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Via Electronic Mail

November 23, 2015

Public Utility Commission of Oregon
Attn: Filing Center
PO Box 2148
Salem, OR 97308-2148

RE: UG 288 – Pre-Hearing Brief of Avista Corporation

Attached for filing with the Commission is the Pre-Hearing Brief of Avista Corporation in Docket UG-288.

Please direct any questions regarding this filing to Patrick Ehrbar at (509) 495-8620.

Sincerely,

A handwritten signature in black ink, appearing to read "David J. Meyer", is positioned above the typed name. The signature is fluid and cursive, with a long horizontal stroke at the end.

David J. Meyer
Vice President and Chief Counsel for Regulatory
and Governmental Affairs

Enclosure

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

In the Matter of
AVISTA CORPORATION, dba AVISTA UTILITIES

Request for a General Rate Revision

DOCKET NO. UG-288

PRE-HEARING BRIEF OF AVISTA CORPORATION

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1 **BEFORE THE PUBLIC UTILITY COMMISSION**
2 **OF OREGON**

3
4 UG-288
5

In the Matter of)
AVISTA CORPORATION, dba AVISTA) PRE-HEARING BRIEF OF AVISTA
UTILITIES) CORPORATION
)
Request for a General Rate Revision)
)
_____)

6
7 COMES NOW Respondent, Avista Corporation (hereinafter “Avista” or “the Company”),
8 and respectfully submits this Pre-Hearing Brief in the above-captioned matter.¹

9 **I. INTRODUCTION**

10 On May 1, 2015, Avista filed revised Tariff Schedules to effect a general rate increase for
11 Oregon retail customers of \$8,557,000 or 8.0 percent of its annual revenues. The filing was
12 suspended by the Commission on May 6, 2015, per its Order No. 15-143. Settlement conferences
13 were held with the parties on September 15, 2015, and again, on October 20, 2015, resulting in a
14 Partial Settlement Stipulation that was filed with the Commission on November 6, 2015. In the
15 Stipulation, the parties agreed on several (but not all) adjustments to the proposed revenue
16 requirement, resulting in a reduction in Avista’s revenue requirement increase from \$8.557
17 million to a base revenue increase of \$6.741 million. The revenue requirement issues that were
18 resolved are set forth in the table below:

¹ Avista has elected to give rather extensive treatment to the issues in its Pre-Hearing Brief, in order to fully apprise the Commission and other parties of its position in advance of the hearing.

Table No. 1:

SUMMARY OF ADJUSTMENTS TO REVENUE REQUIREMENT AND RATE BASE AS AGREED TO BY PARTIES IN PARTIAL SETTLEMENT STIPULATION			
000s of Dollars			
	Rev. Req. Incr	Rate Base Incr	
	/ (Dec)	/ (Dec)	
Revenue Requirement As Filed by Avista	\$ 8,557	\$ 217,824	
Cost of Debt	(23)	-	
State Effective Tax Rate	(41)	-	
Uncollectibles	(7)	-	
Working Cash	(116)	(1,090)	
State Taxes	(1,353)	-	
Depreciation	(278)	112	
D&O Insurance	(52)	-	
Various A&G Expenses	(31)	-	
Wages & Salaries	(65)	-	
Property Tax	(69)	-	
Prepaid Pension Asset	(605)	(5,655)	
Other Revenues - Miscellaneous Revenue	(34)	-	
Load Forecasting	867	-	
Cost Allocations	(9)	-	
Summary Total of Adjustments to Revenue Requirement (1)	(1,816)	(6,633)	
Adjusted Revenue Requirement and Rate Base: (1)	\$ 6,741	\$ 211,191	
(1) Per Partial Settlement Stipulation filed on November 6, 2015			

2

3 In addition to resolving certain revenue requirement issues, the parties agreed upon a
4 natural gas decoupling mechanism, designed to break the link between a utility's revenues and a
5 consumer's energy usage. In doing so, the parties agreed upon a revenue-per-customer
6 decoupling mechanism which will compare actual decoupled revenues to allowed decoupled
7 revenues determined on a per-customer basis, with any differences deferred for later rebate or
8 surcharge.²

9 The parties also agreed to move the Company's energy efficiency programs to the Energy
10 Trust of Oregon ("ETO"). As such, the parties agreed that Avista would establish a separate
11 natural gas energy efficiency tariff to collect costs, through retail rates, and not through a deferral

² (See Partial Settlement Stipulation at ¶(6))

1 mechanism, as is currently used for Avista’s energy efficiency programs for administering and
2 delivering energy efficiency programs.³

3 Finally, the parties agreed on rate design (not rate spread) issues, with the result that the
4 Residential Service Schedule 410 monthly basic charge will be increased from \$8.00 to \$9.00 per
5 month, while the customer charge for General Service Schedule 420 will increase from \$14.00 to
6 \$17.00. Other monthly customer charges for Large General Service Schedule 424 and
7 Transportation Service Schedule 456 will remain unchanged.⁴

8 Prior to entering into the Partial Settlement Stipulation, each party’s proposed revenue
9 requirement was as follows. Staff proposed a decrease in the Company’s revenue requirement of
10 \$227,000.⁵ NWIGU/CUB arrived at a natural gas revenue increase of \$3.93 million.⁶ (CUB also
11 separately recommended a further adjustment to reduce revenue requirement associated with a
12 particular plant addition (Ladd Canyon) which would have further decreased rate base by
13 approximately \$1.6 million⁷, resulting in a revenue requirement reduction of \$218,000.)

