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	)
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Request for a General Rate Revision	)
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REPLY BRIEF OF 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 Citizens' Utility Board of Oregon ("CUB") hereby submits its prehearing brief in docket UG 288. The issues CUB shares with the Northwest Industrial Gas Users ("NWIGU") are discussed in the concurrently filed NWIGU-CUB Reply Brief. CUB only remaining issue is rate spread, which is the sole subject of this brief.

II. Argument

This docket is Avista's third general rate case in three years. With a culture of unfettered investment in capital additions,[1] it is likely that there will be several more general rate cases in the near future.[2] The Company's filed case asked for an overall

[1] *See* Staff/600/Moore/3-6.
[2] CUB/100/McGovern-Jenks/1.

increase in billing rates of $8.557 million, or 8.0%.[3] The Company cited that its request for rate relief is largely driven by an increase in its rate base, and to a lesser extent, an increase in operating and maintenance ("O&M") and administrative and general ("A&G") expenditures, as well as by the net change in retail revenue since the Company's last general rate case.[4] Despite the fact that costs of service are going up substantially, Avista proposes to disproportionately burden residential customers with a 7.2% increase, while other rate schedules would receive a rate decrease.[5] NWIGU generally supports the Company's proposed rate spread.[6] Staff also supports the Company's general approach for rate decreases for certain classes, but proposes that rate reductions for certain schedules be limited to no more than 4%.[7]

CUB's examination of the Company's LRIC Study and resulting rate spread recommendation revealed that the Long Run Incremental Cost ("LRIC") study is fundamentally flawed, and it is unsupported by sound analysis and policy. Staff's and NWIGU's rate spread recommendations are also based on Avista's problematic LRIC study, and they share the same policy flaws as Avista's proposal. Accordingly, CUB respectfully urges the Commission to order Avista to apply a rate spread that would have no customer class receiving more than three times the increase of any other customer class. For transportation customers, this should be done after imputing Avista's commodity costs. Interruptible customers should receive the average increase.

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[3] Avista/100/Morris/8.
[4] Avista/100/Morris/9.
[5] Avista/1900/Ehrbar/14. Note that this proposal is based on the revised revenue requirement resulting from the Partial Settlement Stipulation filed in this case. The Company's original rate spread proposal had residential customers absorbing an 8.9% increase, with other schedules getting rate decreases. Avista/1900/Ehrbar/2.
[6] NWIGU/100/Collins/5.
[7] Staff/1300/Compton/7.

A. There is only one Long Run Incremental Cost Study in this case, and it is flawed.

Despite a multitude of assertions to the contrary, there is only one LRIC on the record in this case. The Company routinely argues that there are three by characterizing Staff's and NWIGU's analysis as separate LRIC studies, but those parties have not filed their own, independent LRIC studies.[8] If a party's review and analysis of the Company's LRIC study are to be considered wholly separate LRIC studies, then the Commission actually has before it four LRIC studies including CUB's review and analysis of the Company's LRIC study.

Additionally, Avista, NWIGU and Staff give too much weight to the results of Avista's LRIC study. As discussed more fully below, a LRIC study does not strictly dictate rate spread—it "is as much of an art as it is a science"[9] and requires application tempered with sound ratemaking policy. In this particular case, Avista's LRIC study contains several major flaws.

i. System costs are driven primarily by industrial customers.

CUB's Opening Testimony in this case demonstrates that the capital spending driving the rate case is largely driven by large customer load growth, rather than residential customers.[10] As Avista recognizes, load growth for small customers is relatively flat, and there is no near-term need to acquire additional supply-side resources

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[8] *See e.g.* Avista's Post-hearing Brief at 65; Avista/1900/Ehrbar/5-6. NWIGU's witness did not conduct an independent LRIC study, but did review and critique the results of the Company's LRIC study. NWIGU/100-103/Collins. Similarly, Staff did not produce its own independent LRIC study. Staff/1300/Compton/2.

[9] *In re Matter of Investigation of Methods for Estimating Marginal Cost of Service for Electric Utilities*, OPUC Docket No. UM 827, Order No. 98-374, 1998 Ore. PUC LEXIS 246, 31 (Sept. 11, 1998).

