BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 288

In the Matter of AVISTA CORPORATION dba AVISTA UTILITIES, Request for a General Rate Revision.	STAFF'S PREHEARING BRIEF

1. Introduction

Staff of the Public Utility Commission of Oregon (Staff) files this prehearing brief in anticipation of the hearing scheduled for December 2 and December 4, 2015. In brief summary of the proceedings, Avista (Avista or Company) filed two rounds of testimony in support of its requested general rate increase. Staff and the intervenors, the Citizens' Utility Board (CUB) and the Northwest Industrial Gas Users (NWIGU), filed their respective responsive testimony to the Company's original filing. The Company, Staff and the intervenors jointly filed a Partial Stipulation resolving many, but not all, of the disputed issues.

In its prehearing brief, Staff will discuss its concerns associated with the issues that remain in dispute with Avista. There are eight open issues set forth in the Partial Stipulation (listed immediately below), and one additional one (Rate Spread):

(a) Return on Equity (ROE) and Capital Structure;
(b) Information Technology related to Project Compass;
(c) Plant Investment;
(d) Wage & Salaries: Bonus Incentives;
(e) Medical Benefits;
(f) Pension Expense;
(g) Post Retirement Medical Expenses;
(h) 2015 Bonus Depreciation in ADFIT; and
(i) Rate Design.

Per the schedule in this case, Avista filed its Reply Testimony on November 16, 2015. Staff will address certain aspects of the filing in its prehearing brief but, for matters not

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specifically addressed, Staff reviewed the Reply Testimony and found it to be unpersuasive. Staff stands by the adjustments it proposed in its Staff Opening Testimony.[1]

2. Burden of Proof on Remaining Contested Issues.

Avista has the burden to show that the rate or schedule of rates (and related adjustments and issues) it proposes to be established, increased or changed is "fair, just and reasonable." ORS 757.210(1)(a).

3. Avista has failed to establish that the rates related to the remaining contested issues would be fair, just and reasonable.

A. Capital Structure on Cost of Common Equity (ROE)

As the Commission well knows, rate of return, with its accompanying subparts, is an extremely complex subject area. All active parties filed extensive testimony and exhibits on the topic. Staff's prehearing brief will present a relatively "high-level" review of the issue and discuss the approach and analysis performed by its witness, Matt Muldoon, and explain the areas of dispute he has with the work presented by Avista's hired-consultant's, Adrien M. McKenzie.[2]

Mr. Muldoon sets forth three Tables that show Avista's currently-authorized capital structure and associated costs, its requested capital structure and costs, and Staff's recommended capital structure and associated costs.[3] *See* Staff/200, Muldoon/2. In summary, Staff recommends a capital structure of 49.86 percent equity (common stock), long-term debt (LT Debt) of 50.14 percent, and a "return on equity" (ROE) of 9.11%. *Id.* In contrast, Avista requests a capital structure of 50 percent equity, 50 percent LT Debt and a ROE of 9.90 percent. *Id.*

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[1] Staff notes that it has sent the Company "data requests" (DRs) concerning some aspects of its Reply Testimony but had not yet received its responses as of the time this prehearing brief was filed.

[2] While Staff's prehearing brief will summarize the issue, Staff recommends the decision makers review the parties' testimony in depth to fully understand this complex topic.

[3] Throughout this brief, Staff will refer to the testimony submitted by its witnesses by either naming the witness directly or by the term "Staff."

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(1) Capital Structure

Staff has three reasons for its recommended capital structure of 49.86% equity and 50.14% LT Debt. First, this is Mr. Muldoon's best estimate of capital structure at the end of the 2016 test year, a time period that includes the results of two successive stock buyback programs by Avista. Second, Staff's recommended capital structure is within the range that optimizes the Company's financial performance balanced against the risk of leverage. Lastly, the capital structure excludes elements not historically considered LT Debt by the Commission. Consistent with ORS 757.415(3), Staff's capital structure does not include short-term debt (debt with maturities less than one year) and imputed debt from the Company's contracts. *See generally* Staff/200, Muldoon/2-3.

