BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 288

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In the Matter of	)
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AVISTA CORPORATION, dba AVISTA UTILITIES	)
	)
Request for a General Rate Revision	)
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REPLY BRIEF OF THE

NORTHWEST INDUSTRIDAL GAS USERS AND THE CITIZENS'

UTILITY BOARD OF OREGON

January 8, 2015

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I. Introduction

Pursuant to Administrative Law Judge ("ALJ") Patrick Power's Prehearing Conference Memorandum of June 5, 2015, the Northwest Industrial Gas Users ("NWIGU") and the Citizens' Utility Board of Oregon ("CUB") hereby submit their joint reply brief in docket UG 288.

A. Partial Stipulation

For the reasons stated in the Stipulating Parties' Joint Testimony in Support of Partial Stipulation, NWIGU and CUB continue to support the Partial Stipulation filed in this case and urge the Commission to approve it.

B. Contested Issues

The parties to this case were unable to reach agreement on several issues. NWIGU and CUB shared an expert in this case and jointly raise several issues for the

Commission's consideration in this brief. In short, NWIGU and CUB urge the Commission to:

1. Reject Avista's Proposed Return on Equity and impose an ROE of 9.35%.
2. Reject Avista's proposed capital structure and impose a capital structure comprised of 51.5% long-term debt and 48.5% common equity.
3. Reduce Avista's proposed rate base by $30 million consistent with Staff's recommendation in this proceeding, and find the East Medford and Ladd Canyon projects imprudent.
4. Disallow costs associated with cost-overruns for Project Compass consistent with Staff's recommendation in this case.
5. Reduce the Company's pension expense by $340,000.
6. Reduce revenue requirement by the amount necessary to reflect the full ADFIT and state income tax effects of 2015 bonus depreciation.

II. Argument

A. The Commission Should Reject Avista's Proposed Return on Equity.

The Commission is charged with balancing the interests of customers and the utility in establishing fair and reasonable rates. In establishing an appropriate return on equity ("ROE"), the Commission must ensure that it is: (1) commensurate with the return on investment in other enterprises having corresponding risks, and (2) sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.[1] Furthermore, the Commission recently affirmed its preference for multi-stage discounted cash flow ("DCF") modeling in NW Natural's most recent general rate case.[2] In that case, the Commission noted that "multi-stage DCF modeling 'improves on the implicit assumption in the single-stage DCF model that dividends grow indefinitely at the same rate,'" and rejected out of hand NW Natural's single-stage DCF analysis.[3] In reviewing the multi-stage DCF modeling, the Commission also stated that the parties' data "should be based on capital market conditions and valuations investors have put on peer utilities, rather than other factors."[4]

NWIGU-CUB's expert witness, Mr. Gorman, recommends an ROE of 9.35%, which is the mid-point of the reasonable range identified in his analysis of 8.9% to 9.8%.[5] Mr. Gorman's recommendation is supported by his reliance on several models: (1) a constant grown DCF model using consensus analysts' growth rate projections, (2) a constant growth DCF using sustainable growth rate estimates, (3) a multi-stage growth DCF model, (4) a Risk Premium model, and (5) a Capital Asset Pricing Model ("CAPM").[6] Mr. Gorman's analysis also establishes that the Company's financial integrity would remain uncompromised with an ROE of 9.35%.[7]

Avista requests a 9.9% ROE, based on the results of three methods—the single-stage Discounted Cash Flow ("DCF") model, the Empirical Form of Capital Asset

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[1] ORS 756.040(1). *See also FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (Fixing just and reasonable rates involves balancing consumer interests with investor interests, which includes enough revenue for operating expenses and capital costs. Return on equity should be commensurate with other investments with corresponding risks and should be sufficient to instill confidence that the utility can maintain its credit and attract capital.); *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 694 (1923) (Regulated utilities are entitled to earn a fair and reasonable rate of return on their capital investments).

[2] *In re NW Natural*, OPUC Docket No. UG 221, Order No. 12-437 at 6-7 (Nov. 16, 2012).

[3] *Id.* at 6 (citing to *In re PacifiCorp*, OPUC Docket No. UE 116, Order No. 01-787 at 32 (Sept. 7, 2001).

[4] *Id.* at 6.

[5] NWIGU-CUB/100/Gorman/44.

[6] *See* NWIGU-CUB/100/Gorman/17-44.

[7] NWIGU-CUB/100/Gorman/44-47.

Pricing Model ("ECAPM") and an equity risk premium approach which takes into account allowed ROE's for other gas utilities.[8] Avista argues that an ROE in the range of 9.5% to 10.8%, or 9.6% to 10.9% after incorporating an adjustment for the impact of common equity flotation costs, is appropriate for its Oregon gas operations.[9]

Avista's requested 9.9% ROE is unsupported for several reasons. First, while the Company critiques Staff's and NWIGU-CUB's use of a multi-stage DCF model, the Company's ROE recommendation relies upon a single-stage DCF analysis. As discussed above, the Commission has explicitly rejected the single-stage DCF model as inferior to multi-stage DCF analysis. Because Avista has provided no reason to reject the notion that multi-stage DCF models are inappropriate, generally, and it has not provided its own multi-stage DCF analysis, the Commission should rely upon Staff's and NWIGU-CUB's multi-stage DCF modeling in making its determination on ROE.