[10] CUB/100/McGovern-Jenks/17.

to meet customer demand.[11] This is not the case with larger customers.[12] Industrial usage and the number of customers have been trending up, and that pattern is expected to continue into the test year.[13]

The Company argues that "only 14% of rate base growth is due to gas distribution growth plant, while the remaining 86% of new capital investment is related to reinforcements, safety, pipe replacement, mandated work, storage, general plant, and Project Compass."[14] Yet, as an example, when CUB asked the Company to provide the number of customers to be in the expected load for 2016, and the rate schedule that would be served by the Ladd Canyon Gate Station Update ("Ladd Canyon Project"), the Company stated that it "does not perform load forecasting at the individual gate station level. The most disaggregated level at which Avista's load forecast is performed is the service schedule in each given forecasting region…"[15] The Company further concedes that historical usage is not tracked at the gate station level.[16] While CUB does not doubt that all customers will benefit from this and similar investments in the gas distribution system, how can the Company appropriately evaluate or assign costs to customer classes if it does not know where the customers are on the distribution system or whether alternatives, such as interrupting interruptible customers, are viable? The Company's focus on the growth in number of customers, rather than the usage of those customers, is problematic and does not help to determine the cost causality of an investment such as the Ladd Canyon Project.

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[11] CUB/100/McGovern-Jenks/17.
[12] CUB/100/McGovern-Jenks/18.
[13] CUB/100/McGovern-Jenks/18.
[14] Avista's Post-hearing Brief at 67.
[15] CUB/110/McGovern-Jenks/1.
[16] CUB/114/McGovern-Jenks/1.

ii. The useful life of investments is overstated for industrial customers.

CUB's Opening Testimony also raised concerns that the Company's LRIC study exaggerates the useful life of investments made for industrial customers when compared to other customer classes.[17] Unlike a residential customer, whose coming and going likely requires no alterations to Avista's system, industrial customers can have specialized needs and are not always guaranteed to stay on the system for the entire predetermined (or assumed) useful life of any system alterations that may have been required in the provision of service.[18]

Avista argues that it is "extremely rare" that an industrial customer would entirely close operations with no other customer taking service in its place.[19] The Company points out that over the past five years, it has only experienced three such situations, which accounts for approximately .4% of the Company's industrial load.[20] The Company goes on to state that it is not "forecasting a significant number of industrial closures in the next five years."[21]

Avista's arguments are unpersuasive. First, even assuming the occurrence is truly "rare," these customers place significant costs on the system that the Company proposes should be primarily borne by residential customers. For example, the Company explicitly concedes that the Ladd Canyon Project was initially driven by a temporary, interruptible industrial customer—Mainline Paving—[22] for a total cost of $1.65 million.[23] As

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[17] CUB/100/McGovern-Jenks/19-20.
[18] CUB/100/McGovern-Jenks/19.
[19] Avista/1800/Miller/13.
[20] Avista's Post-hearing Brief at 69. CUB notes that Avista's brief cites to Avista/1800/Miller/13, which states that the departed industrial load accounts for .04% of industrial load. CUB is unclear about which number is correct.
[21] Avista's Post-hearing Brief at 69.
[22] CUB/100/McGovern-Jenks/10-12.
[23] CUB Exhibit 113 at 1.

discussed in the the NWIGU-CUB Reply Brief, the Company's investment in the Ladd Canyon Project was not anticipated until 2019 or later.[24] The Company first claimed that it accelerated the project because it was needed to meet load growth, which CUB later determined to be the temporary Mainline Paving,[25] and then later justified the project by claiming that it was needed for reliability purposes once Mainline Paving left its system.[26] The Company has not provided compelling or substantial evidence to support its claim that the project was needed in 2016 for either reliability or capacity purposes. This means that residential customers are being asked to pay, for a period of 36 years,[27] a large portion of a capital project driven by the temporary demand of one non-residential customer that was otherwise unnecessary in the test year.[28]

Second, the Company's LRIC gives all equipment a useful life of 36 years, regardless of the customer class it serves.[29] Even at a rate of three instances every five years, the Company's LRIC systematically underestimates the cost of service to the customer on that schedule by overstating the useful life of the equipment.[30]

iii. The Company's LRIC study does not reflect an accurately sized system.