14 After taking into account, however, the impact of the Partial Settlement Stipulation, the
15 following table summarizes what Avista understands to be the revised litigation positions of each
16 of the parties on the remaining contested issues:

³ (See Partial Settlement Stipulation at ¶7)

⁴ (See Partial Settlement Stipulation at ¶5)

⁵ (See STAFF/100, Gardner/4, Table A)

⁶ (See NWIGU-CUB/100, Gorman/2)

⁷ (See CUB/100, McGovern-Jenks/3, lines 5-6)

Table No. 2:

SUMMARY OF ADJUSTED LITIGATION POSITION REVENUE REQUIREMENT				
000s of Dollars				
	Avista	OPUC Staff	NWIGU / CUB	CUB
	Rev. Req. Incr	Rev. Req. Incr	Rev. Req. Incr	Rev. Req. Incr
	/ (Dec)	/ (Dec)	Incr / (Dec)	/ (Dec)
Revenue Requirement As Filed by Avista	\$ 8,557	\$ 8,557	\$ 8,557	\$ 8,557
Agreed Upon Adjustments: (1)	(1,816)	(1,816)	(1,816)	(1,816)
Adjusted Revenue Requirement	6,741	6,741	6,741	6,741
Contested Adjustments				
A. Return on Equity and Capital Structure	-	(1,541)	(1,400)	(1,400)
B. Information Technology Related to Project Compass	-	(132)	-	-
C. Plant Investment	-	(3,194)	-	(218)
D. Wage & Salaries - Bonus & Incentives	-	(329)	-	-
E. Medical Benefits	-	(181)	-	-
F. Pension Expense	-	(361)	(340)	(340)
G. Post Retirement Medical Expenses	-	(25)	-	-
H. Bonus Depreciation	-	-	(667)	(667)
Total of Contested Adjustments	-	(5,763)	(2,407)	(2,625)
Adjusted Litigation Position Revenue Requirements	\$ 6,741	\$ 978	\$ 4,334	\$ 4,116

(1) Per Partial Settlement Stipulation filed on November 6, 2015

2

3 Essentially, the foregoing table provides a road map for a discussion of the remaining revenue
4 requirement issues in this proceeding. These issues are briefly summarized below.

5 **A. Return on Equity and Capital Structure.**

6 While the parties agreed in the Partial Settlement Stipulation to a cost of debt of 5.515%,⁸
7 they otherwise differed on their recommended returns on equity and capital structure. The
8 Company proposes a 50% common equity capital structure and an ROE of 9.9%. It does so
9 through the Direct and Reply Testimony of Mr. Mark Thies, Senior Vice President and Chief
10 Financial Officer, of the Company⁹ and Mr. Adrien McKenzie, Vice President of Financial
11 Concepts and Applications.¹⁰ Staff, through Witness Muldoon, proposes a 49.86% common
12 equity capital structure and an ROE of 9.11%.¹¹ Finally, NWIGU and CUB jointly propose a

⁸ (See Partial Settlement Stipulation at ¶4)

⁹ (AVISTA/200 and AVISTA/1100, Thies/2-8)

¹⁰ (AVISTA/300 and AVISTA/1200)

¹¹ (STAFF/200, Muldoon/1, lines 13-15)

1 48.5% common equity capital structure and an ROE of 9.35%.¹² The impact of Staff’s cost of
2 capital recommendations would be to further reduce the Company’s revenue requirement by
3 \$1,541,000, while NWIGU/CUB’s recommendation would reduce it by \$1,400,000.

4 **B. Information Technology Related to Project Compass.**

5 Staff proposes to reduce rate base by a total of \$1.243 million to reflect the disallowance
6 of a portion of the capital costs associated with the Company’s implementation of its new
7 information technology system known as “Project Compass.”¹³ This adjustment would be a
8 revenue requirement reduction of \$132,000. If approved, it would also necessitate the “write-off”
9 of \$1.243 million of disallowed rate base. Company Witness Mr. Kensok, Vice-President and
10 Chief Information and Security Officer, provided Reply Testimony attesting to the prudence of
11 the project, demonstrating that the Company has successfully and cost-effectively delivered this
12 new customer information system to its customers.¹⁴

13 **C. Plant Investment.**

14 Staff has proposed to reduce the Company’s rate base by \$31,324,722,¹⁵ as well as
15 reducing the associated revenue requirement by \$3,194,000. As previously noted, CUB would
16 reduce the Company’s natural gas revenue requirement by \$218,000 associated with a reduction
17 in rate base of \$1.6 million, associated with a particular project – the Ladd Canyon Gate
18 Station.¹⁶ The Reply Testimony of Company Witness Schuh, Senior Regulatory Analyst,¹⁷ and
19 Mr. Jeffrey Webb, Manager of Gas Engineering and Measurement,¹⁸ specifically addressed the
20 adjustments relating to capital additions proposed by Staff and CUB and explained why their
21 methods do not fairly state costs and rate base for the 2016 rate year.

¹² (NWIGU-CUB/100, Gorman/2, lines 6-7 and /3, lines 6-9)

¹³ (STAFF/300, Johnson/2-5)

¹⁴ (AVISTA/1700, Kensok)

¹⁵ (STAFF/600 Moore/15)

¹⁶ (CUB/100, McGovern-Jenks/3, lines 4-6)

¹⁷ (AVISTA/1400)

¹⁸ (AVISTA/1500)

1 **D. Wage and Salaries/Bonus and Incentives.**

2 Staff proposes to disallow Oregon’s share of 100% of officer incentives, 75% of
3 performance-based incentives and 50% of merit-based incentives for all union and non-union
4 employees.¹⁹ If accepted, this would serve to reduce Avista’s revenue requirement by
5 \$329,000.²⁰ Jennifer Smith, Senior Regulatory Analyst, provides Reply Testimony explaining
6 how the Company’s incentive plan costs included in this case are based entirely on metrics
7 related to ratepayers (O&M cost-per-customer, satisfaction, reliability and response time – none
8 of which depend on the utility’s financial results or other shareholder metrics).^{21/22} Company
9 Witness Smith explains that the Company has adjusted its revenue requirement to reflect a six-
10 year average of incentives, instead of the actual incentives in the Company’s 2014 base year,
11 thereby reducing Oregon’s overall expense by approximately \$0.2 million.²³ The Company has
12 already removed officer incentives based on the Officer Short-Term Incentive Plan, which are
13 premised on earnings-per-share targets. Likewise, the costs associated with long-term officer
14 incentives are based on financial metrics (performance shares), have also been removed from this
15 case and are borne by shareholders.

16 Staff Witness Gardner²⁴ cites in her testimony a recent Portland General Electric General
17 Rate Case Order (Docket UE-283) in which the Commission stated the rationale for
18 disallowance where metrics are based on increased earnings or financial metrics:

19 In accordance with Commission policy, Staff proposed to disallow 100% of
20 officers’ bonuses because they are based on increased earnings. (Order 99-033 at
21 62; Order 97-171 at 74-76) (Emphasis added).

¹⁹ (STAFF/800, Bahr/20-21)

²⁰ (Ibid)

²¹ (AVISTA/1000, Smith/13, lines 12-16)

²² (Ibid.)