Staff notes that CUB-NWIGU's witness Gorman also recommends a capital structure that is more heavily weighted towards debt than the Company's. Specifically, witness Gorman recommends a capital structure with a mix of 48.5 percent common equity and 51.5 percent LT Debt. CUB-NWIGU/100, Gorman/3.

(2) Cost of Common Equity (ROE)

Mr. Muldoon sets forth the eight primary reasons for the differences between his recommendation and Avista's on ROE. These reasons include Avista's:

Misplaced reliance on models that have no weight with this Commission;

Failure to anticipate lower than historical long-term gross domestic product growth rates;

Inappropriate reliance on electric and non-utility stocks rather than gas peer group to measure risk;

Inappropriate removal of low end of modeling estimates while retaining upper outliers;

Inappropriate reliance on high estimates of risk premiums, thus distorting the CAPM model; and

Inappropriate reliance upon "Empirical CAPM" (ECAPM) modeling.

See Staff/200, Muldoon/2-3.

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Mr. Muldoon begins his testimony by noting that Avista's history of filing a rate case each of the last three years decreases its risk and time for recovery of its costs. Staff.200, Muldoon/6. Staff then reviewed projected long-term growth rates for the national economy. The result of recent global turbulence means the rate of long-term growth is predicted to be slower in the future. Staff/200, Muldoon/8. The result of this trend is that there is a strong demand by investors for utility bonds. Staff/200, Muldoon/9. These two factors, frequency of rate case filings and increased investor interest in utility bonds, translates to a lower point ROE from within a range of reasonable ROEs. *Id.*

Mr. Muldoon next presents a broad overview of the modeling techniques he used to determine his range of reasonable ROEs for Avista. *See generally* Staff/200, Muldoon/15-31. Mr. Muldoon relies primarily upon two different multistage "discounted cash flow" (DCF) models, which are applied to a cohort group of peer utilities, to estimate the ROE required by Avista's investors.[4] Mr. Muldoon carefully and thoroughly explains how he employed his two models and why he is confident in their results. *Id.*

Next, Mr. Muldoon selected his group of comparable companies (referred to as "peers") to estimate Avista's ROE. *See* Staff/200, Muldoon/20-23; Staff/202. In doing so, Mr. Muldoon used a sensitivity analysis to remove gas utilities that were in the process of merging with other companies as well as to add water utilities that closely tracked gas utility performance. Consistent with Commission practice, Staff rejected Avista's use of electric utilities as peers for gas utilities. Staff/200, Muldoon/24.

The single most important component of the DCF model is the growth rate of future dividends. *Id.* Mr. Muldoon explains his approach at determining the appropriate rates of long-term growth for his DCF modeling. *See* Staff/200, Muldoon/25-31, 44-45. Mr. Muldoon explains why his results, shown in Staff/203, are actually "conservative" in Avista's favor.

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[4] A DCF model estimates the cost of equity by determining the present value of the future cash flows that investors expect to receive from holding common stock. The DCF model has three main components: a current stock price, an expected dividend, and an expected growth rate in dividends. Staff/200, Muldoon/16.

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Staff/200, Muldoon/28-29. Indeed, Mr. Muldoon's modeling approach is very similar to that used by Staff in other rate cases, including Northwest Natural Company's recently concluded proceeding (Docket No. UG 221). Staff/200, Muldoon/31.

Staff next considered models other than its favored three-stage DCF model. *See generally* Staff/200, Muldoon/31-40. Mr. Muldoon first reviewed Avista's preferred "single state DCF model" and found it to be unreliable and noted that the Commission has previously reached a similar conclusion about the model. Staff/200, Muldoon/30-34.

