BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 288

In the Matter of AVISTA CORPORATION, DBA AVISTA UTILITIES Request for a General Rate Revision	NORTHWEST INDUSTRIAL GAS USERS' POST HEARING BRIEF

Pursuant to the Administrative Law Judge's Ruling in this matter dated June 5, 2015, Northwest Industrial Gas Users ("NWIGU") submits this Post Hearing Brief on rate spread issues. NWIGU is separately filing a joint prehearing brief with the Citizens' Utility Board ("CUB") addressing other issues raised in this proceeding.

I. INTRODUCTION

On May 1, 2015, Avista Corporation ("Avista" or "Company") filed revised tariff schedules to increase rates for Oregon gas retail customers in the amount of $8,557,000, or 8.0 percent of its annual revenues. The filing was suspended by the Commission on May 6, 2015, in Order No. 15-143.

As part of Avista's filing, it included a detailed long run incremental cost ("LRIC") study to establish Avista's proposed rate spread in this proceeding. Avista's LRIC study concluded that there are several rate classes with distribution rates that are priced significantly above their allocated cost of service, which include the Large General Service (Schedule 424), Interruptible Service (Schedule 440), Seasonal Service (Schedule 444), and Transportation Service (Schedule 456).[1] Avista's LRIC study concluded that the distribution rates paid by the Residential Service (Schedule 410) and General Service (Schedule 420) classes, on the other hand, under-collect the

[1] NWIGU/100, Collins/2.

allocated cost of service for those classes. Avista's LRIC results are supported by the LRIC analyses independently done by Staff and NWIGU.

The Company's filing used the LRIC study results to spread the proposed rate increase in a manner that results in the margin-to-cost ratios for the various service schedules moving approximately 50 percent closer to 1.00 unity.[2] This is done to *gradually* move rates closer to unity rather than moving to unity all at once. It should be clear that the LRIC study developed by Avista—and supported by Staff and NWIGU—would justify moving the rate schedules even closer to unity than Avista proposes, but NWIGU believes the gradual move contained in Avista's rate spread proposal is reasonable.

II. PARTIES' POSITIONS

In its original filing, the Company utilized the results of its LRIC study as a guide to spread the proposed margin/revenue increase, consistent with Commission precedent. Specifically, the Company spread the proposed increase in a manner that would result in margin-to-cost ratios for the various service schedules moving closer—but not all the way—to parity by having Schedules 410 and 420 receiving modest rate increases, with no rate changes for Schedule 440 and a 7.0% margin reduction for Schedules 424, 444 and 456.[3] These results are more than justified by the Company's LRIC study, which show that further movement would be necessary to bring all rates schedules to their actual cost of service.

NWIGU performed its own LRIC study and demonstrated that while the Company's LRIC study shows inequities between rate schedules, the lack of parity between rate classes is even more extreme than the Company's LRIC study indicates.[4] Despite the results of NWIGU's studies, NWIGU is not proposing a rate spread different than the Company and Staff.

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[2] Avista/1900, Ehrbar/2
[3] Avista/1900, Ehrbar/1.
[4] NWIGU/100, Collins/4.

Staff similarly provided an LRIC study in response to the Company's filing and concluded "[a]s in the last general rate case for the Company (Docket 284), the cost of service conclusions that support substantial rate reductions for large industrial customers were corroborated by Staff's own studies."[5] Staff agrees there is a disparity among rate classes and that "Staff's cost studies clearly support reducing the target margin revenues for Schedules 424, 444, and 456 by as much as the Company's proffered seven percent."[6] Staff does appear to take a more tempered approach and urges the Commission to limit a rate decrease for sales customers if the authorized overall average billing percentage increase is four percent or greater, or when the total billed rate to any other customers will be more than two percent greater than otherwise would have occurred.[7] Staff goes on to conclude, however, that such limiting factors are not present in this case and, therefore, the larger decrease of seven percent is warranted, especially in light of the small impact on residential customers of only 0.3%.[8]

CUB is the only party that disagrees with the notion that large gas user schedules should receive a rate decrease based on this record—but does so without performing its own cost study and by ignoring the three cost studies in the record. CUB, instead, bases its position primarily on policy arguments and unjustified theories and critiques of the parties' LRIC studies. CUB's specific position is that rates should be spread to customers such that no customer class would receive any more than three times the increase of any other class.[9] As explained below, CUB's position is untenable because it completely ignores the evidence in this proceeding, ignores the results of the LRIC studies, and would make rate subsidies permanent.