CUB's Opening Testimony also criticized the Company's LRIC study because it does not reflect an accurately sized system. In Oregon, revenue requirement is set based on actual, or embedded costs and not forward-looking, or marginal costs.[31] The LRIC is

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[24] LC 61 – Avista Intergrated Resource Plan at Table 7.2.
[25] CUB/100/McGovern-Jenks/9-10.
[26] CUB/100/McGovern/Jenks/11.
[27] Avista/801/Miller/2.
[28] *See* CUB/100/McGovern-Jenks/11. The Company argues that the Ladd Canyon Project was otherwise needed prior to the Pierce Road L Grande HP Reinforcement completion in 2017, but provides no compelling evidence that the project is necessary during the test year. *See* Avista/1500/Webb/19.
[29] CUB/100/McGovern-Jenks/20.
[30] CUB/100/McGovern-Jenks/20.
[31] CUB/100/McGovern-Jenks/21.

simply a tool used to inform rate spread and rate design[32]--its purpose is "not to determine revenue requirement of the existing system, but [to] get a better picture of cost causality on a theoretical marginal system"[33] so that proper price signals can be set. The LRIC study should analyze the *incremental long-term cost* of serving new customers and loads, and "[i]f the current system is oversized, then the LRIC should not be based on the current costs of the current system, but should look at the forward-looking cost of a new system that is sized for the actual expected loads."[34] The Company, on the other hand, argues that the LRIC study "should be based on the replacement cost of the <u>actual</u> facilities that will be reflected in the Company's revenue requirement; that is to say, it should reflect the actual marginal replacement costs the Company expects to incur in the future, rather than a hypothetical replacement of the <u>entire</u> system."[35] The Company argues that "it is nonsensical to base costs on a hypothetical system that will not, and could not, occur in the future."[36] The Company is incorrect.

Understanding the incremental cost associated with a new customer, or a new unit of demand, often involves modeling "a hypothetical system that will not, and could not, occur in the future." For example, the Commission approved PacifiCorp's use of the minimum system approach for calculating the marginal cost of poles and conductors, which is based on a hypothetical system:

> PacifiCorp uses the minimum system approach for calculating the marginal cost of poles and conductors. The minimum system approach is based on a **hypothetical system** where equipment is of the minimum size necessary to meet load…PacifiCorp's minimum system approach employs a **hypothetical** Distribution Feeder Model, which considers customer

[32] CUB/100/McGovern-Jenks/21.
[33] CUB/100/McGovern-Jenks/23.
[34] CUB/100/McGovern-Jenks/22.
[35] Avista's Post-hearing Brief at 70 (emphasis in original).
[36] Avista's Post-hearing Brief at 70.

characteristics, such as density, size, usage, and customer location on the feeder."[37]

In addition, there are numerous other examples of the use of hypothetical investments rather than embedded investments. Electric utilities use natural gas combustion turbines (SCCTs and CCCTs) to create a hypothetical set of generation resources, rather than their embedded existing resource mix, which contains hydro and coal resources.[38]

A proper LRIC or marginal cost study is more than simply an examination of the cost of replacing the exact embedded system in today's dollars.[39] It should be based on the type of equipment that would be used on a forward-looking system (for example, Avista's embedded system includes Adyl-A pipes, which are cracking and need to be replaced).[40] Avista's embedded system is oversized in some areas, because demand has decreased.[41] The forward-looking study should reflect the kind of pipe that the Company would install today, and it should be sized to meet the forward-looking load that the Company currently expects.[42]

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[37] *In re Matter of Investigation of Methods for Estimating Marginal Cost of Service for Electric Utilities*, OPUC Docket No. UM 827, Order No. 98-374, 1998 Ore. PUC LEXIS 246, 8-9 (Sept. 11, 1998) (emphasis added). Notably, the Commission also stated that "[t]he minimum system approach has been used in Oregon for many years. The evidence in this record has not convinced us that we should abandon this approach or limit its applicability.")