Mr. Muldoon then reviewed Avista's risk premium modeling. *See* Staff/200, Muldoon/34-40. He explains in depth why this type of model is, like the single-stage DCF model, generally unreliable and that Avista's use of the "capital asset pricing model" (CAPM) is specifically untrustworthy. The Commission also does not support use of CAPM. Staff/200, Muldoon/39. Interestingly, Mr. Muldoon found that the CAPM model actually supported an ROE *lower* than the upper end of the range produced by his DCF modeling. Staff/200, Muldoon/38.

In determining the point within the ROE range produced by his modeling, Mr. Muldoon considered the ramifications of Avista's history of filing a rate case each of the last three years. Staff/200, Muldoon/40-43. Staff determined, as did the Public Service Commission of Maryland (Maryland Commission), that such frequent filing of rate cases lowers the filing-utility's risk profile. Mr. Muldoon concluded that this translated into a drop in ROE of up to 20 basis points. Staff/200, Muldoon/42.

Staff concluded its testimony by setting forth the related modeling and the relatively minor basis point adjustments it made to ensure the ROE results of its modeling were fair and reasonable and actually conservative in Avista's favor. Staff/200, Muldoon/44-48.

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While Staff is not permitted to submit new testimony in its prehearing brief, of course, Mr. Muldoon has reviewed the Company's Reply Testimony on the ROE and Capital Structure issues. He found it unpersuasive and Staff stands by its proposed recommendations on this topic.

B. Information Technology related to Project Compass

Staff witness Judy Johnson reviewed the costs related to Avista's information technology project known as "Project Compass." Ms. Johnson determined it was appropriate to remove $1.175 million from Avista's rate base, which represents one-half of the total Oregon-allocated cost overruns related to Project Compass. Staff/300, Johnson/4. Ms. Johnson further proposed to remove 100 percent of the Avista bonuses associated with Project Compass ($68,000 on an Oregon-allocated basis) due to the substantial cost overruns that were incurred. Staff/300, Johnson/4-5. The total of Staff's adjustments related to the Project is $1.234 million. Staff/300, Johnson/5.[5]

Staff's position is simple and straightforward. Staff does not dispute that it was necessary for the Company to undertake and complete Project Compass because its computer systems were old and outdated. Staff/300, Johnson/2. However, in reviewing the Company's filing, Ms. Johnson became concerned because she was unable to determine the precise amount of the funds the Company had expended on the Project. *Id.* She was able to sort this out only after asking the Company, in two data requests, to provide this information. *Id.* From the Company's responses to these data requests, Ms. Johnson concluded that Avista had exceeded its budget for Project Compass by 34 percent, or $27 million on a Total System basis. Staff/300, Johnson/3.

Ms. Johnson also reviewed the testimony submitted by David Gomez, her counterpart with the Washington Utilities Transportation Commission (WUTC). David Gomez reviewed the Project Compass project in relation to Avista's currently on-going rate case in Washington.

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[5] It is important to note that while Staff witness Johnson is not an expert in supervising utility projects of this magnitude, she does have considerable experience both as a prior employee of Avista and as a long-time senior analyst on Commission Staff. *See* Staff/301.

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Like Ms. Johnson, WUTC analyst Gomez also concluded that Project Compass had gone over-budget. Staff/300, Johnson/3-4; *see also* Staff/304 (relevant pages from Mr. Gomez's WUTC testimony). Ms. Johnson examined, and concurred with, WUTC analyst Gomez's findings that the Company failed to adequately manage the Project and failed to recognize, evaluate, document and mitigate the possible risks and costs associated with it. Staff/300, Johnson/3-4; Staff/304.

Based upon these findings, Staff removed $1.175 million from the Company's rate base, representing one-half of Oregon's share of the cost overruns. Ms. Johnson chose 50 percent as the appropriate amount on the basis that Avista should be held equally responsible for the Project's large cost overruns. Staff/300, Johnson/4. For similar reasons, Ms. Johnson decided it was not appropriate to employ the Commission's "usual" standard of removing 50 percent of the Company bonuses awarded related to Project Compass. Instead, Ms. Johnson recommends removing 100 percent of these bonus amounts (i.e. $68,000).