Second, an ROE of 9.9% would create an improper balance between the interests of shareholders and ratepayers. Avista has not provided compelling analysis that a 9.35% ROE would damage its credit ratings or substantially reduce investor confidence in the Company, meaning that an ROE of 9.35% is fair and reasonable to the Company. An ROE of 9.9%--which is 400 basis points above the Company's current ROE[10]—would, however, mean that customers are over-paying for equity, thereby resulting in unjust and unreasonable rates contrary to ORS 756.040, *Hope* and *Bluefield*.[11]

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[8] Avista's Post-hearing Brief at 34.
[9] Avista/300/McKenzie/6.
[10] 9.9% is also 400 basis points above the ROE recently approved for Avista by the Washington Utilities and Transportation Commission as a just and reasonable ROE. *Washington Utilities and Transportation Commission v. Avista Corporation*, Dockets UE 150204 and UG 150205 (consolidated), Order 5 (Jan. 6, 2016) at ¶12 and ¶23 (available at http://www.utc.wa.gov/_layouts/CasesPublicWebsite/CaseItem.aspx?item=document&id=1860&year=2015&docketNumber=150204).
[11] NWIGU-CUB/100/Gorman/17.

Third, Avista has not presented compelling evidence that a 9.9% ROE is commensurate with the ROE of other utilities with similar risk profiles due to its flawed analysis—the Company improperly includes a flotation cost adjustment,[12] cherry-picks outlier results in its DCF model,[13] utilizes an unreasonable long-term growth outlook in its ECAPM analysis,[14] inappropriately proposes to increase its ECAPM return estimate by approximately a 1.5% size adjustment return adder,[15] overstates the Company's risk-premium analysis,[16] relies on flawed CAPM analysis,[17] and improperly relies upon a non-utility proxy group as a proxy for Avista.[18] Once these errors are corrected, it is clear that an ROE of 9.35% is appropriate.

Therefore, NWIGU-CUB urge the Commission to adopt an ROE that is no higher than Mr. Gorman's well-supported recommendation of 9.35%. NWIGU-CUB also support Staff's proposed ROE of 9.11%, as it is within the range of returns recommended by NWIGU-CUB Witness Mr. Gorman, and would fairly balance the interests of shareholders and ratepayers.

B. The Commission Should Reject Avista's Proposed Capital Structure.

NWIGU-CUB propose a capital structure comprised of 51.5% long-term debt and 48.5% common equity, which fairly balances the interests of shareholders and ratepayers. Avista proposes a capital structure of 50% long-term debt and 50% common equity,[19] but NWIGU-CUB Witness Gorman's testimony makes clear that the Company's proposed

[12] NWIGU-CUB/100/Gorman/48-49.
[13] NWIGU-CUB/100/Gorman/51.
[14] NWIGU-CUB/100/Gorman/52-53.
[15] NWIGU-CUB/100/Gorman/53-57.
[16] NWIGU-CUB/100/Gorman/58-61.
[17] NWIGU-CUB/100/Gorman/61-63.
[18] NWIGU-CUB/100/Gorman/63-65.
[19] Avista/200/Thies/14.

capital structure is unreasonable for three primary reasons. First, the proposed 50% common equity ratio overstates the percentage of common equity used to fund investment in utility plant and equipment.[20]

Second, previous ratemaking capital structures have been closer to 48.5% common equity and 51.5% common debt, as evidenced by the Company's most recent Washington general rate case.[21] The Company argues that Mr. Gorman's reliance on the Company's capital structure in Washington is misplaced because it includes short-term debt, which is not typically included in Oregon. To be clear, Mr. Gorman did not include short-term debt in his calculation of the proper capital structure. Mr. Gorman's testimony is clear that he developed his recommended capital structure "by starting with Avista's total capital structure recorded in its FERC Form 1, and removing investments funded by common equity that are not related to utility plant and equipment."[22] This is the same data that the Company filed with the Security and Exchange Commission.[23] Accordingly, Avista's criticism is misplaced.

Finally, Avista's proposed capital structure inappropriately includes common equity supporting non-regulated investments, such as goodwill and other non-regulated assets, and investments in subsidiaries.[24] Avista argues that investments funded by common equity not related to utility plant and equipment benefit customers because they improve the Company's overall financial ratios.[25] Avista's argument is unpersuasive. As the Company concedes, there are not certain benefits to customers as these investments

[20] NWIGU-CUB/100/Gorman/12-13.
[21] NWIGU-CUB/100/Gorman/13.
[22] NWIGU-CUB/100/Gorman/12 and NWIGU-CUB/100/Gorman/102.
[23] NWIGU-CUB/209.
[24] NWIGU-CUB/100/Gorman/12.
[25] Avista's Post-hearing Brief at 37 (citing to Avista/1100/Thies/5-6).

