 of 9.54%, as compared with the authorized ROE of 9.5%; and for natural gas it demonstrates a 10.2% ROE as compared to the same authorized ROE of 9.5%.¹²⁵

68 Avista's brief refers to Mr. Norwood's testimony in this connection that:

These results indicate that the overall revenue adjustments approved for Avista by the Commission for 2013, 2014 and 2015, based on the underlying attrition analyses, were very close to what they should have been in order to allow Avista an opportunity to earn its allowed return for its Washington utility operations.¹²⁶

We do not agree that Avista's spending the revenue increases the Commission has authorized each year in the Company's three attrition-based general rate cases completed since 2012 "indicates" that the increases "were very close to what they should have

¹²⁵ Avista Brief ¶¶ 62-63. Avista notes internally to this quote that its "information is based on the Company's Commission Basis Reports (CBR) filed annually with the Commission which provide an after-the-fact 'apples-to-apples' comparison with the ROE authorized by the Commission for the respective periods." *Id.* ¶ 62 n 11 (citing to Exh. KON-1T at 10:20 – 11:15).

¹²⁶ Avista Brief ¶ 62 (citing Exh. KON-1T at 12:3-6 (emphasis added by Avista)).

been.” As acknowledged in Order 05 in the Company’s 2015 general rate case, Avista’s practice is to spend up to its authorized revenue by ramping up expenditures late in the year to fund “shovel-ready work” if any funds are available.¹²⁷ Thus, what is indicated by Avista’s results in recent years appears now to be the realization of the Commission’s earlier expressed concern that:

[A]uthorizing a practice that simply projects future levels of expense and capital expenditures . . . may, as multiple commenters point out, “become a ‘self-fulfilling prophecy’ where there is an incentive for rates of capital expenditure to be driven by an effort to match earlier projections.”¹²⁸

69 The near match between Avista’s earned and authorized revenues in recent years, to which Mr. Norwood refers, tells us nothing about whether the increased revenue and spending were necessitated by circumstances beyond the ability of the Company to control or, indeed, needed at all. The Commission, however, established in its final order in Avista’s 2015 general rate case that a necessary showing to support an attrition adjustment is that the increased capital spending and increased expenses identified as being the causes of attrition are the result of factors beyond the Company’s control.¹²⁹ The Commission elaborated on this point later in Order 05 saying: “it is necessary for Avista, and any other utility seeking an attrition adjustment, to demonstrate that its need to invest in non-revenue generating plant, particularly distribution plant, is so necessary and immediate as to be beyond its control.”¹³⁰ The Commission explained in several

¹²⁷ See *supra* ¶ 58.

¹²⁸ Dockets UE-150204 and UG-150205, Order 05 ¶ 119 (citing *Investigation of Possible Ratemaking Mechanisms to Address Utility Earnings Attrition*, Docket U-150040, Public Counsel’s Comments ¶ 40 (Mar. 27, 2015) (quoting the testimony of David C. Gomez in Avista’s 2014 GRC, Dockets UE-140148/UG-140149).

¹²⁹ *Id.* ¶ 110 (“we . . . require that utilities requesting an attrition adjustment demonstrate that the cause of the mismatch between revenues, rate base and expenses is not within the utility’s control.”); see also *Id.* ¶ 116 (“it is necessary for Avista, and any other utility seeking an attrition adjustment, to demonstrate that its need to invest in non-revenue generating plant, particularly distribution plant, is so necessary and immediate as to be beyond its control.”).

¹³⁰ *Id.* ¶ 116.

paragraphs, previously discussed in this Order, why it would insist on such a showing.¹³¹
The Commission recognized that:

[T]here is risk to the Company's ratepayers by embracing an attrition adjustment that may allow Avista to manage its capital expenditures without regard to rate impact, effective cost control, demonstrated benefit, or actual need, and only in reference to its own budgeted targets.¹³²

Thus, again, while the Commission no longer found it necessary to justify granting attrition adjustments on the existence of extraordinary circumstances, as had been the case in earlier decades, it established that utilities seeking an attrition adjustment would be required "to demonstrate persuasively that the attrition occurring is outside of their control."¹³³

70 Third, Avista presented no persuasive testimony or evidence to support that the circumstances driving the Company's steadily increasing rate of capital investment and steadily increasing expenses are matters beyond the ability of the Company to control.¹³⁴ In its brief Avista does not cite to any testimony by a Company witness that establishes its increasing capital expenditures and operating expenses are beyond its ability to control. Indeed, the only direct testimony Avista cites in this connection is Staff witness Hancock's bare assertion that the "growth rates in [Avista's] expenses and capital investments are largely the result of factors that *appear* to be outside of the control of the utility."¹³⁵ Mr. Hancock does not elaborate on what these "factors" are or explain why they "appear" to be outside the Company's ability to control. Nor does Avista identify any specific "factors" to which Mr. Hancock might be referring, or establish how they create this "appearance."

¹³¹ See *supra* ¶ 56.

¹³² Dockets UE-150204/UG-150205, Order 05 ¶¶ 119

¹³³ *Id.* ¶¶ 119

¹³⁴ We note that Avista's expenses have increased at rates exceeding every measure of inflation presented by parties in this case. Public Counsel Brief ¶ 16 (citing Hancock, TR. 393:7 – 394:20; Hancock, Exhibit No. CSH-10T at 4:4-8).

¹³⁵ Avista Brief ¶ 14 (citing Hancock, Exh. CSH-1T at 21:6-9) (emphasis added).

71 Avista also cites to a colloquy between Commissioner Jones and Mr. Hancock during the evidentiary hearing in this case in which Mr. Hancock stated that he “*felt* the results of [his Attrition Study] were a reasonable approximation of future used and useful and prudent investments, and they were reflective of conditions that were outside of the Company’s control.”¹³⁶ Feelings, like appearances, lack the substance of objective facts that might reflect relevant conditions outside the Company’s control. Avista’s references to Mr. Hancock’s testimony accordingly are misplaced.¹³⁷ Both Avista and Staff read too much into Mr. Hancock’s impressions formed during his analyses. We do not read Mr. Hancock’s carefully qualified testimony concerning conditions outside the Company’s

¹³⁶ Avista Brief ¶ 16 (citing Hancock, TR. 416:4-8).

¹³⁷ Staff’s discussion in its brief concerning Mr. Hancock’s testimony that macroeconomic factors such as the Federal Reserve’s maintenance of a low interest rate policy since the 2007-2008 financial crisis and upgrades to Avista’s credit rating in late 2007 that have improved Avista’s access to capital markets and lower costs of borrowing is simply beside the point. While better access to less expensive debt may arise from factors that are beyond Avista’s control, the ready availability of money to spend does not answer the question whether Avista’s increased capital investments and increases in expenses that outpace the measures of inflation presented as comparators in this case are necessitated or required as a result of factors beyond the Company’s control. Just because money is available to Avista does not mean it is required to borrow it and spend it. Similarly, even accepting Staff’s assertion that “more projects have lower discount rates and positive net present values,” this does not provide any insight into whether the projects in question are required to be undertaken at this time, or even at all, in response to factors beyond Avista’s control.