While Staff is not permitted to submit new testimony in its prehearing brief as noted, Ms. Johnson has reviewed the Company's Reply Testimony on this issue. She found it unpersuasive and Staff stands by its proposed recommendations on this topic.

C. Plant Investment

Staff witness Mitch Moore reviewed Avista's proposed capital additions. *See generally* Staff/600-Staff/605. After concluding his review, Mr. Moore recommended a reduction of approximately $30 million from the Company's capital forecast. Staff/600, Moore/1. The primary reasons for Mr. Moore's adjustment are:

(1) The amount of Avista's proposed capital additions is a dramatic increase over historical average for such additions;
(2) The timing of the capital additions for some of the substantive projects is not consistent with the Company' 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 the overall decline in gas sales; and
(4) The Company failed to provide sufficient documentation to support its capital projects.

Staff/600, Moore/1, 14-15.

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Avista proposes to increase its net rate base in Oregon by adding about $45.6 million to its Oregon plant base in 2015 and an additional $2 million for customer hookups in the first quarter of 2016. Staff/600, Moore/2. Mr. Moore did not include the Project Compass additions in his analysis because, as discussed immediately above, Staff witness Judy Johnson reviewed that Project. Instead, Mr. Moore reviewed the remainder of the Company's Oregon general capital plant and gas distribution projects. General capital plant projects included various multi-year projects such as communications and information technology equipment, website redevelopment, building infrastructure and other equipment, totaling $7.7 million ($16 million when including Project Compass). Gas distribution projects included various ongoing programmatic growth-related work, infrastructure updating, pipe replacement, street and highway replacements and other large projects, totaling approximately $30.2 million. Staff/600, Moore/2, 15.

Mr. Moore compared the proposed capital additions in this filing to the Company's average rate base growth for the years 2002 through 2013 and determined that the proposed increase rate in net plant in Oregon was significantly higher than the average from this past time period. Staff/600, Moore/3-4. Specifically, the proposed additions in this rate case represent a 22.6 percent increase in net plant as compared to the Company's average historical net plant growth rate of 7.75 percent. Staff/600, Moore/4.

Further, the Company's historical average of net plant growth from 2002 through 2013(7.75 percent) is high as compared to its five to six percent system-wide growth rate. Staff/600, Moore/5-6, 8. Mr. Moore concluded that, as compared to the historical and system-wide average growth rates, Avista's proposed 22.6 percent increase in capital additions proposed in this case was "extraordinary" and not supported by Avista's original filing (or in its Reply Testimony as Staff notes in the Introduction section of this brief). Staff/600, Moore/5.

Staff also reviewed the Company's proposed growth rate in relation to its customer growth rate in Oregon and overall gas sales. Mr. Moore found that the Company's load growth

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has been relatively flat and that its total gas sales have declined. Staff/600, Moore/6-7. Thus, while Avista's net plant base doubled between 2007 and 2014, its year-end residential customers over that same period increased by only three percent, commercial customers increased by 2.5 percent and industrial customers increased by 11 percent. *Id.* Further, total gas therms sold to all classes of customers decreased by 7.7 percent over this same period. *Id.*

Based upon the comparisons of proposed increase in net plant additions to historical net plant increases, and on the Company's flat customer growth rates and on its declining gas sales, Staff recommends a growth rate for net utility plant of 7.75 percent for 2015. Staff/600, Moore/5, 15. After separating out the separate adjustment to Avista's Project Compass, the 7.75 percent growth rate translates to an approximate $30 million reduction to the Company's proposed $46 million requested amount for capital additions. Staff/600, Moore/15.