are neither stable nor predictable,[26] and the Company has provided no quantitative analysis supporting this claim as it would apply to Avista's customers in the test year. Furthermore, Mr. Gorman did not err in his goodwill adjustment. Avista argues that goodwill has already been removed from the Company's calculation of capital structure in this case,[27] but Mr. Gorman's adjustment is clearly from the Company's Securities and Exchange Commission ("SEC") consolidated balance sheet, not from the Company's filed case.[28]

When these non-regulated investments are properly adjusted out of Avista's ratemaking capital structure, the Company's capital structure is composed of roughly 51.5% debt and 48.5% common equity. Avista's proposed capital structure is too heavily weighted in common equity, which increases the rate of return and income tax component of revenue requirement.[29] This results in customers paying more for equity, without a certain corresponding benefit.[30] NWIGU-CUB's proposed capital structure, comprised of 51.5% long-term debt and 48.5% common equity, should be adopted because it strikes an appropriate balance between customers and shareholders, but still preserves Avista's financial integrity and access to capital.[31]

C. Prudence of Capital Investments

In this case, Avista is requesting to add $45.6 million to its Oregon plant base in 2015[32] and another $2 million for customer hookups in the first quarter of 2016.[33]

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[26] Avista/1100/Thies/5-6 ("Stronger credit ratios ***can*** lead to higher credit ratings, which ***can*** lead to lower costs for customers.") (emphasis added).
[27] Avista's Post-hearing Brief at 37.
[28] NWIGU-CUB/103/Gorman/1.
[29] NWIGU-CUB/100/Gorman/16-17.
[30] NWIGU-CUB/100/Gorman/17.
[31] NWIGU-CUB/100/Gorman/17.
[32] This total is inclusive of Project Compass, which is addressed by a separate Staff witness. For clarity, NWIGU-CUB's position on Project Compass is discussed in the following section of this brief.

Inclusive in its request are two specific projects—the Ladd Canyon Gate Station Upgrade ("Ladd Canyon Project") and the East Medford Reinforcement Project ("East Medford Project"), which NWIGU-CUB believe to be imprudent investments by Avista. In order to recover its capital investments, a utility must demonstrate that: (1) the investment is presently used for providing utility service, and (2) that the investments were prudently made, based on the information that the utility knew or should have known at the time.[34]

Staff raised several compelling concerns about the prudence of the Company's capital forecast, ultimately recommending a reduction of $30 million and specifically questioning the prudence of the Company's East Medford Project. CUB's testimony challenged the prudence of the Company's Ladd Canyon Project. NWIGU-CUB support Staff's $30 million adjustment to Avista's capital forecast, inclusive of a specific denial of the Company's Ladd Canyon Project and East Medford Project because the Company has not met its burden in demonstrating that these projects are prudent.

(1) The Commission should reduce the Company's capital forecast by Staff's proposed $30 million adjustment.

NWIGU and CUB have reviewed both the Company's testimony and Staff's testimony related to capital additions in this case. Staff recommends a $30 million disallowance for capital additions because: (1) the amount of Avista's proposed capital additions is a dramatic increase over the historical average for such additions, (2) the timing of the capital additions for some of the substantive projects is not consistent with the Company's Integrated Resource Plan ("IRP"), (3) the level of the Company's proposed additions is not supported by its relatively flat customer growth rate, as well as

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[33] Staff/600/Moore/2.
[34] *In re PacifiCorp*, OPUC Docket No. UE 246, Order No. 12-493 at X (Dec. 20, 2012).

the overall decline in gas sales, and (4) the Company failed to provide sufficient documentation to support its capital projects.[35]

In response to Staff's criticism that the Company is building too aggressively for its relatively flat growth rate, the Company argues that it "should invest in plant that provides safe and reliable service to customers, and not be limited by the amount of customer growth that the Company is experiencing; were it to do so, the Company would be shirking its public service obligation, and would not be investing in necessary infrastructure to meet the reliability needs of its <u>existing</u> customers."[36] The Company fails to appreciate, however, that there is a balance between the interests of shareholders and the interests of ratepayers. Avista's net plant base doubled between 2007 and 2014,[37] and in this case Avista is proposing a 22.6% increase in capital additions, with scant evidence in the record to support its request.[38] It may be that there is justification for every proposed project included in this case at some time in the future, but as Staff argues, the Company has not carried its burden in demonstrating that this level of investment in plant is necessary for 2016.[39]

Avista also attempts to camouflage the impact of its aggressive capital spending by arguing that the average monthly bill for its residential customers has not increased significantly in the wake of its increased level of capital expenditures.[40] This is a red herring. As Avista acknowledges, Customers' bills include other rate adjustments, including the commodity cost of gas, which have recently decreased. Gas costs change

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[35] Staff's Prehearing Brief at 7, citing Staff/600/Moore/1, 14-15.
[36] Avista's Post-hearing Brief at 14-15 (emphasis in original).
[37] Staff/600/Moore/6-7.
[38] Staff/600/Moore/5.
[39] *See* Staff/600/Moore/10-14.
[40] Avista's Post-hearing Brief at 16-17.

every year through the Purchased Gas Adjustment ("PGA"), which is independent from general rate cases. While the PGA may serve to offset the impact of some capital expenditures, unlike the effect from any single PGA, these costs will be in rates for many years to come. It is the increase in capital expenditures that prevent customer bills from otherwise reflecting what should be a lower cost of service.[41]

NWIGU-CUB agree with Staff that the Company has failed to provide sufficient justification for its significant increase in capital additions in 2015, and therefore supports the adjustment recommended by Staff.