²³ (AVISTA/1000, Smith/12, lines 6-9)

²⁴ (Docket No. UE-283, STAFF/100, Gardner/8, lines 1-3)

1 The employee incentive plans that remain at issue, in Avista’s case, however, are “based entirely
2 on metrics related to ratepayers – O&M cost per customer; customer satisfaction; reliability and
3 response time.”²⁵ As further explained by Company Witness Smith, none of the incentive-related
4 expenses included in the Company’s case are based on the utility’s financial results or other
5 shareholder metrics and, therefore, there is no basis for exclusion.^{26/27}

6 **E. Medical Benefits.**

7 Staff proposes a decrease in medical expense for the 2016 rate year based on a trend
8 analysis for 2011-2014, as well as a different sharing in the premiums between the Company and
9 union and non-union employees.²⁸ The impact of these adjustments would result in a \$181,000
10 decrease in revenue requirement. Company Witness Smith explains how the Company’s
11 independent compensation consultant assisted the Company in designing a total benefit package
12 (including medical expenses) that reflect market conditions.²⁹ She states that the Company is
13 committed to providing a total compensation program that will attract and retain qualified people
14 required to meet the needs and expectations of all utility stakeholders, including but not limited
15 to, customers, shareholders and regulators. Medical benefits are only one portion of a carefully
16 balanced overall compensation package, which also includes base salaries, performance-based
17 award programs and retirement benefits that are competitive in the marketplace as benchmarked
18 against other similar-sized companies in regional and national markets. The various components
19 within the medical plan (co-pays, deductibles, premium sharing, etc.) are carefully weighed in
20 order to maintain an appropriate level of medical benefits relative to the overall benefit package
21 and ultimately the overall compensation package. It is not appropriate to adjust one component

²⁵ (AVISTA/1000, Smith/13, lines 12-16)

²⁶ (Ibid.)

²⁷ Order 97-171 involving incentive plans for U.S. West Communications (in Docket No. UT-125) similarly referenced the disallowance of employee bonuses that were based on a utility’s “financial results of operations” (Order No. 97-171, at page 69).

²⁸ (STAFF/800, Bahr/16, lines 2-3)

²⁹ (AVISTA/1000, Smith/15-17)

1 of the overall benefits package, as proposed by Mr. Bahr, without revisiting the competitiveness
2 of the whole package with this change. Ms. Smith also discusses changes made in recent years to
3 the Company’s benefit plan in order to reduce overall expenses.³⁰

4 **F. Pension Expense.**

5 Staff proposes to reduce the Company’s pension expense by \$348,000, in order to reflect
6 the difference between using a 7% expected return on assets (EROA) versus a 5.3% EROA
7 assumed by the Company, given its efforts to “de-risk” its pension plan investment. The
8 Company provided the Reply Testimony of Mr. Thies, as well as an independent consultant who
9 has advised the Board on such matters (Ms. Shelly Heier, President and Chief Operating Officer
10 of Verus), demonstrating that Avista’s pension investment strategy is prudent and reasonable and
11 is in the best interests of utility customers.³¹ Staff would reduce the Company’s revenue
12 requirement by \$205,000 while NWIGU/CUB would reduce it by \$340,000, based on their
13 respective views of the Company’s “de-risking” strategy.

14 **G. Post-Retirement Medical Expenses.**

15 Staff raised similar concerns with respect to the assumed EROA associated with the
16 Company’s post-retirement medical expenses, recommending a reduction of \$15,000 in
17 associated revenue requirement.³² Mr. Thies provided Reply Testimony addressing this issue and
18 explained that the EROA used for post-retirement medical expenses was derived from input
19 received from independent consultants related specifically to the post-retirement medical asset
20 mix (6.6%) – rather than Staff’s simple application of the same 7 percent EROA used for the
21 pension adjustment.³³ It is important to note that the post-retirement medical fund is smaller in
22 scale, and no similar derisking strategy has been applied. Staff did not provide evidence or

³⁰ (Ibid.)

³¹ (See AVISTA/1100, Thies/10-23, and AVISTA/1300)

³² (STAFF/800, Bahr/11-13)

³³ (AVISTA/1100, Thies/22-23)

1 testimony supporting a 7 percent EROA for post-retirement medical, and therefore their proposal
2 should be rejected.

3 **H. Bonus Depreciation.**

4 NWIGU/CUB proposed an adjustment to reduce rate base and revenue requirement
5 related to bonus depreciation and the associated Accumulated Deferred Federal Income Tax.³⁴
6 As such, they proposed to remove \$7.541 million of rate base for ADFIT related to the
7 recognition of bonus depreciation and the additional tax depreciation for 2015 and 2016 plant
8 additions. This would reduce the Company's final revenue requirement by approximately
9 \$805,000.³⁵ The Company presented the Reply Testimony of Mr. Don Falkner, Director of Tax,
10 who addressed the proposed Bonus Depreciation Adjustment of NWIGU and CUB, explaining
11 why it is not appropriate to reduce rate base, because Avista has not had the benefit of lower tax
12 payments to the IRS during 2015, nor will it before new rates go into effect in this case.³⁶

13 **I. Remaining Non-Revenue-Requirement Issues: Rate Spread.**

14 CUB takes issue with the Company's Long-Run Incremental Cost of Service Study
15 (LRIC), as well as the Company's proposed spread of the annual margin/revenue increase among
16 the Company's natural gas service schedules.³⁷ Ultimately, CUB asserts that no schedule should
17 receive a rate decrease while other schedules bear an increase. The Company presented the
18 Reply Testimony of Mr. Joseph Miller, Senior Regulatory Analyst³⁸ and Mr. Patrick Ehrbar,
19 Manager of Rates and Tariffs,³⁹ who provided support for the Company's LRIC Study and its
20 proposed spread of rates. Not one – but three separate LRIC studies (Company/Staff/NWIGU)

³⁴ (ADFIT) (NWIGU-CUB/100, Gorman 66-68)

³⁵ Mr. Gorman's total proposal related to state income tax (SIT) and bonus depreciation was \$2.02 million (SIT of \$1.22 million and \$0.805 million Bonus Depreciation). The \$667,000 in Table 2 above reflects the difference between the \$2.02 million and the agreed-upon SIT adjustment in the Stipulation of \$1.353 million.