As further support for its proposed adjustment, Staff reviewed the project justification forms for each of the 40 capital projects that the Company has forecast to be placed in service in 2015. *See generally* Staff/600, Moore/9-14. Overall, Staff concluded that, given the context of such an extraordinary increase in plant this year, following steady, year-over-year increases in previous years, combined with the flat customer growth and declining gas sales, the Company had failed to provide adequate documentation to support the capital expenditures for both the programmatic (ongoing), as well as the "discrete" (i.e. non-routine), capital expenditures. Staff/600, Moore/1, 4. The Company merely provided what it termed "Capital Investment Business Case Forms" (Forms) for the projects. Staff found that these Forms contained high-level, summary information that was insufficient to justify the extraordinarily large increase in capital additions proposed in the filing. Staff/600, Moore/9-10. Staff followed up with data requests to the Company to justify the projects, but found the Company's responses to also be insufficient. Staff/600, Moore/11-12. Staff provides specific examples of Forms that were insufficient as compared to the projects that were proposed. Staff/600, Moore/10-14.

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The Company's East Medford Reinforcement project (East Medford) represents a different "category" of incomplete information. Staff's concern with the East Medford project is the Company has not provided sufficient evidence to show it must be completed this year. *See* Staff/600, Moore/12-14.

Staff further observes that the East Medford project is an example of the Company proposing to complete and bring projects on line sooner than what is set forth in its IRP. The Company's 2014 IRP schedule the East Medford project for 2018.

While Staff is not permitted to submit new testimony in its prehearing brief as noted, Mr. Moore has reviewed the Company's Reply Testimony on this issue. He finds it unpersuasive and Staff stands by its proposed recommendations on this topic.

D. Wage & Salaries: Bonus Incentives

The dispute under Wages & Salaries concerns Avista's request to recover officers' and non-bargaining (non-union) employee bonuses in rates. Commission policy is to disallow 100 percent of officer bonuses, as they are typically based in part on earnings. Staff/800, Bahr/20, citing to Commission Order Nos. 99-033 at 62 and 97-171 at 74-76.

Commission policy also prescribes disallowances of 75 percent of performance-based bonuses and 50 percent of merit-based bonuses for non-union employees. These disallowances are made, in part, on financial-based metrics which benefit shareholders. Staff/800, Bahr/21; Staff/802, Bahr/35, citing to Commission Order No. 97-697.

Staff's adjustment is to remove incentive bonuses of $288,000 in expenses and $278,000 in capital. *Id.*

In its Reply Testimony, Avista witness Smith agrees that past Commission orders are concerned with removing financial-based incentives but she then asserts that the Company's filing has done so. Avista/1000, Smith/12-13. According to witness Smith, the incentives that remain are based entirely on metrics related to ratepayers, such as Operation and Maintenance

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(O&M) cost per customer, customer satisfaction, reliability and response time. Avista/1000, Smith/13.

Staff is not persuaded that O&M cost per customer is a non-financial-based incentive that has no benefit or relation to financial metrics. Staff stands by its proposed adjustment to bonus incentives.

E. Medical Benefits

Staff witness Bahr analyzed the Company's filing related to medical benefits and determined that an adjustment was necessary to health insurance expense in the amount of $175,000 for non-union employees. *See generally* Staff/800, Bahr/14-16. Before continuing, Staff notes that it agrees with Avista's proposed correction to its adjustment (correcting for Staff's inadvertent inclusion of union employees). As such, the correct amount of the adjustment should be $133,000. *See* Avista/1000, Smith/17.

Mr. Bahr proposed his adjustment for two reasons. First, a survey in the Kaiser Family Foundation publication, a publication upon which Staff has historically relied, shows that the average sharing ratio in the industry is 82/18 (i.e. employees pay 18 percent of premium costs while the Company pays the remaining 82 percent) for single employees and 71/29 for families. Staff/800, Bahr/14-15. This is contrasted with the 90/10 sharing ratio used by the Company. Staff/800, Bahr/14. Second, Staff disagrees with the Company's approach to escalate the cost of health care by 15.54 percent from actual 2014 costs in order to forecast 2016 costs (before making the premium sharing adjustment). Staff/800, Bahr/15. Instead, Staff's proposed adjustment employs an analysis of cost trends from 2011 through 2014 to forecast the 2016 costs. *Id.*

Staff has reviewed the Company's Reply Testimony on this issue, found at Avista/100, Smith/14-17, and finds it non-persuasive except for the correction of Staff's values as noted. Staff stands by its corrected proposed adjustment.