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[5] Staff/1300, Compton/2.
[6] Staff/1300, Compton/17.
[7] Staff/1300, Compton/17.
[8] Staff/1300, Compton/20.
[9] CUB/100, McGovern-Jenks/3.

III. THE RATE SPREAD PROPOSED BY THE COMPANY AND SUPPORTED BY STAFF AND NWIGU SHOULD BE ADOPTED

The Commission should find—based on the evidence in the record—that current distribution rates, on a relative margin-to-cost basis, result in some classes paying significantly more than their respective allocated cost of service, and other customers pay significantly less than their allocated cost of service. The Company, Staff and NWIGU are aligned on this conclusion based on the separate technical analysis of each of the parties' independent experts. CUB, which did not perform its own LRIC study or analysis, is the only party that disputes those LRIC results. While CUB attempts to discredit the Company's LRIC by characterizing it as flawed, and to discredit the analysis of NWIGU and Staff because they used some of the Company data in their cost studies, CUB's arguments are undermined by the evidence in the record.

The Commission has used LRIC studies to guide rate spread decisions for decades. All natural gas utilities in Oregon use some form of an LRIC study to form the basis of their rate spread proposals. While the Commission has not used LRIC studies to mandate strict rate parity, the results of the studies have provided informed guidance on class rate spread. What CUB is asking the Commission to do is to depart from its traditional approach, ignore the LRIC studies and analysis done by Avista, Staff and NWIGU, and adopt CUB's policy arguments and unjustified theories to ignore cost of service results when setting gas utility rates.

IV. CUB'S ARGUMENTS ARE FUNDAMENTALLY FLAWED

CUB asks the Commission to issue an order that requires Avista to spread the final revenue requirement to customers in a manner such that no customer class gets any more than three times the increase of any other class.[10] CUB's position is that there are policy considerations or other factors that should limit the Commission's reliance on the Company's LRIC study, or that the Commission should just ignore the LRIC results altogether. For example, CUB asserts that when costs are generally rising, customers should not be given price signals, through lower rates, that costs are falling.[11] CUB also claims that it is the Commission's practice to never give rate

[10] CUB 100, McGovern-Jenks 42:2.
[11] CUB 100, McGovern-Jenks, 40:12.

decreases to one class when another class is receiving a rate increase.[12] CUB's assertion is factually inaccurate. As Staff noted in its testimony, large gas users are sophisticated and have the resources to pay attention to all components of their gas rates.[13] They are therefore unlikely to receive the wrong price signal and will understand the basis for the rate reduction. It also cannot be reasonably disputed that cost based rates will produce efficient price signals and provide all customers with the information needed to make efficient consumption decisions. The record also reflects recent examples of where this Commission has approved rate decreases for some customer classes simultaneously with rate increases for others where the record has supported such an outcome.

An important fact to note about CUB's testimony is that CUB does not provide its own cost of service study, or technical adjustments to the Company's study. Rather, CUB relies primarily on its policy arguments and unproven and speculative theories. Those arguments, however, do not support CUB's position that no decrease is warranted for Avista's larger rate schedules. CUB's mentions the principle of avoiding rate shock as justification for its position. CUB's argument, however, is too general in nature and simply provides a basis for limiting a rate increase to some customers in some circumstances—which are not present in this case. CUB does not explain whether the modest increase residential customers would experience under the Company's proposal, which staff calculates to be 0.3 percent, would actually result in rate shock.[14] Nor does CUB attempt to fairly balance those increases with the demonstrated need for a decrease to other customers. Holding the reduction to seven percent for larger gas users avoids any rate shock for Avista's residential customers in this proceeding.