We note, too, that one of the key purposes of allowing attrition adjustments is to preserve a company’s access to capital markets. This is why such adjustments were allowed in the 1980’s when interest rates were volatile and high. This clearly is not a problem for Avista today; quite the contrary is true according to Staff’s own discussion. While we can accept that “lower capital costs materially increase the likelihood that more capital projects show net benefits” and *could* move forward, this does not answer the question whether all, or any, such projects *should* move forward. This, inherently, is a question the answer to which is firmly within the control of Avista’s management. This is demonstrated, for example, by the Company’s Asset Management Programs, which are the product of long experience and careful planning by the Company to control the pace and costs of replacing infrastructure that approaches the end of its useful life. There is no evidence of factors outside the Company’s control forcing an increase in the pace of investments in infrastructure covered by the Asset Management Programs, or in other infrastructure, year over year. Indeed, the evidence shows that Avista has in place a number of well-managed programs that function effectively to allow the Company to maintain control over its expenditures in systematic and rational ways. *See generally* Rosentrater, Exh. HLR-1T and accompanying exhibits.

control as being a suggestion of logical consequences drawn directly from the Company's testimony and evidence, or his own careful statistical analyses. As he says, these are appearances and feelings, not facts demonstrated by his analyses or presented by the Company. Statistical analyses do not identify or establish causal relationships. Indeed, for example, it is clear that a regression analysis performed on historical data projected into future years, no matter how statistically significant the results may be, simply will tell us nothing that would help determine whether some unspecified future investment will meet the used and useful test. Similarly, such a statistical analysis can tell us nothing about prudence, which is not a general, abstract inquiry, but rather one tied to individual projects the Company decides to, and does, undertake.

72 The Commission's general practice is not to pre-approve capital projects. The Company, by and large, decides (*i.e.*, controls) what projects it will undertake and when it will undertake them. Prudence determinations are made after the fact, usually after the capital project is complete at which time the Commission can evaluate whether it is used and useful and provides benefits to ratepayers commensurate with its final costs. There may be exceptions, such as the costs associated with the pressing need to replace pipe having a high risk of failure that the Commission acknowledged in Avista's 2015 general rate case as requiring at the time a level and pace of investment beyond the Company's control.¹³⁸ The attrition adjustment granted on the gas side in Avista's 2015 case, in addition to revenue authorized in earlier cases, however, should provide the revenue needed to finance the Company's pipe replacement program going forward. Unless and until it is necessary for Avista to manage its pipe replacement program differently and accelerate the pace of its investment in pipe replacement, the annual costs of this pipe replacement are now included for recovery in rates and, hence, within the Company's control going forward.¹³⁹

¹³⁸ See *supra* ¶¶ 55, 66.

¹³⁹ We note, in addition, that Avista has not elected the option of a Cost Recovery Mechanism (CRM) for its expenditures related to the replacement of high-risk pipe though this option has been available to the Company on an annual basis since 2013. See Pipeline Replacement Policy Statement ¶¶ 58-75. The purpose of the CRM is to allow ongoing recovery of the costs associated with the replacement of high-risk pipe, including return of and return on investment. Were a CRM in place for Avista, there would be no basis to claim the need for an attrition adjustment to ensure recovery of the Company's pipeline replacement program costs.

- 73 Avista proposes to maintain a trajectory of rate increases that could continue on the same slope into the indefinite future, yet it has not presented adequate evidentiary support to demonstrate that its current rates are insufficient or that the pace of its capital investments is outside of the Company's control. It appears that Avista could avoid further increases in revenue requirements at this time or, we hope, in the immediate future, if it moderates the pace of growth in its capital expenditures and carefully manages its expenses.¹⁴⁰ Nothing will alter the trend lines indicated by the Company's and Staff's regression analyses unless the Company moderates the pace of its capital investments and takes measures to keep its expenses at or below general and select measures of inflation. It should be Avista's goal to adjust to the "new normal" discussed in the Commission's order in the Company's 2015 general rate case, and in testimony and briefing in this case.
- 74 In sum, for the reasons discussed, the evidence in the record before us simply fails to establish that Avista's current rates are not, or will not remain after the conclusion of this case, fair, just reasonable and sufficient. We also find the evidence does not show that the revenues produced by Avista's approved rates are not sufficient to allow the Company to continue to provide safe and reliable electric and natural gas services to its customers.

IV. Policy Considerations, Looking Forward.

- 75 Our decision here not to base revenue requirements and rates on the Company's attrition studies, or to accept Staff's modified historical test year results as adjusted for attrition, does not mean that there are no circumstances under which the Commission might accept escalation factors based on rigorous trend analyses such as those performed by Avista,

¹⁴⁰ The dissent asserts that the Majority's Order reflects "an attempt to micro-manage the [capital expenditures] and O&M expenditures of Avista." Dissent ¶ 12. Yet, in the same paragraph, the dissent complains that the Majority "offers little specific guidance on evidence in this record on which areas to reduce spending, and the potential impacts on aging infrastructure, technology impacts, and likely impacts on the reliability and compliance issues in the distribution grid." *Id.* We agree that it is not the Commission's role to micro-manage the Company. Hence, there is no specific guidance such as called for by the dissent. We agree with the further discussion in this paragraph of the dissent that the Company's evidence provides a good overview of Avista's management processes that demonstrate persuasively its ability to control its capital expenditures and expenses. Contrary to what the dissent alleges, we do not direct Avista to moderate its capital investments relative its current high rate of investment. Instead, we simply observe that if Avista does not continue increasing the *pace* of its investments year over year, it can avoid further increases in revenue requirements in the near to intermediate term.

Staff, and others, in this case.¹⁴¹ Order 05, for example, discusses specifically that the Commission previously “has accepted some rate escalation or authorization of relief beyond the modified historical test year when rates will be in effect for more than one year.”¹⁴² Order 05 cites specifically the Commission’s approval of a multi-year rate plan for PSE in 2013 where a “general rate case stay-out period was critical to the Commission’s decision to approve an escalation factor for PSE.”¹⁴³ The Commission explained that:

This approach requires the Company to accept some risk that rates in a future year will be sufficient, but it also provides more certainty to customers. It creates an incentive for the Company to control costs during the years that rates are in effect.¹⁴⁴

This discussion leaves open the possibility that the Commission in the future might find acceptable the use of escalation factors such as those determined by Staff in this proceeding, where such a proposal includes mechanisms that result in a reasonable sharing of risks between shareholders and ratepayers, as opposed to what would occur under the proposals in this case that would place all risk on the ratepayers.

76 A future proposal for a multi-year rate plan such as that approved for Avista in 2012, or for PSE in 2013, for example, could include both updated rates as a starting point and rate escalation one year later, or escalation annually for two or three years, subject to reporting requirements and, perhaps, an earnings test or sharing mechanism. Updated rates could be accomplished in an ERF-type proceeding, or on the basis of a carefully negotiated settlement among the parties, supported by evidence and subject to Commission review and approval. Escalation factors similarly could be the product of the Commission’s adjudication based on a well-developed record, or the product of careful

¹⁴¹ We are encouraged by Staff’s refinements of its analytical approach in this case, relative to what it presented in Avista’s 2015 case. ICNU also offers some useful ideas that parties may wish to explore in any future collaborative efforts.

¹⁴² Dockets UE-150204/UG-150205, Order 05 ¶ 130.

¹⁴³ *Id.* ¶ 130 (citing *In the Matter of the Petition of Puget Sound Energy and Northwest Energy Coalition for an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms*, Dockets No. UE-130137 and UG-130138 (consolidated), Order 07, ¶ 171 (June 25, 2013)).

¹⁴⁴ *Id.* ¶ 130.

negotiation with support adequate to establish that the results proposed are fair, just, reasonable, and sufficient. Such escalation factors need not necessarily be attrition adjustments such as discussed in this Order, but may well be another ratemaking tool available to the Commission in appropriate circumstances and with appropriate safeguards to protect ratepayers.