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F. Pension Expense

Staff proposes to reduce the Company's pension expense by $348,000. Staff/800, Bahr/2. Before discussing this issue in depth, Staff notes that it agrees with the $149,000 correction to its adjustment proposed by the Company in its Reply Testimony. *See* Avista/1000, Smith/18 (correcting Staff's inadvertent inclusion of Capital amounts in its O&M adjustment). Accounting for this correction, Staff's pension expense adjustment is $199,000.

The level of pension expense "charged" to ratepayers is calculated and determined by third-party actuaries. Staff/800, Bahr/5. The "equation" used by the third-party actuary, as prescribed by Accounting Standards Codification (ASC) 715, or Financial Accounting Standard (FAS) 87, includes components such as "Expected Return on Assets" (EROA) and the expected discount rate. *Id.* Simply stated, Staff's concern is that Avista's proposed FAS 87 pension expense is inflated due to overly-conservative pension plan investments that in turn generate a lower EROA.

As background, a pension fund can grow either through cash contributions from the Company or through investment returns. Required cash contributions depend on how well funded a plan is. Because a plan's funding can be highly dependent on market swings and interest rates, required cash contributions can be volatile. The volatility of cash contributions is a risk borne primarily by shareholders, as the amount in rates is a calculated, smoothed cost. *See* ACS 715 and FAS 87. The amount charged to customers in rates is calculated by a third-party actuary, but is influenced by the investment choices the Company makes. A Company would expect to earn lower returns on conservative investments but would also expect decreased risk. *See generally* Avista/1300, Heier/2-25.

In this case, the Company reduced its exposure to market volatility by changing the allocation of asset investments in the pension fund. Specifically, Avista moved its mix of "fixed income" (FI) and equity (Equity) in 2014 from 31/69 FI/Equity percent ratio to a 58/42 ratio. Staff/800, Bahr/6. This investment allocation ratio was the most conservative of several options

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recommended by the Company's investment advisor. Avista/1300, Heier/15. Moving its investment allocation to a more conservative mix increases the FAS 87 pension expense to customers, though it also is expected to reduce volatility of the expense. However, besides reducing the volatility of the expense, a company may also change to a more conservative investment mix to reduce the volatility of cash payments it makes to its pension fund – the latter being a risk borne primarily by shareholders.

Because of its change in asset mix, the Company's forecasted EROA used in its filed case decreased from 6.6 percent used in 2014 to a percentage shown in further detail at Staff/800, Bahr/7 (referencing Confidential Staff/803, Bahr/2-5). The resultant EROA proposed by Avista is well below the average EROA of 7.31 percent for other regulated utilities in Oregon in 2014. *Id.* Indeed, no other regulated utility in Oregon has an EROA below 7.0 percent at this time. *Id.*

In response to a Staff data request, Avista defended its proposed low EROA by noting that the pension plan was well-funded and as such, it was appropriate to "derisk" it in 2014 by becoming more heavily invested in FI and less in Equities. *Id.* As to this latter point, Staff analyzed for Oregon-regulated utilities whether a higher-funded status for a fund correlates with lower EROAs. Staff's statistical analysis determined that Avista's assertion, that a higher-funded plan should correlate with lower expected returns on assets, only mildly supported by the evidence. *See* Staff/800, Bahr/8-9.