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[12] CUB 100, McGovern-Jenks 38:1.
[13] Staff/1300, Compton/19
[14] Staff/1300, Compton/20; Staff/1304.

CUB's recommendation – to limit any increase to three times the increase of any other class – is arbitrary and unworkable and would never allow rates to come even close to parity. Under CUB's approach, customer classes with disparately high rates would always have to bear the burden of some amount of increase and could never gain any ground toward achieving lower rates in line with their cost of service. Rate inequities would be permanent and LRIC studies would be meaningless. CUB's approach is arbitrary and should be rejected.

In addition to general policy arguments, CUB made several arguments that are without merit and have no evidentiary support. These arguments are summarized below.

CUB argument #1: Residential customers are not driving the system upgrades and rates increases.[15] This assertion is without evidentiary support and refuted by the evidence in the record. As described in the testimony of Avista's witness Joseph Miller, only 14 percent of rate base growth is due to gas distribution plant growth, whereas 86 percent of the capital investment is related to reinforcements, safety, pipe replacement, mandated work, storage, general plant and project compass.[16] In fact, Mr. Miller explains that the drivers of customer growth from 2014-2016 are new residential (Schedule 410) and small commercial (Schedule 420) customers.[17]

CUB argument #2: The useful life of investments included in the LRIC are overstated for industrial customers.[18] CUB asserts that the useful life of investments included in the LRIC are overstated for industrial customers. This argument is similarly without any merit and directly refuted by the evidence in the record. CUB's argument is based on an *isolated* circumstance where a seasonal asphalt paving customer went out of business. Based on this, CUB concludes that the useful life of investments for <u>all</u> industrial customers should be shortened because if a customer leaves, a new industrial customer may not be able to use the existing infrastructure, leaving the initial investment obsolete.

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[15] CUB/100, McGovern-Jenks/17
[16] Avista/1800, Miller/9.
[17] Avista/1800, Miller/10
[18] CUB/100, McGovern-Jenks/19

First, there is absolutely no evidence that Avista's industrial customers will not remain viable customers of Avista. Second, in the event of a customer leaving the area or going out of business, there is no evidence that a new customers will never be able to use the existing gas facilities. As explained in the testimony of Avista witness Joseph Miller, in the last 5 calendar years (2010-2014), the Company has only experienced three situations where an industrial customer has completely closed its operations without a new customer taking its place.[19] This represents 0.04 percent of industrial load.[20] Accordingly, CUB's argument is a red herring and not credible.

Notwithstanding the fact that CUB's argument is flawed and factually unsupportable, Avista—for the sake of argument—updated its LRIC model and reduced the useful life of industrial facilities by 50 percent.[21] Even including this extreme and unjustified reduction in the useful life of industrial facilities in the LRIC study, the rate spread proposed by the Company and supported by NWIGU and Staff remained justified under that skewed analysis.[22]

CUB argument #3: The LRIC Study does not reflect an accurately sized system.[23] CUB argues that the LRIC study does not reflect an accurately sized system. CUB's theory is that the LRIC study should be based on a system which would be based on a *hypothetical* replacement of the entire system—which would presumably be designed perfectly. Tellingly, CUB admits its theory is farfetched when it states "This line of inquiry may be dismissed as irrelevant because the Company cannot feasibly scratch the entire system and start anew."[24] The purpose of conducting a cost study is to allocate costs of an existing system that has actual costs associated with it, not to allocate unknown costs of a non-existent system. This argument should be rejected.

[19] Avista/1800/Miller/13.
[20] Avista/1800/Miller/13.
[21] Avista/1800/Miller 14-15.
[22] Avista/1800/Miller 14-15.
[23] CUB/100, McGovern-Jenks/20
[24] CUB/100, McGovern-Jenks/23

CUB argument #4: The LRIC is flawed because it assumes that all customers within the rate class have the same cost causality.[25] Avista's cost of service study allocates costs among customer classes. Accordingly, differences between load characteristics within a customer class is a factor that is considered for the costs allocated to the class. Various load characteristics of customers within a class are not a relevant factor in measuring how much cost should be allocated across each rate class. Instead, class load characteristics should reflect the aggregation of all customers that fall within that rate class. Avista's costs then should be allocated to each of the rate classes. Once that is done, rates can be designed—in the rate design process—such that customers with different load characteristics within a rate class get a fair and reasonable allocation of the costs that were allocated to a particular rate class. CUB's criticism of the LRIC study on this basis is without merit.