77 The Commission emphasized the importance of breaking the pattern of annual rate filings when it expressed its openness to using attrition type adjustments in PSE's 2011 general rate case. Indeed, this was a key factor contributing to the Commission's approval of PSE's decoupling mechanisms, ERF, and rate plan proposal in 2013. This remains an important policy goal today.

78 We also support the idea Avista put forward, and other parties endorsed in this case, to change the timing of filing Avista's rate cases, within any given calendar year, to a filing in June or July, rather than the December to February period. Both Staff and the Company testify that Avista should shift from filing general rate cases in the early part of the year to the late summer or early fall.¹⁴⁵ Staff supports such a shift in timing as a means to help spread workload across the year and reduce pressures caused by coincident filings from multiple companies.¹⁴⁶ Mr. Hancock also testifies to the benefits for filings that coincide with the Company's construction season.¹⁴⁷ Avista points in addition to benefits to customers, observing in its brief that "if base rate adjustments occur in the summer months, customers will be aware well before the winter heating season."¹⁴⁸ Avista will continue to control the timing of its general rate case filings and is in a position to shift the timing of its cases from mid-winter to mid-summer, which should benefit ratepayers by not burdening them with rate increases in the coldest months when they have difficulty controlling heating costs, and benefit the Company by reducing regulatory lag.

¹⁴⁵ Morris, Exh. SLM-1T at 3:13-17; Hancock, Exh. CSH-1T at 7-10.

¹⁴⁶ Hancock, Exh. CSH-1T at 8:7-23.

¹⁴⁷ Hancock, Exh. CSH-1T at 9-10.

¹⁴⁸ Avista Brief ¶ 1 n.1 (citing Exh. SLM-1T at 3:9-17).

V. Commission Expectations for Future Rate Filings That Propose to Use the Modified Historical Test Year with *Pro Forma* Adjustments.

79 The Commission has observed in a number of orders during the past two decades that its responsibility in general rate case proceedings is to determine an appropriate balance between the needs of the public to have safe and reliable electric and natural gas services at reasonable rates, and the financial ability of the utility to provide such services on an ongoing basis. In the words of our governing statutes, we are required to determine results that establish “fair, just, reasonable and sufficient” rates for prospective application. This means rates that are *fair* to customers and to the Company’s owners; *just* in the sense of being based solely on the record developed in a rate proceeding; *reasonable* in light of the range of possible outcomes supported by the evidence; and *sufficient* to meet the needs of the Company to cover its expenses and attract necessary capital on reasonable terms.

80 The Commission’s long-established and well-understood ratemaking practice requires companies filing for revised rates to start with an historical test year. This is true whether or not a company claims it suffers from attrition in earnings due to conditions beyond its control. There is a fundamental reason for this starting point in every case: costs, revenues, loads, and all other pertinent factors are known and can be measured with a high degree of certainty because they have, in fact, occurred. The practical value of the historical test year is that the cost, revenue and plant data are available for audit, and the test year captures the complex relationships among the various aspects of utility costs, revenue, load, and other factors over a uniform period of time.

81 The Commission’s past decisions in Avista’s and other investor-owned utility’s general rate cases recognize that there are some expenses or investments that do not take place in the test year that, nevertheless, should be included in the rate-making formula. Thus, subject to important conditions, a company’s rate filing may include restating and *pro forma* adjustments.¹⁴⁹ These are allowed to revise or update expenses, revenues, and rate

¹⁴⁹ WAC 480-07-510 (3)(e)(ii) and (iii) provide as follows:

(ii) "Restating actual adjustments" adjust the booked operating results for any defects or infirmities in actual recorded results that can distort test period earnings. Restating actual adjustments are also used to adjust from an as-recorded basis to a basis that is acceptable for rate making. Examples of restating actual adjustments are adjustments

base so long as there is a mechanism ensuring, and evidence establishing, that these adjustments do not disturb test year relationships.

82 While the Commission traditionally has described its ratemaking practice as being based on the historical test year, a key operative part of this description is “based on.” In point of fact, our practice is quite forward looking and in actuality a process sometimes referred to as a “hybrid test year.” The Commission, for example:

- Approves pro-forma adjustments to test-year costs when the adjustments are adequately supported. The Commission retains significant discretion to apply flexibly the requirements that *pro forma* adjustments be known and measurable, used and useful, and matched to offsetting factors. The Commission has not established bright-line standards governing the timing or the number of adjustments that can be accepted in a given case, and has not established a minimum size for *pro forma* adjustments to be recognized.
- May allow calculation of base power costs using costs projected for the rate year based on data contemporaneous with the end of a general rate case (*i.e.*, at the beginning of the rate year). This has been found appropriate during periods of market volatility and could be shown to be appropriate in other circumstances.
- Has approved power cost adjustment mechanisms, such as Avista’s ERM, that allow recovery of excess power costs incurred during the rate effective period, subject to certain conditions.
- May allow new generation plant or other infrastructure in rate base even when the new facilities are placed in service subsequent to the end of the test period. The more certain the timing of infrastructure being in

to remove prior period amounts, to eliminate below-the-line items that were recorded as operating expenses in error, to adjust from book estimates to actual amounts, and to eliminate or to normalize extraordinary items recorded during the test period.

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

service, that is used and useful, and the more certain the costs, the more likely the post-test period rate base will be approved.¹⁵⁰

- May approve end-of-period rate base when this is shown to be appropriate.
- May allow CWIP (Construction Work in Progress) in rate base.
- May approve hypothetical capital structures to improve a utility's financial condition.
- May set return on equity toward the higher end of a range of reasonable returns.
- May allow an attrition adjustment to *pro forma* rates determined using a modified historical, or hybrid, test year.

In prior orders, the Commission has made clear that while its ratemaking practice starts with known data that are “historical” by definition, these data are adjusted using various approaches to set rates based on expected costs the utility will experience during the rate year following the effective date of the new rates. Whatever tools are proposed for use in a given case, however, must be chosen with specific reference to the needs of the case and the appropriateness of using each tool selected must be demonstrated by applicable evidence.

VI. Comment Concerning the Company's Plans for Advanced Meter Infrastructure

83 Avista plans to deploy advanced metering to approximately 253,000 electric and 155,000 natural gas customers in Washington, encompassing the entirety of its service area in this state.¹⁵¹ According to the Company, the project has already commenced and Avista expects to complete the full implementation by 2021.¹⁵² Avista contends that “AMR [sic]

¹⁵⁰ Reliable estimates can be considered sufficiently known and measurable to be accepted when capital projects are near completion. Alternatively, capital costs can be included in rate base to the extent actually known and measurable and any subsequent costs can be approved for deferred accounting treatment.

¹⁵¹ Avista Brief ¶ 84 (citing Exh. HLR-1T at 9:7-12).

¹⁵² *Id.* ¶ 84.

will support Avista's continuing effort to improve the quality and cost-effectiveness of the services we offer our customers."¹⁵³

84 Avista included in its revenue requirements proposals for electric and natural gas services an "After-Attrition Adjustment" asking to put into rate base \$17.9 million of capital projects associated with its ongoing Advanced Meter Infrastructure (AMI) project that the Company expects to be in service, in part, sometime in 2017.¹⁵⁴ Avista calculates the revenue requirement associated with the 2017 AMI "After Attrition Adjustment" to be approximately \$3.8 million for electric and \$1.2 million for natural gas.¹⁵⁵ As of its initial filing in this case, Avista expected full project capital expenditure costs to be \$166.7 million, with expected incremental operations and maintenance costs of \$123.4 million, resulting in a total estimated cost of \$290.1 million.¹⁵⁶

85 Because we determine in this Order that Avista failed to carry its burden to show its existing rates are insufficient to meet its needs, and therefore will not adjust the Company's revenue requirements from those set in the 2015 case, we do not reach the issues in this case concerning AMI. We nevertheless find it appropriate to comment on the evidence presented and offer the Commission's updated perspective concerning Avista's AMI deployment plans.¹⁵⁷

¹⁵³ *Id.* ¶ 84. We believe Avista meant to refer to Advanced Meter Infrastructure (AMI), not Automated Meter Reading (AMR), a less sophisticated technology that allows for only one-way communication rather than two-way communication as in the case of AMI.