(2) Avista has not demonstrated the prudence of the Ladd Canyon Gate Station Upgrade or the East Medford Reinforcement Project

In addition to the Company's inflated investment in plant, generally, two of the Company's proposed capital projects—the Ladd Canyon Project and the East Medford Project—should be found imprudent. Avista has not sufficiently demonstrated that these projects are needed ahead of the time identified in its most recent Integrated Resource Plan ("IRP"), nor has it demonstrated that the projects are necessary for reliability purposes in the test year. Accordingly, the Commission should reject Avista's proposal to include costs for these projects in rates at this time.

The Company argues that Staff and CUB only called into question the timing, not the prudence, of the Ladd Canyon and East Medford projects.[42] This, however, is incorrect. CUB's testimony made clear that it challenged the prudence of the Ladd

[41] *See e.g.* https://www.eia.gov/dnav/ng/hist/rngwhhdd.htm.
[42] Avista's Post-hearing brief at 17.

Canyon Project on several grounds, as discussed more fully below.[43] More importantly, however, Avista misunderstands the prudence standard as it applies to capital projects.

In NW Natural's most recent general rate case, the Commission stated that "[i]n reviewing the prudence of specific costs incurred by a utility, we review whether they are costs that a reasonable utility management would have made, in good faith, under the same circumstances, *and at the relevant point in time*."[44] In that case, NW Natural proposed to include its Mid-Willamette Valley Feeder project in rates for reliability purposes, despite the fact that it was built ahead of the need identified in NW Natural's IRP.[45] In evaluating the prudence of the project, the Commission identified the following types of evidentiary support that would support a finding that the investment was necessary for reliability purposes: (1) comprehensive cost-benefit analysis of whether and when the investment should be built, (2) evaluation of a range of alternative build dates and the impact on reliability and customer rates, (3) credible evidence on the likelihood of disruptions based on historical experience, (4) evidence on the range of possible reliability incidents, (5) evidence about projected loads and customers in the area, and (6) adequate consideration of alternatives, including the use of interruptibility or increased demand-side measures to improve reliability and system resiliency.[46] The Commission also found it unacceptable that NW Natural failed to disclose that its project was moving forward, despite characterizing the project as a "possible future project" in IRP documents.[47]

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[43] *See* CUB/100/McGovern-Jenks/9-16.

[44] *In re Northwest Natural Gas Co.*, OPUC Docket No. UG 221, Order No. 12-437 at 16 (Nov. 16, 2012) (emphasis added).

[45] *Id.* at 13-16. Also of note, NW Natural conceded in the case that the project was not needed to meet load.

[46] *Id.* at 16-17.

[47] *Id.* at 18.

Undoubtedly, the *timing* of a project is a factor in determining the *prudence* of the project—they are not distinct inquiries. To be clear, NWIGU and CUB challenge the prudence of the Company's investments in the East Medford Project and the Ladd Canyon Project because they were built prior to the time identified in Avista's most recent IRP, and without sufficient justification for an accelerated timeline on the record of this proceeding.

East Medford Project

Avista's East Medford project is estimated to cost approximately $5 million, which the Company proposes to include in rate base in the test year.[48] The project consists of a 3.2 mile pipe installation to complete a 12" high-pressure loop across the east side of Medford, Oregon.[49] The Company argues that this project is necessary to ensure there is adequate capacity to meet demand on the "design day" temperature days,[50] despite the fact that Avista's 2014 IRP did not identify the project as necessary until 2018.[51] The Company concedes that the project is not necessary to meet load growth until 2018,[52] but argues that the timeline was accelerated due to corrected modeling in its load study that revealed "many more customers [were] at risk of loss of service on a design heating degree day."[53] This is not an unfounded risk, they argue, as the most recent heating degree day in the Company's Oregon service territory occurred on December 8, 2013 in Klamath Falls, Oregon.[54] In short, the Company argues that the project is necessary in 2016 for reliability purposes.

[48] Avista's Post-hearing Brief at 13 (citing to Avista/1500).
[49] Avista/1500/Webb/9.
[50] Avista/1500/Webb/11-12.
[51] Staff/604/Moore/5-7; Avista/401/Morehouse: "Avista Utilities 2014 Natural Gas IRP" at 129-130.
[52] Avista/1500/Webb/11.
[53] Avista/1500/Webb/12.
[54] Avista/1500/Webb/12.

In the Company's most recent IRP, Staff noted that Avista's discussion of distribution system planning was informative, but perhaps not adequate to support a prudence determination for specific projects, such as the East Medford Project, in rates.[55] The Company has failed to make up for the dearth of information related to this project in this case, and therefore has not met its burden of proof that the project should be included in rates in 2016.