Staff also observed that Avista's funding percentage for its pension plan still fell over the course of the 2014 calendar year despite its "derisking" strategy. Staff/800, Bahr/9. Further, even though the funded percentage fell during 2014, the Company lowered its EROA even further in 2015 as shown in greater detail at Staff/800, Bahr/9 (confidential). Avista's strategy is even more questionable in light of the fact that PacifiCorp's 2013 funded percentage was the highest of all six regulated utilities in both 2013 and 2014, yet it maintains an EROA well above Avista's. *Id.*

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Finally, Staff observes that the Company's actual earnings from its pension asset from 2012 through 2014 were significantly higher than its requested EROA amount Staff/800, Bahr/11.

In light of these considerations, Staff proposes to reduce the Company's proposed Oregon-allocated FAS 87 expense by a (corrected) amount of $149,000. This represents an EROA with a return of 7.0 percent rather than the Company's proposed percentage shown at Staff/800, Bahr/7, 11 (confidential number).

Staff has reviewed Avista's Reply Testimony and finds it unpersuasive. As such, Staff stands by its corrected adjustment.

G. Post-Retirement Medical Expenses

Staff's post retirement expense adjustment is made for reasons very similar to the Pension Expense issue discussed immediately above. Like FAS 87, FAS 106 addresses the treatment of retirement benefit costs and defines the calculation of the cost using variable inputs such as EROA, discount rates, etc., to the expense "equation." Staff/800, Bahr/10. Like the FAS 87 pension expense, the Company proposes to use an EROA that, in Staff's opinion, represents an investment mix that is overly conservative. *Id.* The Company's forecast is out-of-synch with its earned returns from 2012 to 2014 and even with its requested rate of return in this case. *Id.* Staff proposes to adjust the Company's filed EROA to 7.0 percent. This results in an adjustment of $24,000. Staff/800, Bahr/12. However, Staff notes that a correction similar to the one made for the Pension Expense adjustment should be made to this adjustment (relating to the inclusion of Capital and O&M). As corrected, Staff's proposed adjustment for Post-Retirement Medical Expense is $14,000.

Staff has reviewed Avista's Reply Testimony on this matter and finds it unpersuasive. As such, Staff stands by its corrected adjustment.

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H. 2015 Bonus Depreciation in ADFIT

While Staff did not file testimony on this issue, it presents the following observations based upon testimony and evidence submitted so far in this proceeding.

In its Reply Testimony, Avista disagrees with CUB-NWIGU witness Gorman's proposal to reduce rate base by $7.5 million for additional "accumulated deferred federal income tax" (ADFIT) related to bonus depreciation. Avista did not include bonus depreciation for 2015 in its originally-filed case because the bonus depreciation deduction had expired at the end of 2014. *See* Avista/1600, Falkner/2. Also the Company did not pro form its 2016 additions. Avista/1600, Falkner/4 at 7-8.

CUB-NWIGU witness Gorman testifies that it is anticipated that Congress will reenact bonus depreciation for 2015 and 2016. NWIGU-CUB/100, Gorman/66- 67. Staff draws the same conclusion in its opening testimony. Staff/100, Gardner/12-13.

Avista explains the concepts of "bonus depreciation" and the book to tax timing difference and the impact on ADFIT in its Reply Testimony. Avista/1600, Falkner/2, footnote 1. Staff testifies that the Commission's policy regarding normalization is consistent with the Internal Revenue Code (IRC) regarding public utilities and, therefore, agrees with Avista's explanation of these concepts as set forth by Avista in its testimony as cited. Staff/100, Gardner/8.

Staff further notes that the Commission must comply with ORS 757.269. This statute mandates "... amounts for income taxes included in rates are fair, just and reasonable if the rates include current and deferred income taxes and other related tax items that are based on estimated revenues derived from the regulated operation of the utility." Staff/100, Gardner/8-9. Note that current and deferred income taxes are based on estimated revenues. Staff believes projecting the availability of bonus depreciation is consistent with this directive.

Staff has proposed reducing Avista's 2015 and 2016 filed capital additions of $46.3 million and $2 million, respectively, to $17 million for 2015 and $0 for 2016. Staff/600,

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Moore/2. Therefore, assuming the Commission adopts Staff's rate base disallowance, Staff is unable to support the $7.5 million reduction in rate base CUB-NWIGU witness Gorman has proposed, since it is based on the levels of capital additions in the initial filing that Staff has proposed to adjust.