CUB argument #5: Excess system capacity is relevant to this discussion about LRIC.[26] CUB also raised several concerns related to the system's excess capacity. To the extent the system has excess capacity, that is a factor that distorts the allocation across all rate classes. Since there is no legitimate way to correct the cost of service study for the realities of the actual load relative to the capacity on the system, and with the understanding that Avista is entitled to full recovery of all prudent and reasonable costs that are used and useful in providing service, there is no simple fix to this alleged problem—and it is not quantifiable. Nevertheless, this alleged problem impacts all rate classes equally and no bias exists between rate classes.

[25]CUB/100, McGovern-Jenks/21
[26]CUB/100, McGovern-Jenks/23-24.

CUB argument #6: 456 Transportation Customers are only overpaying by 3 percent.[27] CUB argues that transportation customers—those which purchase only transportation service from the Company—are not significantly overpaying on a cost of service basis. First, it is important to note that CUB arrives at this conclusion without providing any cost study that would support that conclusion. Second, the analysis is completely flawed and should be rejected. CUB arrives at its conclusions by taking the Schedule 456 margin revenue and adding to it an estimated cost of wholesale natural gas and interstate pipeline transportation—apparently CUB's attempt to make transportation service a bundled service. CUB then takes that transportation "bundled" rate and compares that fictitious rate to the margin produced by other rate schedules, which is completely inappropriate. Other rate schedules do not include wholesale natural gas or interstate pipeline transportation—so the comparison is completely inappropriate and one sided. And more importantly, in a general rate case the Commission is only establishing the Company's distribution rates. In determining the proper distribution related rates, it doesn't matter whether a customer is purchasing gas from Avista or a third party. CUB's analysis is improper.

CUB argument #7: The Rate Spread in this proceeding will cause Rate Shock. CUB's mentions the principle of avoiding rate shock, presumably as justification for its position on rate spread in this proceeding. CUB, however, does not explain whether the modest increase residential customers would experience under the Company's proposal, which staff calculates to be 0.3 percent, would actually result in rate shock.[28] As Staff explained in its testimony "…from the viewpoint of promoting social equity by reducing inter-class cross subsidization, when Company and Staff evidence hold that margin percentage decreases should range from 19 to 35

[27] CUB/100, McGovern-Jenks/25-31.
[28] Staff/1300, Compton/20; Staff/1304.

percent, then the burden should be to produce a compelling reason why a mere 7 percent industrial margin decrease cannot be part of the outcome of this case—especially when the impact on residential customers is only 0.3%"[29] The Company's proposed rate spread will not result in rate shock.

Notwithstanding the above, NWIGU is sensitive to the notion of rate shock and understands that the Commission must consider the impacts to other customer classes when it reduces rates for others. For that reason, NWIGU supports the Company's filing, which would result in a 7.0% margin reduction for Schedules 424, 444 and 456 instead of an even larger reduction that NWIGU's analysis demonstrates could be justified.

CUB argument #8: Staff and NWIGU did not perform LRIC studies. CUB tries to discredit Staff's and NWIGU's LRIC analysis by claiming that Staff and NWIGU did not conduct independent LRIC studies, but reviewed and made technical adjustments to the Company's study. While CUB's statement is technically true, there is no basis to argue that the results of those studies are not legitimate. Because the Company has the data and information needed for an LRIC study, it would be an inefficient use of resources and extremely difficult for non-Company experts to develop a new LRIC Study from scratch, without using the existing LRIC study as a starting point. It is very common—and not at all improper—to start with the Company study and to make technical adjustments to the study, just as Staff and NWIGU did. CUB's comment should be dismissed as irrelevant.