First, Avista did not provide comprehensive cost-benefit analysis of an appropriate range of dates for the project, including impacts on reliability and on customer rates. The analysis in the IRP suggests that the project would not be needed until 2018, but is lacks a comprehensive review of a range of dates.[56] While its IRP was pending, the Company discovered that its SynerGEE load study had an incorrect input for the pressure of delivered gas from Northwest Pipeline, which impacts the Medford high pressure system.[57] Once this was updated, the Company marked the East Medford Project as "priority #1"[58] but there is no analysis that supports the Company's updated prioritization or suggests that alternatives other than immediate construction were analyzed.

Second, the Company also failed to submit credible evidence on the likelihood of disruption in 2016 based on historical experience—as the Company anecdotally conceded, it has *rarely* had to engage in manual intervention in order to ensure reliable

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[55] *In re Avista Utilities*, OPUC Docket No. LC 61, Order No. 15-063, Appendix A pg. 10 (Mar. 2, 2015).
[56] LC 61 – Avista 2014 Integrated Resource Plan at 129-130.
[57] Avista/1500/Webb/11.
[58] Avista/1500/Webb/12.

service to customers in its Oregon territory[59] and has not curtailed interruptible customers in Oregon since 2007.[60]

Third, the Company has not provided support or adequate analysis of the range of possible reliability incidents—as the Company explains, its “Cold Weather Action Plan” is a “decision tree intended to initiate high-level manual intervention activities in particular areas at a pre-defined temperature” and simply means that “additional attention is paid to the system in order to address any *potential* system deficiencies that are identified…it does *not* necessarily mean that manual intervention occur[s] in the field each and every time that the temperature threshold was reached.”[61] The Company’s characterization implies that there is a range of possible reaction to reliability incidents under the Cold Weather Action Plan that have not been analyzed in the context of this project. Moreover, the Company has not provided compelling evidence about projected loads and customers in the area that would support inclusion of the East Medford Project in rates for 2016—as the Company concedes, the project is not needed to meet load growth.

Finally, the Company has failed to demonstrate, either in this case or its IRP, that it adequately considered alternatives to constructing the project in 2016, including the use of interruptibility or increased demand-side measures to improve reliability and system resiliency.

Avista’s justification largely rests on its claim that implementation of the “Cold Weather Action Plan,” which requires “manual intervention,” is not an appropriate

[59] CUB/211. Note these adjustments include manual adjustment of pressure regulating stations.
[60] CUB/213.
[61] CUB/211.

remedy to a design day capacity deficiency.[62] From the outset, it is important to note that no party has argued that the East Medford project will not ever be necessary or that manual intervention via the Cold Weather Action Plan is an ideal, long-term solution. Rather, the question is whether the Company has met its burden in demonstrating that the project is needed in 2016 and capable of being included in rates. As discussed above, it has not. For these reasons, NWIGU and CUB urge the Commission to find Avista's East Medford Project imprudent.

Furthermore, the Company concedes that it knew *during the course of the IRP* that the East Medford Project would be completed in 2015 instead of the 2018 projection included in the IRP.[63] Prior to the IRP filing date with the Commission, a request with Avista's Capital Planning Group ("CPG") had already been filed for a project to be completed in 2015.[64] The CPG finalized the budget request for this project a mere four days after the Company filed its IRP with the Commission.[65] While the analysis may have come too late for incorporation in the Company's filed IRP, NWIGU and CUB can find no evidence on the record in Avista's IRP proceeding (docket LC 61) that the parties or Commission were ever updated on the accelerated date for the East Medford Project—the Company knew it was quite likely that the project would move forward in 2015 prior to the date its IRP was filed with the Commission, but declined to tell the parties. Although the Company may not have been actively building the project as was the case with NW Natural, NWIGU and CUB can find no meaningful distinction between an authorization to spend the dollars for this project and actual cash outlays because

[62] Avista/1500/Webb/15-17.
[63] Avista/1500/Webb/13; Avista's Post-hearing Brief at 20-21.
[64] Avista/1500/Webb/13.
[65] Avista/1500/Webb/13.

construction had started. Not informing the parties to LC 61 of the accelerated nature of this project is flatly inappropriate.

Finally, Avista has informed the Commission and parties to this case that the in-service date for the East Medford Project may slip beyond the rate-effective date in this proceeding.[66] Pursuant to ORS 757.355, a utility may not recover in rates costs associated with capital investments not presently used in the provision of utility service. Accordingly, if the Commission determines that costs associated with the East Medford Project are appropriately included in rates in this case, NWIGU and CUB request that the Commission order Avista to provide an officer's certificate attesting to the completion date of the East Medford Project before March 1, 2016.

Ladd Canyon Project

Similar to the East Medford Project, the Company argues that the Ladd Canyon Project is necessary for reliability purposes. The Ladd Canyon Project (previously known as the Union Gate Station), is a rebuild of the existing gate station #0817, which the Company argues will "increase the capacity of the gate station and upgrade outdated facilities and equipment."[67] The Company argues that the project is necessary in 2016 "to serve an existing capacity deficit at this site" and to allow the Company to "reinforce additional loads in the area when the last phase of the Pierce Road L Grande HP Reinforcement is completed in 2017."[68] Total projected costs for the project are $1.65 million.[69]

[66] Avista's Post-hearing Brief at 19, n. 65.
[67] Avista/1500/Webb/18.
[68] Avista/1500/Webb/18 (emphasis in original).
[69] Avista/1500/Webb/26.