Avista also testifies that, even if bonus depreciation is extended for 2015 and 2016, the Commission should not accept Mr. Gorman's adjustment to ADFIT because the Company has incurred carrying costs for the 2015 quarterly estimated tax payments to the IRS which did not include a bonus depreciation deduction. Avista/1600, Falkner/3-4. This infers that Avista believes Mr. Gorman's proposed adjustment would be a wash and offset by Avista's 2015 quarterly estimated tax payments.

Staff would like to reiterate that its policy has been to disallow working cash in rate base for gas utilities except for materials and supply inventory. Staff/100, Gardner/7. Consequently, Staff would not accept any rate base treatment for the estimated tax payments Avista has made, and associated carrying costs, as an offset to any bonus depreciation adjustment to ADFIT.

I. Rate Spread Issue

In the last Avista general rate case (Docket UG 284), in its Order No. 15-109, the Commission ruled against the having rate decreases to some customers while other customers received rate increases unless there was compelling evidence to do so:

> We appreciate that rates may be misaligned relative to cost-of-service and that rate cases provide opportunities to make adjustments that more closely align rates with costs. Absent compelling evidence that warrants more immediate action, however, we are not inclined to raise some rates while reducing others. In this case [UG-284] there is no evidence that suggests that Avista's rates for its larger customers are so high and need to be reduced at this time. (Emphasis added.)

Order No. 15-109 at 5.

In this case, CUB opposes having selected customers receive a general rate reduction, as proposed by Avista for some of the large industrial customers, while the residential and small commercial/industrial customers receive a relatively modest increase. CUB's argument against

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the reductions in this case is that rate decreases in the presence of rate increases sends the wrong message.

On this issue, Staff supports Avista's general approach for reasons surrounding the notion of cost-based rates. Staff/1300, Compton/16. Staff reaches its conclusion for the following reasons.

To start, if the Commission's intent was to wait until a then-imminent new general rate case to more fully consider this issue, that case is here. Staff/1300, Compton/19, 20. Staff further opined that the general objective should be to "promot[e] social equity by reducing inter-class cross-subsidization." Staff/1300, Compton/20. And that, while the cost-of-service evidence would support margin percentage decreases as high as 35%, the request is for decreases of only 7%. The impact of such on residential customers would be only 0.3% (not 3%). Staff/1300, Compton/20 and Staff/1304. Staff also notes that three LRIC studies (Company's, Staff's, NWIGU's) support the rate reductions. Avista/1900, Ehrbar/5,6. As to CUB's "sending the wrong message" concern, Staff responds by noting that the affected large industrial customers have expert utility professionals who would not be misled. Staff/1300, Compton/19.

Based upon its analysis as set forth above, Staff concludes there is "compelling evidence" to support nuanced rate decreases to some customers even while other customers receive rate increases. Staff's recommended nuanced approach in this circumstance is set forth in detail at Staff/17-18; Staff/1303, Compton/4. In brief summary, if the overall total bill rate increase in this case is four percent or less, the Commission should provide rate decreases to the identified large industrial customers but, to help mitigate possible rate shock, if the overall total bill rate increase is greater than four percent, the affected large industrial customers would not receive any rate decrease, but they would also not receive a rate increase. *Id.*

In its Reply Testimony, the Company disagrees with Staff's proposed nuance approach and argues that both Staff's and NWIGU's testimonies support positive and negative price adjustments that are similar to the Company's. Avista/1900, Ehrbar/7-8.

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Staff stands by its recommendations set forth in its Opening Testimony.

4. Conclusion

For the reasons stated, the Commission should adopt Staff's proposed adjustments as stated in its testimony and as summarized, and corrected, in this prehearing brief.

DATED this 23rd day of November, 2015.

Respectfully submitted,

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