¹⁵⁴ *Id.* ¶ 83 (citing Exh. EMA-6T at 32-33).

¹⁵⁵ *Id.* ¶ 83 (citing Exh. EMA-6T at 32-33).

¹⁵⁶ Public Counsel/ICNU Joint Brief on AMI ¶ 1 (citing Rosentrater, Exh. HLR-1T at 19-20).

¹⁵⁷ We find the dissent's harsh assessment of Staff's testimony on the AMI issue to be both misplaced and inappropriate. The Commission unanimously agreed in its Order in Avista's 2015 general rate case that:

[The AMI] issue is not ripe for Commission determination. *The Commission's longstanding practice is to review the prudence of a utility's investment in plant after that plant is placed in service and is used and useful.* In contrast, this case discusses a proposal for a future investment that, if we took that first step towards a prudence determination, could be viewed as the Commission indicating pre-approval.

- 86 We begin with the observation that Avista can file an accounting petition at any time asking for deferred accounting treatment of the ongoing expenses it continues to incur as it moves toward initial deployment of AMI in Washington.¹⁵⁸ Were the Commission to rule favorably on such a petition, these costs could be included in FERC Account No. 182.3 or 186 and the Company’s opportunity to recover prudently incurred costs going forward would be protected until such time as Avista makes a timely request for rate recovery of all, or a portion of, its costs. The Commission discussed this very point in its final order in Dockets UE-150204 and UG-150205, Avista’s 2015 general rate case.¹⁵⁹
- 87 In Avista’s 2015 case, the Commission viewed the Company’s request for “guidance” concerning AMI to be tantamount to a request that the Commission take the first step towards a prudence determination.¹⁶⁰ The Commission declined to take this step because it found the issue not ripe for determination under the circumstances then present.¹⁶¹ The Commission stated its “longstanding practice ... to review the prudence of a utility’s investment in plant after that plant is placed in service and is used and useful.”¹⁶² The Commission noted its concern “that any ‘guidance’ we offer would be viewed as [pre-

Dockets UE-150204 and UG-150205, Order 05 ¶ 191. Nothing changed between our order entered in that case on January 6, 2016, and Avista’s filing of this case six weeks later. Yet, the dissent apparently ignores the determination quoted above, stating that “simply adhering to a rigid prudency standard or a used and useful standard is insufficient and borders on irresponsible for an investment of this magnitude.” Dissent ¶ 20. We disagree. Under these circumstances it is completely understandable that Staff elected to refrain from expending significant resources on this issue. We do address the subject of AMI in this Order, as appropriate, and recommend to the Company that it consider the opportunity to file an accounting petition outside the context of a general rate case. The dissent acknowledges this option and supports such an approach.

¹⁵⁸ We note that our decision in these dockets to reject the deferred accounting alternative Avista sought to bring forward via testimony in its rebuttal case in this proceeding was based on fairness to the parties, not the merits of such accounting treatment for these costs. *See* Order 04.

¹⁵⁹ *See* Dockets UE-150204 and UG-150205, Order 05 ¶ 194.

¹⁶⁰ *Id.* ¶¶ 190 – 91.

¹⁶¹ *Id.* ¶ 191.

¹⁶² *Id.* ¶ 191 (emphasis in original).

approval]¹⁶³ and we reiterate here that our dicta in this order on the subject of AMI is just that and nothing more.

- 88 It is clear from the evidence Avista and other parties presented in this proceeding, and from the parties' briefs, that AMI will continue to be a contentious issue going forward. Given this, and the magnitude of the planned investment, we encourage Avista to engage the parties and work with them to resolve through collaborative effort as many of the issues, both large and small, as can be resolved. We similarly encourage the parties, and other interested stakeholders to participate in good faith in such efforts. As Avista continues to refine its project and its analyses of costs and benefits, transparency and open lines of communication will promote better outcomes in future proceedings.
- 89 In this connection, too, we encourage Avista to continue refining its business case and to do its best to understand and address the issues identified by parties to this proceeding who allege the Company's business case needs adjustments and improvements if they are to be persuaded of its merit. This would redound ultimately to the Company's benefit when we, in a future case, are asked to make a timely determination on the merits of Avista's AMI deployment and the questions whether, and to what extent, its costs should be allowed for recovery in rates.
- 90 In addition to refining further its business case, we would like to see fuller discussion in a stakeholder workshop, or in a future proceeding, of Avista's and the other parties' expectations concerning the various uses to which AMI technology can be put immediately, in the intermediate term, and in the long term. As we observed in Order 05 in Avista's 2015 general rate case, deploying advanced metering technologies can allow a utility to reduce its operating expenses associated with meter reading and to communicate more frequently with the meter and potentially other devices that use electricity.¹⁶⁴ AMI can allow a utility to gain quickly awareness of outages, provide conservation voltage reduction services, reduce unbilled usage, and potentially enable demand response, time of use rates, and prepaid services.¹⁶⁵ Avista's and the other parties' views on the questions raised by the prospect of automated disconnection enabled by AMI are critically important matters we eventually must consider. Discussion of these topics now

¹⁶³ *Id.* ¶ 191 n.310.

¹⁶⁴ *Id.* ¶ 176 (citing Kopczynski, Exh. DFK-5 at 10-12).

¹⁶⁵ *Id.* ¶ 176 (citing Kopczynski, Exh. DFK-5 at 11-17).

should lead to timely and appropriate solutions and fuller discussion in testimony filed on these subjects in future cases.

- 91 Other topics requiring additional discussion include the questions of customer privacy and the protection of personal and proprietary information the Company may acquire via AMI. In addition, we expect there will be some customers who will want to opt out of AMI and continue to have their service usage measured by mechanical devices. The Company will need to present the Commission a plan to provide for customer “opt out”, including tariff proposals to address costs and related issues with opting out, such as the avoidance of cross-subsidization.
- 92 Recognizing that our discussion here is not exhaustive, we mention finally the subject of cyber security. It is the Company’s responsibility to protect this new, sophisticated technology, the customers behind it at one end and their personal data, and the Company’s broader infrastructure and data at the other end, as well as the infrastructure in between. The Commission will continue to discuss this topic with the Company and must be kept apprised of cyber security matters on an ongoing basis, assuming full or partial deployment of AMI.
- 93 In closing, the Commission’s introductory remarks on the subject of AMI in the *Decision* section of Order 05 in the Company’s 2015 general rate case bear repeating:

We generally support utilities’ provision of technologically advanced service to customers when a utility demonstrates that the investment is used and useful and prudent. We acknowledge that Avista has been a leader among the region’s utilities in deploying advanced “smart grid” technologies over the past decade in both the Spokane distribution system and the Pullman area that included both distribution and metering technologies.¹⁶⁶

We expect Avista to continue planning and evaluating carefully the costs and benefits of AMI as its expected deployment date approaches.¹⁶⁷

¹⁶⁶ *Id.* ¶ 188.