[38] *See e.g. In re Portland General Electric*, OPUC Docket No. UE 262, Order No. 13-459, Appendix A at 6 (Dec. 9, 2013).

[39] CUB/100/McGovern-Jenks/21-22.

[40] CUB/100/McGovern-Jenks/23.

[41] CUB/100/McGovern-Jenks/23-25.

[42] CUB/100/McGovern-Jenks/23.

B. The Company misunderstands the purpose of the LRIC study in relation to rate design.

i. The magnitude of a residential ratepayer subsidy is exaggerated.

The Company argues that its proposed rate spread "makes necessary progress toward achieving unity" (1.0)[43] by assuming that the purpose of the LRIC[44] is to strictly prescribe rate spread. CUB correctly notes that the LRIC is simply a tool used to inform rate spread and rate design[45]--its purpose is "not to determine revenue requirement of the existing system, but [to] get a better picture of cost causality on a theoretical marginal system."[46]

For example, CUB's Opening Testimony demonstrates that residential customer rates are within a reasonable range when considering the Company's revenues compared to cost of service.[47] Avista "takes issue" with CUB's argument that "customers under Schedule 410 pay for 98% of their own cost of service [and] this is pretty close to paying exactly the amount that the study says customers should pay."[48] In response, the Company notes that Schedule 410 and 420 provide 65.8% or $34.9 million and 25.7% or $13.6 million in total margin revenue, respectively, and it argues that these schedules,

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[43] Avista's Post-hearing Brief at 70.

[44] The Commission uses the same definition for marginal cost and for LRIC. "[A marginal cost study] is designed to demonstrate the marginal costs or savings from providing one unit more or less of electric service." *In re PacifiCorp*, OPUC Docket No. UE 94, Order No. 96-175, 1996 Ore. PUC LEXIS 120, 8 (Jul. 10, 1996). "As part of its filing, PGE submitted a long-run incremental cost (LRIC) study. LRIC is a measure of the long-run costs or savings from providing one unit more or less of service." *In re Portland General Electric*, OPUC Docket No. UE 88, Order No. 95-322, 1995 Ore. PUC LEXIS 45 at 10 (Mar. 29, 1995).

[45] CUB/100/McGovern-Jenks/21.

[46] CUB/100/McGovern-Jenks/23.

[47] CUB/100/McGovern-Jenks/25-31.

[48] Avista's Post-hearing Brief at 74 (internal quotations omitted), citing to CUB/100/McGovern-Jenks/26.

despite being "relatively close to unity on a percentage basis," can have significant impacts on customers of other schedules.[49]

Avista is entirely missing CUB's point. The purpose of the LRIC study is not to be precise—if a customer class is at 98%, 99% or 102% of marginal cost, that customer class is within a reasonable range of covering its cost of service. The Commission simply has not endorsed the notion that margin-to-cost ratios must achieve unity at the disproportionate expense of residential customers, as discussed in the following section of this brief.

ii. Residential customers also subsidize other rate schedules.

In response to the Company's argument that residential customers' rates are being subsidized by other rate schedules, CUB's Opening Testimony pointed out that subsidies can go both ways and cited to the example of the allocation of excess pipeline capacity in the Purchased Gas Adjustment ("PGA") allocations.[50]

In response, the Company argues that CUB is "obviously confusing the costs and revenues associated with <u>interstate pipeline capacity</u> and <u>distribution system capacities</u>."[51] CUB, however, is not confused. CUB's discussion of the allocation of pipeline capacity release revenue was illustrative of the fact that subsidies do not always go to benefit residential ratepayers. The Company purchases pipeline capacity based on design day requirements and then markets the unused capacity.[52] Because industrial customers have high load factors, the unutilized capacity is coming primarily from

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[49] Avista's Post-hearing Brief at 74.
[50] CUB/100/McGovern-Jenks/31-33.
[51] Avista's Post-hearing Brief at 75 (emphasis in original).
[52] CUB/100/McGovern-Jenks/31.

residential customer and other customers with heating load.[53] Because these capacity payments flow through to customers on a per therm basis, customers with high load are receiving a large portion of a benefit (excess capacity for market) that they did not create.[54] While challenging this construct may be more appropriately addressed in the PGA, the fact remains that this is an example of other customer classes being subsidized by residential customers. As noted, CUB's discussion of this issue in this case was to inform CUB's recommendation on rate spread.[55]

C. The Company's rate spread proposal is unsupported by both Commission precedent and sound ratemaking policy, and would result in unjust and unreasonable rates.