³⁶ (AVISTA/1600)

³⁷ (See CUB/100, McGovern-Jenks 19-35)

³⁸ (AVISTA/1800)

³⁹ (AVISTA/1900)

1 support the Company’s proposed spread of rates in this case; CUB presented none. Absent
2 Commission action in this proceeding, the class returns will continue to drift further away from
3 unity.

4 **II. THE PLANT ADDITIONS INCLUDED WITHIN THE REVENUE REQUIREMENT**
5 **ARE PRUDENT AND TIMELY TO ENSURE RELIABILITY OF SERVICE**

6 **A. Staff Has Arbitrarily Reduced the Overall Level of Plant to be Reflected in the**
7 **Revenue Requirement.**

8 In developing its revenue requirement, Avista included a level of plant-in-service
9 developed in the following manner: As in prior cases, it began with rate base for the historical
10 test period, on an average-of-monthly-averages (AMA) for the 12 months ending December 31,
11 2014. The plant was then restated to an end-of-period (EOP) basis as of December 31, 2014. The
12 2015 capital additions were then included, along with associated accumulated depreciation and
13 accumulated deferred federal income taxes (ADFIT) at a 2015 EOP basis.⁴⁰ Next, plant-in-
14 service at the December 31, 2014, was adjusted to a 2015 EOP basis. Finally, the only 2016
15 additions included were those relating to new customer hookups (together with the associated
16 depreciation and ADFIT at a 2016 AMA basis).^{41/42}

17 As of September 30, 2015, the Company has already transferred to service approximately
18 \$27.3 million of the \$47 million of rate base that it proposed, and is “on track to transfer the full
19 amount of the 2015 capital additions included in the original filing by the end of 2015,” as
20 testified to by Company Witness Schuh.⁴³

21 Staff recommended the rejection of the Company’s pro forma capital additions. It started
22 with the Company’s plant additions on an AMA basis for 2014, and then arbitrarily restricted the

⁴⁰ This included associated depreciation expenses for the capital additions.

⁴¹ (AVISTA/1400, Schuh/2, lines 10-20)

⁴² The 2016 level of capital relating to new customer hookups was included because the revenue associated with those hookups was also included in the Company’s test year Revenue Load Adjustment, and are still included with the agreed-upon level of customer load included in the Partial Settlement Stipulation. (AVISTA/1400, Schuh/2, fn. 2)

⁴³ (Id. at page 3, lines 1-3)

1 net plant increase to 7.75% for 2015, and disregarded, altogether, the 2016 growth capital.⁴⁴ It is
2 important to recognize that Staff did so, without any demonstration whatsoever of imprudence
3 concerning these plant additions (with the exception of Staff's proposal related to a portion of
4 Project Compass, discussed elsewhere). Instead, it arbitrarily capped capital spending, for rate
5 recovery purposes, at 7.75% for 2015. It arrived at this by examining historical net plant between
6 2002 and 2013 and computing an average net plant increase during that time period of 7.75%. It
7 then applied this to the Company's 2014 AMA balance of \$210.76 million and determined that a
8 limit or cap of \$16.33 million should be placed on net plant investment for 2015.⁴⁵ The bottom
9 line is that Staff removed \$31.32 million of net plant for 2015 that will be providing service to
10 our customers, without any demonstration that this plant was not needed to provide safe and
11 reliable service to the Company's customers.⁴⁶ Staff is not making the argument that it is not
12 used and useful during the 2016 rate year. In doing so, as noted by Company Witness Schuh:

13 . . . This method effectively removed 55 percent (approximately 27 projects) that
14 are needed to run the day-to-day operations of the Company. Projects such as
15 those to replace failed pipe, improve public safety, pipe that is experiencing
16 encroachment issues and capital maintenance to the Jackson Prairie Storage
17 Facility, to name just a few, were not even considered for recovery.⁴⁷

18 Furthermore, the growth rate of 7.75% was based on a 2002-2013 time period that is not
19 representative of the Company's current capital investment plans, as discussed by Company
20 Witnesses Schuh and Thies.

21 While Staff did not take issue with the prudence of capital additions (with the exception
22 of a portion of Project Compass), it did suggest, however, that the East Medford Reinforcement
23 Project was premature. CUB also did not question the prudence of particular projects, but

⁴⁴ (STAFF/600, Moore/15, lines 6-14)

⁴⁵ (STAFF/600, Moore/15, line 12)

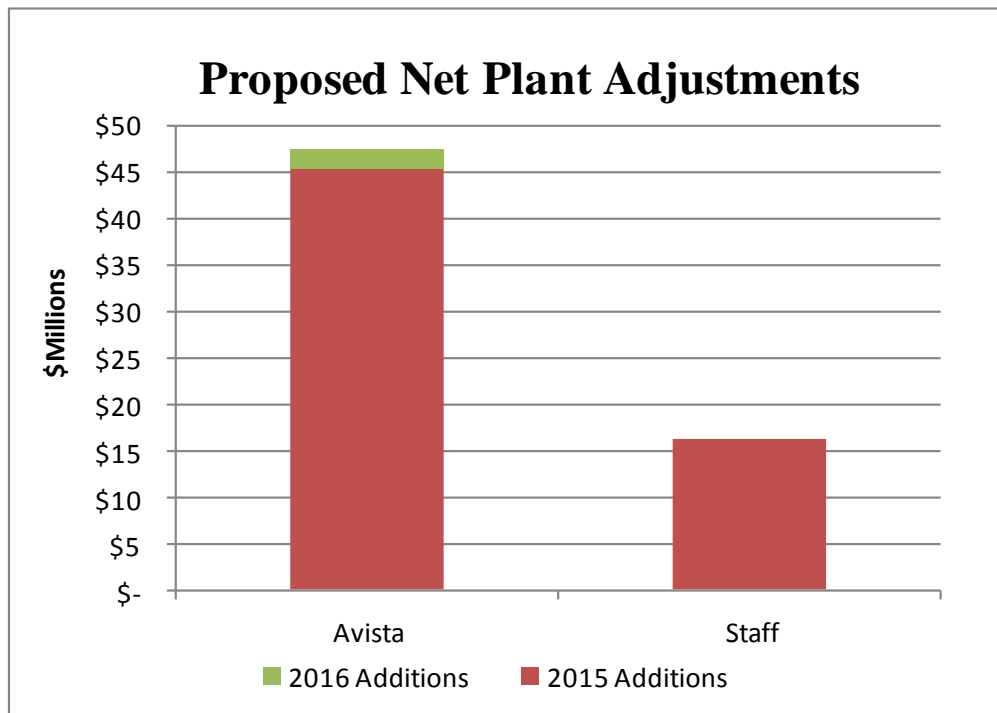
⁴⁶ (AVISTA/1400, Schuh/3, lines 19-21)

⁴⁷ As noted, as of September 30, 2015, the Company has transferred approximately \$27.3 million of the proposed \$47 million. The Company already has \$11 million more in capital investment serving customers two months ago than the \$16.3 million that Staff is recommending for recovery. (AVISTA/1400, Schuh/4, lines 10-14)

1 suggested that the Ladd Canyon Gate Station was not necessary at this time. (These are discussed
2 elsewhere in this Brief.)