[29] Staff/1300, Compton/20; Staff/1304.

V. NWIGU'S INDEPENDENT LRIC ANALYSIS SUPPORTS THE COMPANY PROPOSAL

While Avista's LRIC study is accurate to the extent it shows a lack of parity among rate classes, the Company's methodology understates that lack of parity. This is in large part because of the Company's reliance on a methodology that utilizes a "peak and average" approach of separating its system main investment into capacity and commodity components. The Company attempts to justify this approach by describing it as striking a balance between the way the system is designed (to meet peak demand) and the way it is actually utilized on an annual basis (i.e. throughput that occurs throughout the year).

As mentioned above, NWIGU made adjustments to the Company's LRIC study. The flaw with the Company's study is that it designs its system (and therefore incurs costs) only on the basis of peak demand.[30] The Company does not design its system based on annual throughput. If it did, it would likely under build the system and, on peak days, core customers entitled to service would not be served.

Another flaw with the Company's approach is that it double counts the "average" component of demand.[31] This is because average demand is used for both the "peak" and the "average" components of the calculation. This results in an over-allocation of costs to high load factor customers.[32] Even with these mistakes, and even understating the rate disparities, Avista's cost study shows extreme rate disparities.

NWIGU submitted its own analysis of the LRIC study, revising the Company's methodology and correcting for these flaws. NWIGU's approach shows that an even greater disparity exists among customer classes.[33] For example, under the Company's cost of service study modified by NWIGU, the Transportation Service Schedule 456 class would require a decrease of 37.74% in distribution margin revenue to bring its present rates to cost of service,

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[30] NWIGU/100, Collins/3.
[31] NWIGU/100, Collins/3.
[32] NWIGU/100, Collins/3.
[33] NWIGU/102 at line 11.

compared to a decrease of "only" 29.94% under the Company's methodology.[34] NWIGU's proposed cost of service for this class results in a decrease in present rates that is approximately 26% larger than the decrease calculated by the Company in its proposed cost of service study.[35]

The Commission, however, does not need to adopt NWIGU's LRIC study in order to approve the 7 percent rate decrease for industrial rate schedules. Avista and Staff performed LRIC studies that rely on the peak and average methodology, and those LRIC studies still show significant rate disparities. Based on the record that has already been developed in this matter, which is agreed to by Staff, NWIGU and Avista, it is clear that a rate reduction is warranted for large gas users. Rates for those classes are too far from parity to be fair, just and reasonable and the Commission has an appropriate record before it on which to correct the disparity.

As mentioned above, NWIGU is sensitive to the notion of rate shock and understands that the Commission must consider the impacts to other customer classes when it reduces rates for others. For that reason, NWIGU supports the Company's filing, which would result in a 7.0% margin reduction for Schedules 424, 444 and 456. Based on the LRIC study provided by NWIGU, a larger reduction is warranted, but NWIGU is supportive of an incremental approach in order to avoid rate shock to other customer classes. Under the Company's approach, rate schedules for large users would move closer to parity, and the residential and general classes would continue to under-collect based on their allocated cost of service.[36] In fact, Residential Schedule 410 would only slightly move from a 0.98 margin-to-cost ratio to a 0.99 margin-to-cost ratio.[37]

VI. CONCLUSION

NWIGU respectfully requests the Commission adopt the rate spread presented in Avista's case, which is supported by Staff and NWIGU. Based on the record in this matter, a margin reduction for Schedules 424, 444 and 456 is warranted. Such an adjustment will serve to bring rates closer to parity without imposing an undue burden on other customer classes. This result

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[34] NWIGU/100, Collins/4
[35] NWIGU/100, Collins/4.
[36] Avista/1900, Ehrbar/3.
[37] Avista/1900, Ehrbar/3.

would be consistent with the Commission's long standing practice of using LRIC studies to inform rate spread decisions and to move class rates towards parity.

NWIGU is separately filing a joint brief with CUB to address other issues raised during these proceedings.

Dated this 8th day of January 2015.

Respectfully submitted,

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