The Company uses its LRIC study as a basis for its rate spread proposal in this case. As CUB pointed out, marginal cost studies are theoretical and contain a number of assumptions.[56] In fact, in the Company's last general rate case, its marginal cost study supported an entirely different rate spread proposal.[57] In this case, the Company's LRIC is flawed, as discussed above, and does not provide a sound basis upon which to spread revenue requirement among the rate classes. Furthermore, the Company's rate spread proposal is not supported by Commission precedent, nor is it consistent with sound ratemaking policy.

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[53] CUB/100/McGovern-Jenks/31-32.
[54] CUB/100/McGovern-Jenks/32.
[55] CUB/100/McGovern-Jenks/32.
[56] CUB/100/McGovern-Jenks/38.
[57] *See* UG 246 –Avista/900/Ehrbar/8 at Table 3 (note: the Company's rate spread proposal, based on its LRIC study, did not include rate decreases for any customer class).

The Commission has articulated a policy, grounded in fairness and concern for residential customers, that in the event of an overall rate increase, no rate schedule should receive a rate reduction, generally. In docket UE 94, the Commission explicitly stated:

> This Commission has long recognized the need for cost-based ratemaking and has taken steps to reduce differences in class recovery of marginal cost. We have also recognized, however, ***the importance of protecting residential customers from rate shock*** as we move to a more balanced distribution of the costs of service. ***To minimize such price impacts and to respond to customers' perceptions of fairness, this Commission has adopted a policy that precludes any customer class from receiving a rate reduction in the face of an overall increase in revenue requirement***.[58]

The Commission seems to have largely retained this policy in the interceding twenty years. In Avista's last general rate case, the Commission rejected the settlement stipulation signed by the Company, Commission Staff, NWIGU and CUB, stating that "[a]bsent compelling evidence that warrants more immediate action…we are not inclined to raise some rates while reducing others. In this case, 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."[59]

Notably, CUB found only one case—where rate spread was a litigated issue—in which the Commission imposed a rate decrease for some customers in the face of an increase in others. In docket UG 132, the Commission adopted Staff's recommendation to move NW Natural's schedules by reducing key industrial rates, maintaining rates for current market-based schedules, and increasing residential and commercial rates.[60] The underlying facts in that case, however, are vastly different than those present here. —NW

[58] *In re PacifiCorp*, OPUC Docket No. UE 94, Order No. 96-175, 1996 Ore. PUC LEXIS 120, 11-12 (Jul. 10, 1996) (emphasis added).
[59] *In re Avista Utilities*, OPUC Docket No. UG 284, Order No. 15-054 at 5 (Feb. 23, 2015).
[60] *In re Northwest Natural*, OPUC Docket No. UG 132, Order No. 99-697, 1999 Ore. PUC LEXIS 61, 147-148 (Nov. 12, 1999).

Natural's LRIC study revealed that there was no relationship between the incremental cost NW Natural was incurring and the rates it was charging to various customers and the accuracy of the Company's LRIC study was questioned.[61] But, according to NW Natural's LRIC study in that case, residential customers were at 88% of average marginal cost recovery at current rates, whereas three industrial rate schedules were above 300% of marginal cost (309%, 378% and 616%).[62] Conversely, Avista's residential customers are currently at 98% margin-to-cost at present rates and large general service is at 178% margin-to-cost at present rates.[63]

Finally, Avista's reliance on previous cases in which the Commission approved a stipulation that included increases for some customers and decreases for others is unpersuasive.[64] Settlement stipulations are, by nature, creatures of compromise and the circumstances that gave rise to CUB's endorsement of a particular rate spread in another case were directly attributable to the circumstances present in that particular case. Avista, Staff and NWIGU have not provided compelling evidence that residential customers should be burdened with rate increases, in the face of rate decreases for other customer classes.