3 The illustration below shows that Staff's net plant adjustment falls well below the level of
4 plant that Avista will have in service during the 2016 rate year. Accordingly, as explained by
5 Company Witness Schuh, Staff's proposal falls short of the level of rate base that will be in
6 service during the rate year.

7 **Illustration No. 1:**⁴⁸



8
9 While the 2015 level of capital of additions is higher than in previous years, and for the
10 near-term future years, the main projects driving the increase in capital additions in 2015 are
11 Project Compass, the Aldyl-A Pipe Replacement Project, the East Medford Reinforcement
12 Project and The Ladd Canyon Project. Project Compass, the East Medford Reinforcement
13 Project, and the Ladd Canyon Project are each addressed separately later in this brief

⁴⁸ (AVISTA/1400, Schuh/9)

1 The Aldyl-A Replacement Project is a 20-year program designed to systematically
2 replace select portions of the pipe found within our distribution systems in Oregon, Idaho and
3 Washington. The Company began this program in 2012 and reflected Aldyl-A capital additions
4 as early as in Docket No. UG-246. As it has continued with the program, the Company is now
5 proposing to recover approximately \$6.3 million in plant additions relating to Aldyl-A in 2015.⁴⁹
6 Of the \$6.3 million transferring to plant this year, approximately \$1.04 million is an increase
7 over 2014 levels of Aldyl A. The increased level of spending for 2015 is a part of the overall
8 systematic program to address risks.⁵⁰

9 The East Medford Reinforcement Project is expected to cost approximately \$5 million
10 and to be placed in service by the end of 2015, as discussed below.⁵¹ Finally, Ladd Canyon plant
11 additions represent another \$1.6 million of plant in service.

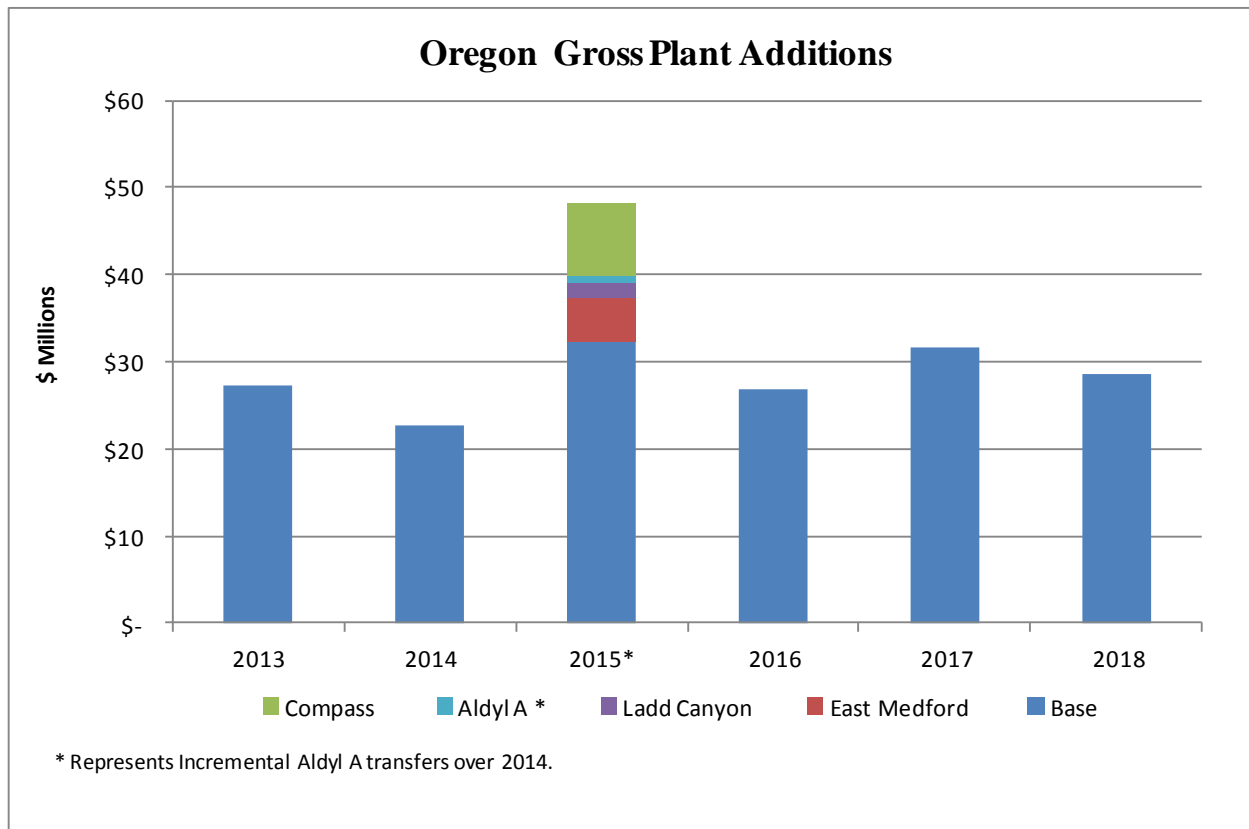
12 The following illustration⁵² shows the impact of these capital additions in 2015, and
13 offers a comparison to prior years, as well as into the future:

⁴⁹ (AVISTA/1400, Schuh/10, lines 2-9)

⁵⁰ (AVISTA/1400, Schuh/10)

⁵¹ (AVISTA/1500)

⁵² (See AVISTA/1400, Schuh/11)

Illustration No. 2:

2

3 As shown in the above illustration, it is anticipated that capital additions in 2016-2018 will return
 4 to a more normal level of between \$25 and \$32 million a year. That does not suggest, however,
 5 that the capital additions in 2015 are not needed at this time, as explained elsewhere in the
 6 Company's filing.