¹⁶⁷ *See* Staff Brief ¶ 73 (citing Rosentrater, HLR-9T 5:16-18).

VII. Cost of Service Study

- 94 Although we do not reach questions related to the various cost of service studies brought forward in this proceeding, we nevertheless address Staff's recommendation that we initiate industry-wide generic cost of service proceedings. The parties' differences over appropriate methodologies evidenced in the record of this proceeding are suggestive in this connection.
- 95 Avista proposed to use what it referred to as the Peak Credit methodology to classify production and transmission expenditures into energy-related and demand-related costs for its electric services, and the Peak and Average Ratio methodology to classify distribution main investment into demand- and commodity-related costs for natural gas.¹⁶⁸ Avista argues that its methodologies strike an appropriate balance between the how the Company's systems are designed and how they are used to provide energy.¹⁶⁹
- 96 ICNU and NWIGU argue that the Company's methodologies do not allocate enough costs as demand-related expenditures, resulting in harmful impacts that overstate the cost to serve industrial customers. ICNU and NWIGU offer their own cost of service studies, which they argue are more accurate and would be better used for setting rates.¹⁷⁰
- 97 Commission Staff did not present a cost of service study; rather, Staff considered the Company's proposals to be "directionally accurate for the purposes of setting rates" in this case but disagreed with the level of precision the Company derives from its cost of services studies.¹⁷¹ Staff recommended that the Commission defer all major decisions regarding any specific cost of service methodology to a forum in which all utilities participate and can take direction from the Commission.
- 98 Specifically, Commission Staff recommends that the Commission initiate concurrent generic electric and natural gas cost of service proceedings for Avista and the other investor-owned utilities. Through concurrent generic proceedings, the Commission could

¹⁶⁸ Knox, Exh. TLK-1T at 11:8-10; Miller, Exh. JDM-1T at 11:6-11.

¹⁶⁹ Knox, Exh. TLK-4T at 2:15-19.

¹⁷⁰ Collins, Exh. BCC-1T at 12:10-13:7; ICNU Brief ¶ 49.

¹⁷¹ Ball, Exh. JLB-1T at 9:19-22.

“articulate a coherent and consistent COSS approach for all IOUs in Washington through a single policy statement or order.”¹⁷² According to Staff, a consistent COSS approach for all IOUs would reduce the analytic burden of reexamining COSS methodologies for each company in each rate case.

99 In their cross-answering testimony, ICNU and NWIGU agreed with Staff’s recommendations for generic proceedings for all the IOUs.¹⁷³ Avista stated in rebuttal testimony that it has its reservations about the results of generic proceedings applied to investor-owned utilities with substantial differences, but agreed that there may be value in such a proceeding if it addresses the cost of serving customers with distributed generation.¹⁷⁴

100 The Commission agrees that generic cost of service proceedings may provide an opportunity for establishing greater clarity and some degree of uniformity in cost of service studies. While we are given pause by the lack of clear descriptions in the record of how those proceedings are expected to unfold, we are swayed by the parties’ representations of their potential value. Though we believe it is possible to create a consistent framework, we expect this will be a challenging undertaking, given the numerous issues that a cost of service study must address. We therefore direct Staff and the other parties to the generic proceedings to actively collaborate, prior to the initiation of those proceedings, to more clearly define their scope and expected outcomes, as well as a reasonable procedural schedule that will facilitate the desired outcomes. We caution Staff and the other parties who participate in these generic proceedings that while the goal to create consistent guidelines that reduce the analytical burden in future rate cases is laudable, it must be balanced against the need to provide flexible methodologies that take into account a utility’s unique circumstances.

FINDINGS OF FACT

101 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the

¹⁷² Ball, Exh. JLB-1T at 4:17-19.

¹⁷³ Stephens, Exh. RRS-12T at 2:3-5; Collins, Exh. BCC-6T at 2:6-8.

¹⁷⁴ Ehrbar, Exh. PDE-8T at 10:21-25.

following summary of those facts, incorporating by reference pertinent portions of the preceding detailed findings:

- 102 (1) The Washington Utilities and Transportation Commission (Commission) is an agency of the State of Washington vested by statute with the authority to regulate rates, regulations, practices, accounts, securities, transfers of property and affiliated interests of public service companies, including electric and natural gas companies.
- 103 (2) Avista Corporation d/b/a Avista Utilities (Avista or Company) is a “public service company,” an “electrical company,” and “gas company” as those terms are defined in RCW 80.04.010 and used in Title 80 RCW. Avista provides electric and natural gas utility service to customers in Washington.
- 104 (3) On February 19, 2016, Avista filed with the Commission revisions to its currently effective Tariffs WN U-28, Electric Service, and Tariff WN U-29, Natural Gas Service.
- 105 (4) Avista proposed revenue requirements for electric and natural gas operations based on attrition studies that did not follow the methodology identified in Order 05 in Dockets UE-150204 and UG-150205 which begins with development of a modified historical test year with *pro forma* plant additions. Avista begins with an attrition analysis, which it then modifies by the addition of what it calls “after-attrition adjustments.”
- 106 (5) Avista failed to demonstrate that its increasing capital costs and expenses are caused by factors beyond the Company’s ability to control, a showing necessary to support an attrition adjustment.

CONCLUSIONS OF LAW

107 Having discussed above all matters material to this decision, and having stated the following summary conclusions of law, incorporating by reference pertinent portions of the preceding detailed conclusions:

- 108 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, these proceedings.

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- 109 (2) Avista is an electric company, a natural gas company, and a public service company subject to Commission jurisdiction.
- 110 (3) At any hearing involving a proposed change in a tariff schedule the effect of which would be to increase any rate, charge, rental, or toll theretofore charged, the burden of proof to show that such increase is just and reasonable shall be upon the public service company. RCW 80.04.130 (4).
- 111 (4) Avista failed to carry its burden to prove that its existing rates for electric service and natural gas service provided in Washington State are insufficient to yield reasonable compensation for the service rendered or are otherwise in any manner not fair, just, reasonable, and sufficient. The Commission accordingly has neither the authority, nor an obligation, to determine fair, just, reasonable, or sufficient rates, charges, regulations, practices or contracts to be hereafter observed and in force or to fix the same by order. RCW 80.28.020.
- 112 (5) Avista's existing rates continue to be fair, just, reasonable, and sufficient and should remain in effect prospectively from the date of this Order.
- 113 (6) The Commission should retain jurisdiction over the subject matters and the parties to this proceeding to effectuate the terms of this Order.

ORDER

THE COMMISSION ORDERS THAT:

- 114 (1) The proposed tariff revisions Avista Corporation, d/b/a Avista Utilities, filed on February 19, 2016, and suspended by prior Commission order, are rejected.
- 115 (2) Avista's existing fair, just, reasonable, and sufficient rates for electric service and natural gas service will remain in effect prospectively from the date of this Order.
- 116 (3) Staff is directed to initiate, within 60 days after the date of this order, a collaborative effort with interested stakeholders, preferably including representatives of all investor-owned utilities in Washington, to more clearly define the scope and expected outcomes of, as well as a reasonable procedural schedule for, generic cost of service proceedings that will provide an opportunity to establish

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greater clarity and some degree of uniformity in cost of service studies going forward.

- 117 (4) The Commission retains jurisdiction over the subject matters and parties to this proceeding to effectuate the terms of this Order.

DATED at Olympia, Washington, and effective December 15, 2016.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.