The Company's most recent IRP identifies the Union Gate Station as necessary for upgrade in 2019 or later.[70] There is no substantive discussion of this project contained within the Company's IRP filing. In its initial testimony, the Company argued that the project was necessary because "[t]he existing gate station has reached its physical capacity due to the growth in the area and needs to be upgraded to support the gas load increases."[71] CUB's testimony criticized the Company because that gas load increase appeared to be driven by a single, temporary interruptible customer (Oregon Mainline Paving) and this was the apparent basis for the Company's decision to move forward with the project on a more aggressive timeline.[72] In its Reply Testimony, the Company's argument shifts to one of reliability, with the Company claiming that "the current capacity of this gate station is a limiting factor on Avista's ability to serve customers reliably today in the Ladd Canyon/Union area on a design heating degree day."[73] The Company now also argues that the project is necessary before the Pierce Road L Grande HP Reinforcement is completed in 2017.

The Company's analysis of this project suffers from the same flaws as its analysis for the East Medford project. It does not provide a comprehensive cost-benefit analysis of whether or when the project should be built, it does not evaluate the range of alternative build dates, and it does not analyze the impact on reliability and customer rates. The Company fails to provide any credible evidence on the likelihood or impact of disruptions based on its historical experience, nor does it evaluate any reliability concerns, in light of the range of options available under its Cold Weather Action Plan.

[70] LC 61 – Avista Intergrated Resource Plan at Table 7.2.
[71] Avista/600/Shuh/19.
[72] CUB/100/McGovern-Jenks/10.
[73] Avista/1500/Webb/19 (emphasis in original).

The Company does provide some discussion about the projected load and customers in the area, but it fails to provide in-depth analysis of alternatives, including the use of interruptibility or increased demand-side measures to improve reliability and system resiliency.[74] For these reasons, NWIGU and CUB urge the Commission to find Avista's Ladd Canyon Project imprudent for 2016 and exclude these costs from customer rates.

D. The Commission Should Disallow Certain Costs Related to Avista's Project Compass.

In 2010, Avista began its Project Compass—a replacement of its legacy customer service and work management system.[75] In support of its argument for recovery of $27 million in cost-overruns for this project, Avista "reminds" the Commission that Project Compass was a part of its two most recent general rate cases, and that in UG 284, the Company "clearly explained why Project Compass required more time and dollars than originally estimated to successfully complete the Project."[76] The Company also argues that "the settlement agreement, supported by all parties, in Docket No. UG 284, and the OPUC Staff testimony supporting that settlement agreement, recommended recovery of the costs associated with Project Compass, including the increased costs associated with the delay in the Go Live Date."[77] Avista's reliance on the settlement stipulation in its previous rate case as justification of any and all costs in this case is wholly inappropriate for several reasons.

First, to suggest that the Commission's evaluation and approval of the project in previous rate cases somehow justifies the substantial cost overruns in this case is out of

[74] *See e.g.* Avista/1500/Webb/20. The Company makes claims that interrupting customers will not alleviate design day deficiencies, but does not provide any underlying analysis.
[75] Avista Post-hearing Brief at 53.
[76] Avista Post-hearing Brief at 55.
[77] Avista Post-hearing Brief at 56.

place. The Commission does not have the authority to bind a future Commission.[78] In evaluating a utility's request for a rate revision, the Commission makes a determination based on the record before it.[79] The Company does not have a blank check for the project simply because some costs have already been recovered, or because there was some warning that the project may be more expensive and delayed from previous estimates. In short, the Commission is not precluded from disallowing costs in this case, as supported by the record.

Second, to rely on the settlement agreement in UG 284 as a basis for cost-recovery in this case is also inappropriate. As clearly stated in the Amended Stipulation, the parties agree that it represents "a compromise in the positions of the parties."[80] In evaluating the finalization and implementation of the project within this case, the parties retain the ability to analyze and criticize the Company's request. A settlement agreement in a previous docket does not preclude or undercut the parties' recommendations in this case.[81]

Avista further argues that bonus amounts paid to employees are appropriately recovered from ratepayers "based on a very successful effort in implementing Project Compass."[82] It is difficult to see how cost overruns of $27 million—or 34%[83]--can be deemed a "very" successful effort in implementing the project for which customers should pay bonuses to employees.

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[78] *See In re Central Lincoln People's Utility District*, OPUC Docket UM 1087, Order No. 05-981, 4 (Sept. 7, 2005).
[79] *See* ORS 757.210.
[80] UG 284 – Amended Stipulation filed March 6, 2015.
[81] As an example, Avista's proposed ROE is not consistent with its settlement for ROE in its most recent general rate case, UG 284.
[82] Avista Post-hearing Brief at 64.
[83] Staff/300/Johnson/5.

NWIGU-CUB concur with Commission Staff that Avista has not met its burden in justifying the substantial cost-overruns for this project, including significant bonuses for employees. Customers should not be burdened with excessive cost-overruns and bonuses for a project that is grossly over budget. Therefore, NWIGU-CUB support the adjustments proposed by Staff for this project—a reduction of $1.75 million in rate base, which represents one-half of Oregon's share of cost overruns and a reduction of $68,000 for Oregon-allocated bonuses related to the project.