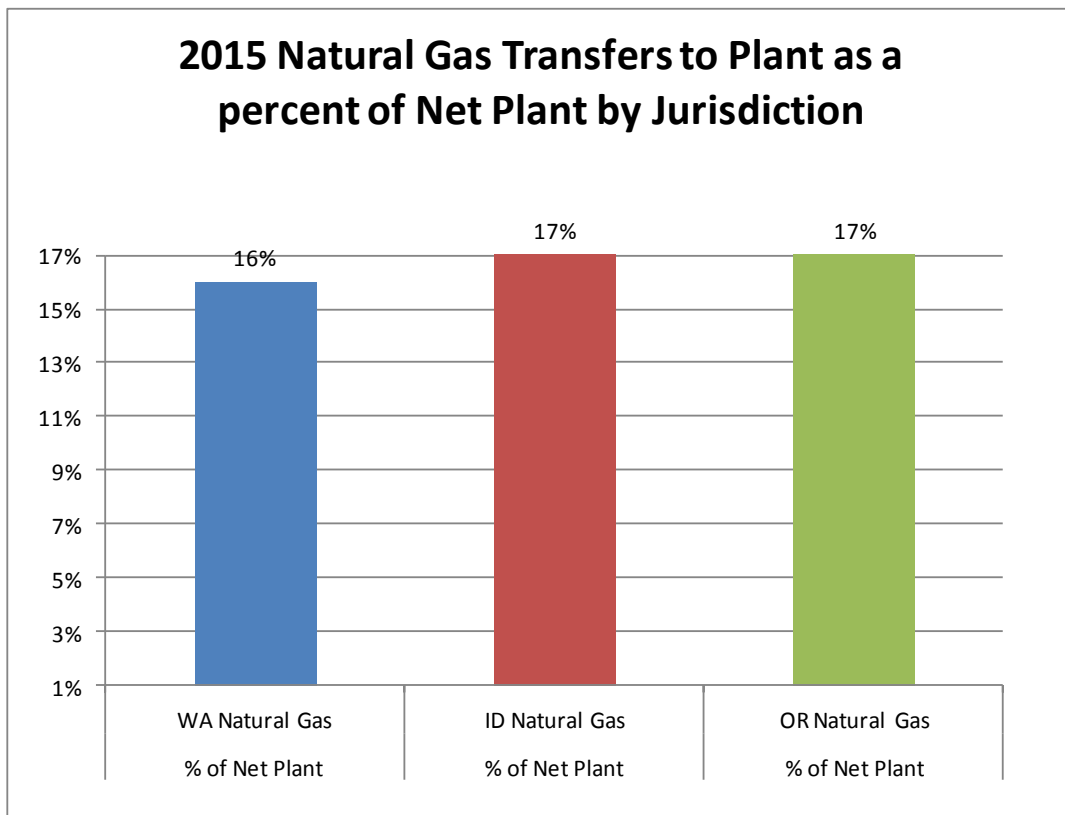
7 Staff Witness Moore's suggestion that Avista's level of capital additions is not supported
 8 by the Company's "relatively flat growth" in terms of number of customers misses the point.⁵³
 9 The Company should invest in plant that provides safe and reliable service to customers, and not
 10 be limited by the amount of customer growth that the Company is experiencing; were it to do so

⁵³ (See STAFF/600, Moore/1, lines 11-13)

1 the Company would be shirking its public service obligation, and would not be investing in
2 necessary infrastructure to meet the reliability needs of its existing customers.

3 Nor is it true that “Oregon ratepayers are being asked to shoulder an outsized share of the
4 Company’s system-wide rate-base growth” as suggested by Staff.⁵⁴ The additional capital
5 spending is not unique to Oregon; rather, projects such as Project Compass, Aldyl-A and other
6 projects are responsible for higher levels of capital spending throughout all of the Company’s
7 jurisdictions. This has resulted in a level of capital investment that has increased in 2015 in the
8 same proportion for all of our jurisdictions, as shown below:⁵⁵

9 **Illustration No. 3:**



10
11 As addressed by Ms. Schuh, the Company manages its plant investment as a system – all
12 jurisdictions and all services together. Managing Avista’s utility plant on a system basis allows

⁵⁴ (STAFF/600, Moore/8, lines 18-20)

⁵⁵ (AVISTA/1400, Schuh/15)

1 for a complete assessment of system risks and needs, and ensures that the capital dollars required
2 to address the highest priority investments are available, irrespective of the particular service or
3 jurisdiction. Avista’s annual capital budget and five-year capital plan is the result of
4 prioritization of projects within individual departments, followed by the CPG’s prioritization of
5 departmental projects on a total-utility basis. The development of system priorities helps to
6 ensure that the Company is addressing the highest-priority risks and needs across the entire
7 system in a timely manner, as compared to an approach that might allocate investment based on
8 the number of customers, rates of customer growth or energy use, percent of rate base, rate
9 impact, state jurisdiction, or on some other arbitrary basis.

10 At the end of the day, Avista has provided extensive evidence in support of its current
11 and planned capital additions. This takes the form of original Business Cases, an example of
12 which is included in Exhibit AVISTA/1401 (Schuh). In addition, the Company has not only
13 provided extensive information in its pre-filed case, but also in response to detailed discovery
14 requests. In the final analysis, it is arbitrary to impose a 7.75% “cap” to restrict the level of
15 recoverable capital additions in 2015 – when all of the evidence demonstrates that higher levels
16 of capital additions are in-service, prudent, and necessary to serve Avista’s customers during the
17 2016 rate year.