Dissenting Opinion of Commissioner Jones

A. Overall Comments

- 1 Our decision must result in fair, just, reasonable and sufficient rates based on the evidentiary record in the proceeding. In contrast to the Majority opinion, I believe Avista has adequately carried its burden in justifying need for additional revenue based on a thorough and comprehensive attrition analysis. I believe that other parties have an obligation to respond to the Company's analysis with equal rigor and detail and if a party does not support an attrition analysis it undertake a revenue requirement analysis such as a modified historical test year or hybrid approach in order to justify its end result. In this proceeding, I believe that Staff is the only party that has responded with a legitimate attrition analysis which complements its modified historical test year approach and results in a reasonable revenue requirement.
- 2 Unlike the Majority opinion, I believe that the use of a modified historical test year method does not result in fair, just, reasonable, and sufficient rates for the Company. Avista naturally makes this argument in both its direct and rebuttal cases and demonstrates with some analytical rigor why this is so. I share Avista's view that in an era of relatively low load growth and high capital expenditures, the Company faces a fundamental, almost structural, mismatch between revenues, operating and maintenance expenditures (O&M), and capital expenditures (capex). Staff clearly agrees with the Avista's arguments on these fundamental conditions and therefore agrees that an attrition adjustment is necessary, through a complementary modified historical test year analysis that is calculated at the end of such historical review.
- 3 Avista and the Staff largely agree on the mechanics of an attrition analysis, particularly the use of linear regression and the 2007-15 timeframe as a common historical period for their trending analysis. They differ however on important inputs and assumptions such as the critical escalation factor for O&M expenses, and several other factors. Overall, I prefer the approach that Staff has taken in this proceeding, especially on the O&M escalation factor and Staff's preference for a weighted average during the historical period of Avista data using ECI and PPI indices. Although it differs slightly from the O&M escalation factor the Commission used in the previous rate proceeding, I believe Staff's overall approach is well grounded in both theory and fact and should be approved while Avista's specific proposal should be rejected.

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- 4 In addition to the attrition issue, I believe it is important to respond to the evidentiary record in this case and render my best judgment on other key issues. In particular, I agree with Staff on having just one rate adjustment during an 18-month period in which new rates are effective, rather than Avista's proposal to establish two separate rate periods for rate increases and a potential adjustment for power costs. I think rate stability and gradualism are more persuasive on this point.
- 5 Additionally, I believe that Advanced Metering Infrastructure (AMI) is another key issue on which we should offer guidance. Specifically, I think Avista's position is superior to Staff since it appears to me that Staff performed no real analysis regarding the economics of the AMI issue, and effectively took the convenient route of merely stating that any determination on AMI was premature. I agree with Avista's proposal to allow an after-attrition adjustment for 2016 AMI capital expenses already incurred by contract, an adjustment which I understand is slightly less than \$5 million.
- 6 Accordingly, I believe that Avista has met its burden of proof and there is ample evidence in the proceeding to render a reasoned decision on revenue requirements. In my view, that is what the Hope and Bluefield standards require of us and we should do nothing less. While the Commission may differ with various parties on the end result of various issues, my colleagues and I are obligated to review all the evidence in detail, exercise our informed judgment, and render a more specific decision on the multitude of issues comprising the authorized revenue requirement of the Company. Accordingly, although the Majority Opinion is rejecting the Company's filing largely on a burden of proof argument on attrition, I believe it is important to respond to the evidentiary record in this case and render my best judgment on key issues.
- 7 The Majority Opinion spends a disproportionately large part of its arguments on recounting the history of Avista rate cases over the past 15 years. While this makes for interesting reading, I don't believe that this historical narrative is directly on point and not relevant to the evidentiary record in this case. We should focus our analysis and use our informed judgment to determine the specific elements of the revenue requirements in this case. The Majority Opinion appears to use this historical narrative of Avista rate cases to buttress its arguments that the Company did not meet its burden of proof, resulting in the dramatic denial of any revenue increase in this case. I respectfully disagree with that approach.

8 Accordingly, having reviewed the record and actively participating in the proceeding, I believe the Staff position is the most reasonable. Staff's attrition analysis would yield additional revenue of \$25.6 million for electric operations and \$2.1million for gas operations. Because I differ with Staff on a few key points my revenue requirement would be slightly higher, but the end-result is comparable. Although these numbers have not been thoroughly vetted by the Company and Staff, the effect of my positions on attrition and post-attrition adjustments, over an 18- month period, would yield a revenue increase to the Company of about \$26 million for electric and \$2.4 million for gas operations. I believe these to be reasonable end-result numbers for the 18-month stay-out period based on the totality of evidence and arguments proffered in the proceeding.

B. Differences with the Majority opinion on Attrition

9 I believe that the use of a specific attrition adjustment to a company's revenue requirement is simply another "tool in the regulatory toolbox" that we should be able to use in a flexible manner in general rate cases. In the most recent Avista rate proceeding, we specifically rejected application of the "exceptional circumstances" condition to justify our acceptance of the Company's attrition analysis and, in my view, promoted its relevance and placement as yet another tool comparable to other regulatory methods traditionally used to deal with regulatory lag. As the Majority Opinion states as well, these include ratemaking tools such as end-of-period (EOP) rate base, the flexible use of CWIP (during periods of substantial generation plant investment), and the use of multi-year rate plans with escalations based on a K-factor, an approach which is essentially a variation of attrition analysis.

10 To date, Avista is the only regulated Washington utility that has taken up the Commission's challenge, established in a 2011 Puget Sound Energy (PSE) general rate proceeding, to come forward with substantive, comprehensive attrition analyses and subject them to the cross-examination and vetting in a general rate case.

11 I recognize the Majority opinion's concern with Avista's management of capital expenditures and what they allege is a lack of justification that such expenditures are beyond the control" of utility management. I oppose, however, the drastic remedy they intend, namely the complete rejection of all elements of the Company's petition following a time-consuming and robust adjudication of these issues..

- 12 Unlike my colleagues, I do not believe it is our duty to attempt to micro-manage the capex and O&M expenditures of Avista and attempt to substitute our judgment for the Company's management. In its Opinion, the Majority states its desire that Avista "moderate" its capital investments in areas like transmission, distribution, generation, and other infrastructure in the future. Yet it offers little specific guidance on evidence in this record on which areas to reduce spending, and the potential impacts on aging infrastructure, technology impacts, and likely impacts on the reliability and compliance issues in the distribution grid. Instead, I believe our role should be more of a high-level review of the methodology, cost-effectiveness, and internal controls applied by management and the Board of Directors. The role of the Commission and Staff should be to ensure that proper information is submitted to us timely, that our questions are answered, and that proper governance mechanisms and management controls are put in place to manage such expenditures. In this proceeding, Company witnesses including Mr. Morris, Mr. Norwood, and Mr. Thies have set forth in their testimonies the methods by which they manage and control costs, both operating and capital costs, some of which are specified below for capital projects. Other parties did not challenge or rebut these internal management processes. Accordingly, although developing a bright-line test for what is "beyond the control" of the Company may be interesting, I believe that Avista did meet its burden of proof in this case in a reasonable way.
- 13 Staff's witness Mr. Hancock testified that the Avista's capex expenditures were largely beyond the control of the Company. No other Staff witness offered testimony on the merits of the Company's Asset Management Plan or for overall capital expenditures and the internal budget and management control processes in place and discussed in the Company's testimony. Although Staff has indicated that it wishes to develop an "econometric model" that assesses such expenditures and develops tangible metrics and benchmarks (other than the traditional SAIDI and SAIFI for reliability purposes), no such study or set of metric was developed and submitted for the record in the proceeding. Accordingly, it is my view that any argument for adopting such an approach here should not be given any weight or importance at this time (perhaps the Commission could take up such an approach in an all-utility workshop sometime in the future).
- 14 In addressing Mr. Hancock's attrition analysis, the Majority Opinion takes certain comments out of context at hearing, and draws too fine a line on certain of his statements both on the trending analysis and the beyond the control argument. Mr. Hancock, in response to questions from me , admitted that the assessment of beyond the control is a

complex subject and that his role was primarily to carry out a full attrition analysis by the numbers, as Mr. McGuire did in the previous Avista proceeding. He states clearly that that load growth is basically “flat”, that O&M expenditures continue to grow, and legitimate capital expenditures continue to be substantial as well. He also points out that a modified historical test year will not produce sufficient results, and that Avista will continue to experience attrition during the rate year. This produces the precise mismatch that an attrition analysis is meant to address.