E. Avista's proposed FAS 87 expense is overstated due to the Company's proposed reduction to expected return on assets for its pension trust fund asset.

Avista proposes to include in rates pension expense of $28.7 million on a system basis, which represents an increase of $437,243 on an Oregon allocated basis for the 2016 test year.[84] The increase is due, in part, to Avista's decision to engage in a pension de-risking strategy that includes liability-driven investing ("LDI"), which the Company implemented starting in 2010.[85] In 2014, Avista changed its asset plan mix for its retirement plan assets from a 31% fixed income allocation to a 58% fixed income allocation.[86] Avista's move to a 58% fixed income allocation results in a substantial reduction in the expected return on assets ("EROA")[87]—from 6.6% used in 2014[88] to

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[84] Avista/500/Smith/16.
[85] Avista/1300/Heier/2.
[86] NWIGU-CUB/100/Gorman/68-69.
[87] In NWIGU-CUB/212, the Company explains "The EROA is an average of estimates developed based on the informed judgment of three independent compensation consultants."
[88] Staff/800/Bahr/9.

5.3% used in the test year.[89] Avista claims this is necessary because it reduces exposure to market volatility,[90] which Avista argues is appropriate given the plan's funded status.[91]

Avista's proposal raises two fundamental questions: (1) whether Avista's decision to engage in LDI and shift to a 58% fixed income allocation was prudent, and (2) whether Avista's proposed EROA would ultimately result in just and reasonable rates. NWIGU-CUB's testimony in this docket did not focus on the prudence of Avista's decision to shift to a 58% fixed income allocation, but NWIGU-CUB supports the arguments made by Commission Staff.

With regard to the appropriate EROA to include for ratemaking purposes in this case, Staff proposes to use a 7% EROA for ratemaking purposes, rather than the Company's proposed 5.3%. NWIGU-CUB Witness Gorman proposes to wholly eliminate the effect of the reduction in the expected return on pension assets in this case, meaning that the Company should continue to use a 6.6% EROA for ratemaking purposes.[92]

Staff notes that a utility could be incented to shift to a more conservative investment mix to reduce the volatility of cash payments made to its investment fund, which is a risk that is borne primarily by shareholders in Oregon.[93] The Company agrees—and states that Avista's desire to shift the risk profile of its investments was due to the volatility of the funded status over several years, which led to "considerable

[89] Avista/1300/Heier/1. CUB notes that the Company's proposed EROA—5.3%--was initially designated as confidential. In the Company's 1300 Reply Testimony and briefs, this number was no longer treated as confidential. Accordingly, CUB has not designated this number as confidential.
[90] Staff/802/Bahr/16-17.
[91] Staff/800/Bahr/7.
[92] NWIGU-CUB/100/Gorman/69.
[93] Staff's Preheaing Brief at 13.

increases in pension expense and contributions."[94] Notably, a significant amount of contributions between 2007 and 2014 were discretionary cash contributions, presumably with a tax benefit.[95] While shifting to a more conservative investment mix may reduce the volatility of cash payments and shareholder risk, it does so at the expense of customers who are burdened with increased FAS 87 expense. The Commission has previously questioned the appropriateness of reducing volatility risk to shareholders at the expense of Avista's customers. In 2007, the Commission investigated whether Avista over-hedged its gas supply to the detriment of customers.[96] In response to the investigation, Avista agreed to pay customers $500,000 and to reduce its hedging.[97]

The Company's argument that its de-risking strategy is an industry norm is also unpersuasive. The sources cited by Avista are not utility-industry specific—in fact, it is not clear whether any utilities that may have been included in some of the sources cited by Avista have specifically engaged in a de-risking strategy similar to Avista.[98] The Company merely points to two utilities—NV Energy and Northwestern Energy—that have adopted a similar EROA as a result of a de-risking approach.[99] Notably, Northwestern Energy's EROA is 500 basis points greater than Avista's proposed 5.3% EROA.[100] Alternatively, the other five regulated utilities in Oregon alone had an average EROA in 2014 of 7.31%.[101]

[94] Avista/1300/Heier/8-9.
[95] Avista/1100/Thies/11.
[96] *See In re Avista Utilities*, OPUC Docket No. UM 1282, Order No. 07-200 (May 22, 2007).
[97] Order No. 07-200 at Appendix A.
[98] Avista/1300/Heier/16-19.
[99] Avista/1300/Heier/18.
[100] Avista/1300/Heier/18. NV Energy's EROA is 5.3%.
[101] Staff/800/Bahr/7.

Based on Oregon's share of operation and maintenance expense associated with the pension cost, NWIGU-CUB propose a reduction to pension expense of $340,000.[102] An EROA of 6.6% would more fairly balance the interests of shareholders and ratepayers, and would result in just and reasonable rates.