18 Finally, Staff Witness Mr. Moore states “growth in rate base should happen at a measured
19 pace so that rate-payers are not burdened with sharp rate increases”.⁵⁶ Illustration No. 3 below
20 shows the average monthly bill for an Avista residential customer served on Schedule 410 for the
21 period January 1, 2007 through March 1, 2016.^{57/58}

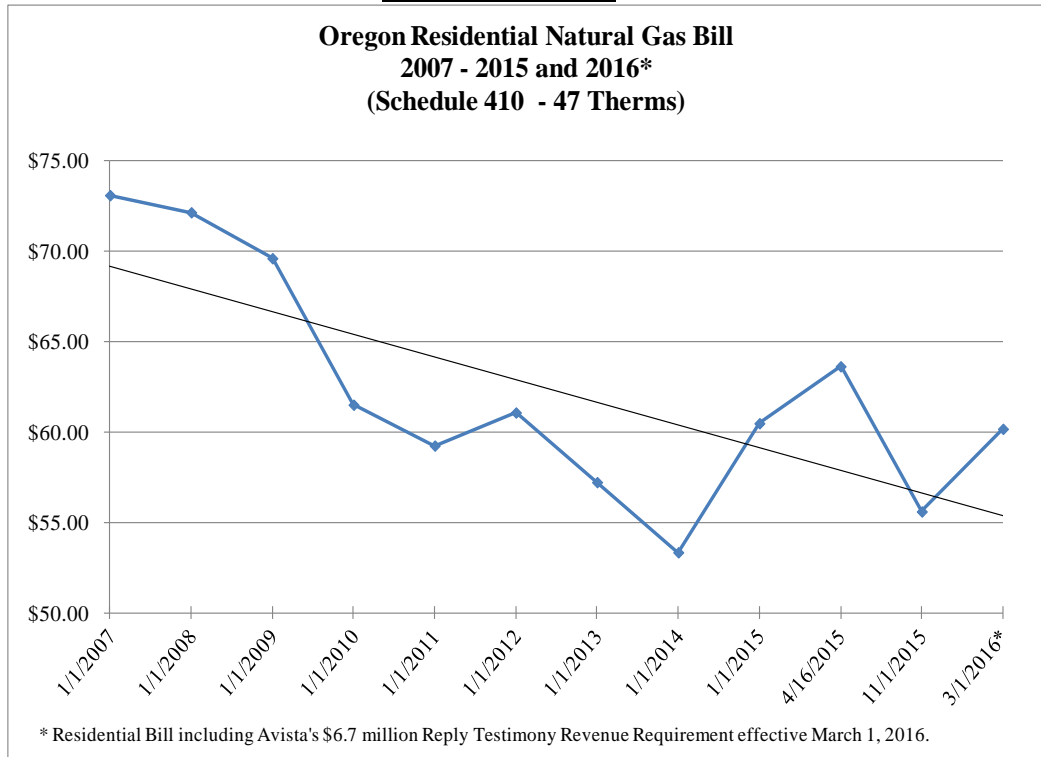
22

⁵⁶ (STAFF/600, Moore/3, lines 10-11)

⁵⁷ For 2007 through 2015, the Illustration provides the average monthly bill, using the rate effective January 1 for each year, for a residential customer using an average of 47 therms per month. In addition, the Illustration provides the average monthly bill including the following rate adjustments: the April 16, 2015 general rate increase (Avista’s last general rate case Docket No. UG-284), and the November 1, 2015 recently-approved

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Illustration No. 3



11 This illustration demonstrates that the Company's increased level of capital expenditures
12 in recent years, including 2015, has not led to a significant increase in customers' bills. The
13 effects of lower interest rates and natural gas commodity costs have served to offset increases in
14 capital expenditures – capital expenditures which are necessary to continue to provide safe and
15 reliable service to our customers.

16 **B. Only Two Specific Plant Additions Were Called Into Question by the Parties – Not**
17 **as to Their “Prudence,” But Rather as to Their Timing.**

18 Staff and CUB only challenged the timing of two specific plant additions. The first
19 relates to the final phase of the East Medford High Pressure Reinforcement Project as discussed
20 by Staff, and the second relates to the Ladd Canyon Gate Station Upgrade, addressed by CUB. In
21 response, the Company sponsored the testimony of Mr. Jeffrey Webb, its Manager of Gas

Purchased Gas Cost Adjustment rate reduction. Finally, the Illustration shows the average monthly bill effective March 1, 2016, with the Company's Reply Testimony proposed revenue requirement of \$6.7 million.

⁵⁸ (AVISTA/1400, Schuh 6)

1 Engineering and Measurement.⁵⁹ Mr. Webb graduated with a degree in Mechanical Engineering,
2 and after working with Puget Sound Energy as a Design Engineer, joined Avista in 2007 as a gas
3 design engineer and was promoted in 2013 to Manager of Gas Engineering and Measurement,
4 where he manages the Gas Engineering Department. In that role, he is responsible for managing
5 the design and system engineering of Avista’s natural gas distribution system in Oregon,
6 Washington, and Idaho.

7 In his Reply Testimony, Mr. Webb addressed the methods used to prioritize the
8 completion of capital investments and speaks more specifically about the Company’s East
9 Medford Reinforcement and Ladd Canyon Gate Station Upgrade Projects, both of which will
10 improve system reliability.

11 **(1) *East Medford High Pressure Pipeline Reinforcement.***

12 Staff Witness Moore objects to the inclusion of the East Medford Project in the
13 Company’s revenue requirement in this case – but does not object to the prudence of the
14 investment. In fact, he states that “Staff supports the completion of this project.”⁶⁰ Instead, his
15 only concern is with respect to the timing of the completion of the reinforcement.

16 Mr. Moore points to the Company’s 2014 Natural Gas Integrated Resource Plan (IRP),
17 where the Company indicated that the project was slated for completion in 2018.⁶¹ Mr. Moore
18 selectively excerpts certain language from the 2014 IRP to that effect, but excludes additional
19 language relating to the East Medford Project which makes note of:

20 other factors [that] may drive completion of the project including reliability needs,
21 flexibility of natural gas supply management and optimizing synergies of other
22 construction projects to reduce project cost. Avista will continue to evaluate forecasts and
23 assess the most appropriate timing for completion of this project.⁶²

⁵⁹ (AVISTA/1500, Webb/1, lines 1-17)

⁶⁰ (STAFF/600, Moore/14, line 13)

⁶¹ (*Id.* at page 14, lines 4-12)

⁶² (AVISTA/1500, Webb/8, lines 5-9)