- 15 Mr. Hancock expresses confidence in the accuracy of the historical numbers, his more granular analysis of trending, and most importantly, the use of statistically significant techniques to arrive at an approximation of expenses and plant-in-service during the rate year. It does not do justice to his robust analysis to state that this is merely an “appearance” to what might be reasonable to be in service during that period. The Commission continues to reserve its right of prudence, and this does not amount to what some call a pure “future test year.” This is the same attrition analysis that the Commission has used and referred to in previous Avista proceedings and specifically approved in the last case. In summary, I believe his analysis is thorough and robust, and consistent with what we have reviewed in the past in Avista cases. I am simply using my informed judgment, based on this portion of the record, in concluding that his analysis meets the Commission’s standards and produces a reasonable revenue requirement.
- 16 My assessment of the evidence submitted in this proceeding is that the Company’s asset management process and overall capital expenditures are reviewed thoroughly with proper internal methodologies applied for overall cost, relevant function, and cost-effectiveness. I point specifically to the testimony of Avista witness Ms. Rosentrater (HLR-1T, HLR-6 and HLR-9T), describing in detail the Company’s “Electric Distribution System 2016 Asset Management Plan”; a detailed 88 page document that provides both the rationale and methodology for measuring how such asset investments enhance the reliability and efficiency of the Company’s distribution system. In particular, I point to two elements of the plan that support the Company’s capex proposals: (1) the wood pole management program setting forth a methodology for pole replacement and minimum inspections every 20 years of each pole; and (2) the distribution transformer change-out program that manages change-out of inefficient transformer to newer ones conforming to current codes and assessing the risk of containing PCB-containing oil that could potentially leak. These are just two examples of a comprehensive asset management program that is not only oriented just toward SAIDI and SAIFI metrics, but

is also one that is routinely discussed with Commission Staff informally at least once a year. Unfortunately, despite this, Staff offers scant detailed testimony on Avista's asset management program to challenge the rationale and costs of these investments. Overall, I believe that Avista's Asset Management Plan is well developed and sufficiently vetted as a means to maintaining a reliable, modernizing distribution grid that complies with the most recent engineering standards.

- 17 In support of my position, I point to Avista witness Ms. Schuh who offers substantive direct (KKS-1T) and rebuttal (KKS-9T) testimony on the Company's total proposed capital investments in 2017 and for the first six months of 2018. Her testimony addresses the need for capital additions that include the Spokane River Projects, AMI, General Plan, AFUDC, and certain updates to the Company's capital additions initiated since its original filing. Regarding the treatment of the Spokane River projects, Staff offers a \$17 million after-attrition adjustment for these projects, the Company proposes a \$67.1 million attrition adjustment for the totality of such investments. I concur more with Avista's approach here given our past treatment for hydroelectric upgrades at facilities such as Noxon. Company Witness Mark Thies in his direct testimony (MTT-1T) describes in detail, as he has in previous Avista cases, the internal management processes that review the capital investments, both on a yearly and a five-year planning basis. The review process is led by a Capital Planning Group (CPG) that receives requests from the various operating divisions, which are then vetted with Company Officers and then sent to the Finance Committee of the Board of Directors. He states that the Company does have to prioritize such investments and that, in recent years, it has chosen to defer certain capex investments for a variety of reasons but that such a rejection or deferral must be reasonable and prudent from an a reliability and asset management perspective.
- 18 I am generally persuaded by Avista's arguments that it is necessary to continue to invest in its distribution system to replace aging infrastructure, replace older equipment as it fails to perform to specifications, and to adopt new technologies which are "smarter" and capable of more real-time adaptation in certain substations and feeders in its evolving distribution system. In general, I believe it is more important to maintain a safe, reliable and technologically modern distribution for Avista and its customers, than denying them any cost recovery or ability to earn a return on such assets.
- 19 Avista has demonstrated over the years, including evidence submitted here, its ability to innovate in the distribution grid, to obtain federal funding for co-shared technology

projects such as distribution upgrades in Spokane and smart grids in Pullman (federal co-shared ARRA funding), and to respond to severe outages such as the 1996 ice storm and the November 2016 windstorm. I see no need for the Commission to change course now, and to deny its ability to earn a return on legitimate capex in this proceeding. In fact, I believe that regulatory consistency from the previous Avista proceedings obliges us to be consistent in application of our previously articulated principles with respect to attrition and maintain this course for the Company's proposed expenditures in both O&M and capes. Parties may argue the fine points of how well that has been achieved in this case and may differ, but I think there is no question that the Company has met its burden of proof and justified a specific attrition adjustment.

C. AMI Investments

20 I believe it is important to offer some guidance to Avista on its cost-benefit analysis for AMI, as compared to the previous proceeding and address some of the detailed testimony by both the Company and Public Counsel. This is one of the biggest issues in the case and one which we have an obligation to assess and address in detail. Unfortunately, Staff and ICNU offered no substantive testimony on the Company's contentions regarding the merits of AMI investment. I recognize that the Company has signed six contracts related to this extensive project with a proposed capex of \$166 million, and that the metering and meter management contract was not signed until the end of September, 2016. While this may be too far into the rate-effective year for full consideration, there is evidence in the proceeding that other contracts were signed in the spring of 2016 providing ample time for Staff and other parties to vet them in the record.

21 Overall, I believe that the CBA (cost-benefit analysis) of the AMI project in this proceeding has become more refined and detailed compared to analysis presented in the previous proceeding on this issue. I now believe the Company has produced a comprehensive analysis of the AMI project, including a \$20 million contingency that properly addresses all of the potential quantifiable benefits in six major categories, as well as discussion of non-quantifiable benefits such as environmental externalities and the social cost of carbon which are inherently difficult to quantify. The Company's CBA is also more candid than the analysis produced in the previous rate proceeding, clearly showing that the overall benefits over the life of the project ranges from a negative of \$18 million (including the \$20 million contingency) to a positive \$64 million.