F. The Commission should impose rates that reflect bonus depreciation for 2015.

Bonus depreciation is "a tax deduction a company is allowed to take on its federal tax return for capital investment the company made which reduces taxable income, and therefore, reduces the amount of taxes a company pays to the IRS."[103] For the first two quarters of 2015, Avista did not reflect any benefit from bonus tax depreciation because it was uncertain that Congress would approve bonus tax depreciation for 2015 capital additions.[104] As of December 20, 2015, Congress and the President approved the bonus depreciation deduction for 2015.[105] Accordingly, Avista's most recent revised testimony proposes to reflect in rates in the test year benefits from bonus tax depreciation for the third and fourth quarters of 2015.[106]

ORS 757.269(1) requires the Commission to balance the interests of the customers of a utility and the utility's investors by setting fair, just and reasonable rates *that include amounts for income taxes*.[107] The Commission is compelled, during ratemaking proceedings, to ensure that the income taxes included in the electric or natural gas utility's rates:

[102] NWIGU-CUB/100/Gorman/69.
[103] Avista/1600/Revised – Falkner/2.
[104] Avista/1600/Revised-Falkner/2.
[105] Avista/1600/Revised-Falkner/4.
[106] *See* Avista's Reply Testimony Replacement Pages and Affidavits filed December 30, 2015 at Avista/1000/Revised – Smith/19.
[107] Emphasis added.

> (a) Include all expected current and deferred tax balances and tax credits made in providing regulated utility service to the utility's customers in this state;
>
> (b) Include only the current provision for deferred income taxes, accumulated deferred income taxes and other tax related items that are based on revenues, expenses and the rate base included in rates and on the same basis as included in rates;
>
> (c) Reflect all known changes to tax and accounting laws or policy that would affect the calculated taxes;
>
> (d) Are reduced by tax benefits generated by expenditures made in providing regulated utility service to the utility's customers in this state, regardless of whether the taxes are paid by the utility or an affiliated group;
>
> (e) Contain all adjustments necessary in order to ensure compliance with the normalization requirements of federal tax law; and
>
> (f) Reflect other considerations the commission deems relevant to protect the public interest.[108]

For ratemaking purposes, bonus depreciation has three effects. First, it will increase the amount of accumulated deferred federal income tax (ADFIT).[109] Second, by reducing taxable income, it reduces state income taxes for 2015.[110] Third, by reducing 2015 state income taxes, it reduces the 2015 utilization of Oregon Business Energy Tax Credits (BETC), freeing up additional BETCs for use in 2016.[111] As compared to the original filing, the additional ADFIT reduces revenue requirement by $0.8 million and the reduction in state income tax will reduce Avista's revenue requirement by an additional $1.22 million.[112] The plain language of ORS 757.269(2) requires that rates reflect "all expected current and deferred tax balances."

Avista's most recent filing updated the ADFIT and state income tax to reflect the fact that the Company included a partial benefit of bonus depreciation in its third quarter tax payments. Commission Staff has sent out data requests following up on the

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[108] ORS 757.259(2).
[109] NWIGU-CUB/100/Gorman/67.
[110] NWIGU-CUB/100/Gorman/67-68.
[111] NWIGU-CUB/100/Gorman/68.
[112] NWIGU-CUB/100/Gorman/67-68.

information in the Company's most recent filing. NWIGU and CUB will review the answers and may find it necessary to provide further analysis or discussion of this filing.

Avista argues "it is not appropriate to reduce rate base <u>for the full benefit of bonus depreciation</u> because Avista has not had the <u>full</u> benefit of lower tax payments to the IRS during 2015."[113] The Company concedes, however, that "because bonus depreciation was ultimately approved for 2015, the Company can make a refund request from the IRS in 2016" but will not actually receive any refund until March 2016 or later.[114] In short, the Company acknowledges that its 2015 tax liability will reflect bonus tax depreciation, but proposes keeping for shareholders half of the ratemaking benefits because of the lag from the refund. This makes little sense. The Company's tax liability for 2015 is what it is, regardless of whether it overpaid in the short-term. Rates should properly reflect the ratemaking treatment of the actual tax *liability*, not quarterly estimated tax *payments*. The adjustments NWIGU-CUB are requesting are necessary in order to reflect the actual state tax liability and the actual deferred tax balance (ADFIT) that are caused by Avista claiming 2015 bonus depreciation. Therefore, the Company should be ordered to adjust rate base for the full ADFIT related to the bonus depreciation and adjust Oregon taxes so the actual tax liability is reflected.

III. Conclusion

For the reasons stated above, NWIGU and CUB urge the Commission to:

1. Reject Avista's Proposed Return on Equity and impose an ROE of 9.35%.
2. Reject Avista's proposed capital structure and impose a capital structure comprised of 51.5% long-term debt and 48.5% common equity.

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[113] Avista/1600/Revised – Falkner/3 (emphasis in original).
[114] Avista/1600/Revised – Falkner/4.

3. Reduce Avista's proposed rate base by $30 million consistent with Staff's recommendation in this proceeding, and find the East Medford and Ladd Canyon projects imprudent.

4. Disallow costs associated with cost-overruns for Project Compass consistent with Staff's recommendation in this case.

5. Reduce the Company's pension expense by $340,000.

6. Reduce revenue requirement by the amount necessary to reflect the full ADFIT and state income tax effects of 2015 bonus depreciation.

Dated this 8th day of January, 2016.

Respectfully submitted,

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