D. CUB's rate spread proposal is well-supported, and would ensure just and reasonable rates.

The Company argues that CUB's proposal that no customer should receive any more than three times the increase of any other class is "arbitrary."[65] Avista, Staff and NWIGU all advocate for a rate spread in which some customers will enjoy rate decreases

[61] 1999 Ore. PUC LEXIS 61, 136-151.
[62] *Id.* at 137-138.
[63] Avista/1900/Erhbar/2.
[64] *See* Avista's Post-hearing Brief at 73, note 305.
[65] Avista's Post-hearing Brief at 76.

while residential customers would bear large rate increases. CUB's recommendation recognizes that it is possible to send price signals that move costs closer to parity, while at the same time sending price signals to all classes of customers, alerting that Avista is making significant new capital investments in its system and thus driving prices higher.[66] This can be accomplished by having the schedules that are paying less than parity absorb an increase that is several multiples higher than the increase for the customers who are paying more than parity.[67] Accordingly, CUB is recommending a 3-to1 ratio, in which residential and small commercial customers incur 3 times the increase that would fall to most industrial customers.[68] CUB recommends that interruptible customers receive the average increase.[69]

The Commission has a history of imposing ratio-based rate increases to ensure that no customer class is subjected to rate shock. In docket UE 94, the Commission approved a contested settlement agreement that allocated 1.5 times the average increase to residential customers and .5 times the average increase to general service customers, as a way to move customers towards parity.[70] This equates to a 3-to1 rate spread.

In docket UE 88, the Commission reaffirmed the use of "4-to-1" rate spread for PGE (which was initially adopted in PGE's prior general rate case, Docket UE 79).[71] In doing so, the Commission found that this methodology "help[s] set rates more in line with actual costs caused by each customer class" and although it would not completely eliminate the rate disparity among the classes, it would "achieve a more balanced

[66] CUB/100/McGovern-Jenks/40-41.
[67] CUB/100/McGovern-Jenks/40-41.
[68] CUB/100/McGovern-Jenks/42.
[69] CUB/100/McGovern-Jenks/42.
[70] *In re PacifiCorp*, OPUC Docket No. UE 94, Order No. 96-175, 1996 Ore. PUC LEXIS 120, 9-12 (Jul. 10, 1996).
[71] *In re Portland General Electric*, OPUC Docket No. UE 88, Order No. 95-322, 1995 Ore. PUC LEXIS 45, 10 (Mar. 29, 1995).

distribution of the costs of service without subjecting residential customers to rate shock." Although CUB's proposal in this case is for the use of a 3-to-1 rate spread methodology, the underlying principles remain intact—customer classes are moved closer their respective cost of service, and residential customers are not subjected to rate shock.

Accordingly, CUB's recommendation is based on the following sound policy considerations, which are supported by OPUC precedent:

- Marginal cost studies should be used to inform and guide rate spread and rate design, but they should not be used to dictate rate spread or rate design;
- Only on rare occasions will marginal cost equal the utility's revenue requirement. The Goal is not to price at marginal cost, but to use the marginal cost of service study to inform rate spread and rate design, in order to send the most appropriate price signals;
- Price signals contain a directional element. If costs are generally rising, all customer classes should receive a price signal; and
- While the cost of service study is an important element to cost allocation, cost allocation is also informed by other concerns such as fairness and avoiding rate shock.[72]

Imposing a rate spread that adheres to the principles cited above, which are consistent with prior Commission precedent and ratemaking policy, ensures that customer rates for each rate class are just and reasonable.

[72] CUB/100/McGovern-Jenks/35-41.

III. Conclusion

In sum, CUB respectfully urges the Commission to order Avista to apply a rate spread that would have no customer class getting more than three times the increase of any other customer class. For transportation customers, this should be done after imputing Avista's commodity costs. Interruptible customers should receive the average increase.

Dated this 8th day of January, 2016.

Respectfully submitted,

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