- 22 As to the benefits of AMI, I largely concur with the Company's contentions regarding end-use energy efficiency, conservation voltage reduction (CVR), efficiency of outage management, outage duration, and other specific benefits. I largely disagree with Public Counsel's witness Ms. Alexander and believe that she takes an overly negative and cautious approach on the quantifiable benefits of the investment. For example, she argues that the Company has used unproven national or generic data on the benefit analysis for conservation voltage reduction (CVR), but Ms. Rosentrater demonstrates persuasively that for the Pullman project co-funded with ARRA funds, Avista used actual, feeder-specific data in its analysis. In fact, I believe that for certain benefit cases, Avista is still using an overly conservative approach, especially on the potential to reduce outage durations. I believe the AMI project has been sufficiently vetted with a refined CBA and is sufficiently "in the ballpark" to offer specific guidance in the proceeding, and that its net cost-benefit analysis, with a \$20 million contingency, does not differ that significantly from Ms. Alexander's analysis.
- 23 In contrast to the Company's evidence, I am disappointed in Staff's lack of detailed testimony on the detailed cost benefit analysis in this case, and the lack of a rigorous review of the AMI investments. I don't believe that it is "premature" to engage in such analysis. In fact, in my view, simply adhering to a rigid prudence standard or a used and useful standard is insufficient and borders on irresponsible for an investment of this magnitude. The only party to fully challenge Avista's cost benefit analysis is Public Counsel's witness Ms. Alexander. The Majority Opinion characterizes my views as harsh and inappropriate, but I think it is entirely legitimate to point out a lack of engagement by Staff in reviewing the detailed cost-benefit study in this case. Staff, as pointed out above, certainly did that for another major element of this case, the attrition analysis. It is true that the Company ultimately bears the burden to prove its case, but without robust engagement by the Parties, especially Staff, it does not provide a full analysis as the Commission renders its final judgment. I am simply stating my desire, in the second consecutive Avista proceeding, to have a more detailed and robust record from the Parties other than the Company.
- 24 While I think it is too early to make final call on the prudence of each of these AMI investments, especially the gas and electric meter deployment which will commence in the third quarter of 2017, I think we should offer some guidance in this proceeding. Avista has conceded that it is not asking for an overall prudence determination for all of the gas and electric meters to be installed over five years, as well as the meter data

collection, head end system, and other components of this complex project. Instead, it is willing to accept prudence determinations in “chunks” as capital is deployed and meters installed in general rate proceeding over the next several years. Company Witnesses Ms. Rosentrater and Mr. Norwood specifically affirm this step-by-step approach on prudence in their rebuttal testimony.

- 25 Because I support an attrition adjustment, I similarly believe it would be appropriate to provide an after-attrition revenue requirement adjustment in the amount of \$4.9 million for the AMI investment, as proposed by the Company. This would reflect the actual capital expenses of approximately \$18 million that that Company has incurred in the first and second quarters of 2016 in signing five separate contracts with several vendors (excluding the Itron contract that was signed in late September, 2016). An allowance of this nature would be a reasonable first step while consideration of subsequent capex for gas and electric meters that are placed in service in 2017 through 2020 can be handled in future rate proceedings.
- 26 In contrast to an allowance here, if the Majority opinion allows the Company to file a separate petition for deferred accounting as a regulatory asset (FERC Account 182.3), I would support that approach as well. The Commission has already approved such treatment for existing in-service meters that are to be replaced as a regulatory liability using the same FERC Account. In my view, affording similar treatment for the new AMI investment would be fair and reasonable.

D. ROE and Risk Mitigation

- 27 The Hope and Bluefield tests require us to balance both the interests of the utility investors and the end-use consumers of electricity and natural gas. In doing so, we must focus on the end-results, and not whether the specific method used to support an attrition adjustment or any other methodology gets bogged down in a maze of details surrounding inputs and assumptions.
- 28 Both the Company and Staff use an attrition adjustment in this case and, just as it has over the most recent proceedings, Avista has proffered an attrition analysis to justify its revenue deficiency as the basis for its need for a rate increase. In principle, an attrition adjustment improves the opportunity for the Company to earn its authorized return on equity (ROE), since it basically equalizes the mismatch between revenues, O&M expenses, and capital expenditures during a rate year.

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- 29 In addition to allowing an attrition adjustment, we have also granted Avista full decoupling for both electric and gas operations, thereby enhancing its ability to earn its authorized ROE. We have used other risk mitigation techniques for Avista in recent cases as well.
- 30 Unlike the Majority opinion, I believe that adjusting Avista's ROE is a more appropriate and targeted approach for considering the effects of the risk mitigating allowances we have granted in the past and are under consideration in this proceeding. Rather than rejecting Avista's rate petition outright on a burden of proof argument, I would authorize an attrition adjustment as described above, subject to a corresponding downward adjustment to its authorized ROE in recognition of the decreased risk the Company faces as a result of continuing with an attrition allowance.
- 31 By rejecting the Company's petition outright the Majority opinion effectively sustains Avista's authorized capital structure (48.5 percent equity ratio) and ROE (9.5 percent) for the foreseeable future. As explained below, I do not think this is a reasonable result.
- 32 There is evidence of Avista over-earning over the past several years, especially on electric operations. Such over-earning could be due to a number of factors including the rate increases we granted the Company in the multi-year rate plan in the 2013 rate proceeding, the effect of decoupling, or the temporary effect of the purchase of the Juneau utility in 2014. On the gas side, the Company has shown consistent under-earning over the 2013-16, timeframe although it did show a spike up in the first quarter of 2016. When questioned at hearing, Company witness Mr. Norwood explained such temporary overearning on the gas side to two potential factors, re-assigning at year-end some of the costs of gas operations among jurisdictions and between gas and electric operations, and to the relatively smaller total amount of gas rate base compared to electric rate base. While not entirely persuasive and while there is non-controverted evidence of over-earning on the electric side, I am persuaded that, on a combined basis for the 2013-2016 period, that Avista has come fairly close to earning its authorized ROE of 9.5 percent.
- 33 Given my contention above that previous attrition allowance coupled with other regulatory measures have reduced the Company's risk, I do believe it is appropriate that we examine the specific evidence in the proceeding produced by the three cost-of-capital witnesses.

- 34 In this case, Mr. Gorman argues persuasively for a 9.2 percent ROE, while Mr. Parcell argues for 9.1 percent based on a number of methodologies including two variants of discounted cash flow (DCF), Risk Premium (CE), and CAPM (although both witnesses argue that the utility of CAPM in this low-interest rate environment is weakened by the continued generous monetary policies of the Federal Reserve). Meanwhile, Company witness Mr. MacKenzie argues for an increase in authorized ROE to 9.9 percent, based on a combination of these analyses, and a fairly similar proxy group as Mr. Gorman for his DCF analysis.
- 35 At hearing, I was more persuaded by the testimonies and answers to questions from Mr. Parcell and Mr. Gorman and less persuaded by answers offered by Mr. MacKenzie. All three witnesses argued that we should give much lesser weight to the CAPM analyses, mainly due to the continued easy monetary conditions of the Federal Reserve, and that we should place more weight on their analyses using either DCF or Risk Premium or CE.
- 36 I do not support Mr. MacKenzie's argument to use his "upper end" of 9.9 percent ROE, since I believe that the Company has already been slightly over-earning given its actual electric ROE, and that this would result in a revenue requirement that is in excess of the just and reasonable standard. I would instead argue that the methodologies used by Mr. Parcell and Mr. Gorman, namely the constant growth DCF and risk premium, produce a range of results that meet the fair, just and sufficient standard. Both witnesses have argued persuasively that such results should enable Avista to maintain its financial metrics with the credit rating agencies to maintain its current corporate credit rating, and that it is highly uncertain when and how the Federal Reserve will address monetary policy conditions. I agree.
- 37 In summary, based on the above, I would lower the authorized ROE for Avista in this case by 20 basis points to 9.30 percent. This would produce an overall pre-tax rate of return (ROR) of about 7.35 percent based on its current capital structure of 48.5% equity, and with weighted debt cost of 5.51 percent. I think this is a fair and reasonable end result that is more targeted and surgical than the Majority opinion's decision to reject any request for rate relief in this case. More importantly, I believe that my approach, if adopted, would produce end results that satisfy both our state's statutory standards and Hope and Bluefield.

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PHILIP B. JONES, Commissioner