1 Moreover, the IRP, itself, notes that the projects contain “preliminary estimates of timing and
2 costs of major reinforcement solutions,” and that “the scope and needs of these projects generally
3 evolves with new information requiring ongoing reassessment.” Indeed, the IRP stresses that
4 “actual solutions may differ due to differences in actual growth patterns and/or construction
5 conditions from the initial assessment.”⁶³

6 Turning now to the East Medford Project itself, this is a multi-year project to install 12”
7 steel gas main in order to complete a supply main loop around the City of Medford, to improve
8 both capacity and reliability.⁶⁴ This Commission is familiar with the various phases of this
9 project, having previously approved, in rates, costs associated with earlier phases. The Project
10 was first presented to the Commission in Avista’s 2007 general rate case (UG-181), as part of an
11 initial project plan to complete the reinforcement as a three-phase project, with a first phase to be
12 completed in July of 2008, the second phase in October of 2008, and the third phase in October
13 of 2009. Subsequently, the project plan was updated, as other projects were reprioritized, for
14 reasons discussed in Mr. Webb’s testimony. The last phase represents the portion of the East
15 Medford reinforcement that is currently under construction and is contested by Staff Witness
16 Moore. This phase will be completed and in service by the end of 2015.⁶⁵ Exhibit AVISTA/1501
17 provides a system diagram showing the respective phases.

18 As noted, subsequent to Docket No. UG-181, in which the project was first addressed,
19 other capital projects rose to a higher priority level than the immediate completion of the East
20 Medford project, as explained by Mr. Webb.⁶⁶ These capacity projects included the Roseburg
21 Reinforcement (Oregon), Sutherlin (Oregon) Reinforcement, the Chase Road Reinforcement
22 (Post Falls, Idaho), the Clarkston (Washington) Reinforcement, and the Grants Pass (Oregon)

⁶³ (Id. at page 8, lines 16-20)

⁶⁴ (Id., at page 9, lines 3-7)

⁶⁵ (Id. at page 10, lines 1-3)

⁶⁶ (Id. at page 10, lines 20-24 through page 11, lines 1-9)

1 Reinforcement.⁶⁷ At the time, these projects had a higher risk of customer outages on peak
2 days.⁶⁸

3 What, then, accounts for the acceleration of the East Medford Project from 2018 to 2015?
4 Mr. Webb explained that, in late July of 2014, Avista’s Gas Engineering Department identified,
5 through its SynerGEE® Load Study, that the Medford Distribution System was incorrectly
6 modeled for the delivery of gas from the Williams Northwest Pipeline transmission deliveries at
7 Avista’s Jones Creek gate station. The SynerGEE® Load Study had incorrectly assumed delivery
8 at 400 psig; however, Avista’s contract with Williams only guaranteed delivery at 300 psig.⁶⁹
9 Correcting for this resulted in the reprioritization of the East Medford Reinforcement as a
10 “priority one” project given the revised modeling conditions – all of which revealed “many more
11 customers to be at risk of loss of service on a design heating degree day.”⁷⁰ Exhibit
12 AVISTA/1502 contains an email dated August 1, 2014, highlighting the need for accelerated
13 completion of the last phase of the East Medford Project.

14 Mr. Webb then goes on to explain why the final approval of the East Medford Project did
15 not occur until after the filed date of the IRP:

16 . . . All of the additional information that led to a re-evaluation of the priority of
17 the East Medford reinforcement as the highest priority reinforcement, occurred
18 subsequent to the completion and distribution of the final draft of the IRP.
19 Additionally, the approval of the updated timing of the East Medford
20 reinforcement did not occur until after the filing date of the IRP. Furthermore, the
21 IRP recognizes that facts can, and likely will change following the completion of
22 the IRP.⁷¹

23 Page 1 of Exhibit AVISTA/1503 illustrates that, without completing the reinforcement project,
24 approximately 9,500 customers would be at risk of an outage on a design heating degree day in

⁶⁷ (Ibid.)

⁶⁸ (Ibid.)

⁶⁹ (Id. at page 11, lines 15-24 through page 12, lines 1-2)

⁷⁰ (Id. at page 11, lines 2-5)

⁷¹ (Id. at page 13, lines 18-23)

1 East Medford.⁷² Nor will the implementation of a “Cold Weather Action Plan,” as suggested by
2 Staff Witness Moore, suffice to address design day deficiencies.⁷³ This “backup” plan requires
3 the initiation of “manual intervention” at a high level and is usually only required where certain
4 reinforcement projects have yet to be completed or are in progress. This intervention includes the
5 review of low pressure areas to ensure identification of areas of concern and identification of
6 customers to notify in order to shed load or curtail service, as well as the assignment of field
7 personnel to monitor pressures at gas meters and regulator stations.⁷⁴ As explained by Company
8 Witness Mr. Webb:

9 Depending on the assessment, these actions could include the continuation of
10 monitoring, requesting a media blast to request a temporary thermostat turn down,
11 taking extraordinary measures to manually improve the capacity of the system by
12 bypassing regulator stations or manually shedding load, and/or preparing relight
13 lists (to restore service to customers who lost gas service).⁷⁵

14 A gas distribution system, however, should be designed to operate without invoking such
15 extraordinary measures called for by the manual intervention protocols. At most, these efforts are
16 what Mr. Webb characterized as “last-ditch efforts to maintain service” and “do not represent a
17 guarantee that service will be able to be maintained.”⁷⁶

18 These concerns are neither hypothetical nor academic, given the fact that the most recent
19 design heating degree day in our Oregon service territory occurred as recently as December 8,
20 2013, in Klamath Falls, Oregon.⁷⁷ By way of summary, the completion of the East Medford
21 Project in 2015 is necessary to address a current distribution system design heating degree day
22 deficiency in the Medford area, which puts as many as 9,500 customers at risk of losing service.

⁷² Indeed, even with the completion of the project, 4,200 customers will remain at risk of an outage on a design heating degree day. These remaining at-risk customers, however, can be addressed with smaller-scale capacity improvements to the Company’s intermediate pressure distribution system over the next several years, as explained by Mr. Webb. (AVISTA/1500, Webb/15, lines 9-15)

⁷³ (STAFF/600, Moore/13)

⁷⁴ (AVISTA/1500, Webb/15, line 19 - /16, line 15)

⁷⁵ (Id. at page 16, lines 15-19)

⁷⁶ (Id. at page 17, lines 5-7)

⁷⁷ (Id. at page 12, lines 9-11)

1 The Project was appropriately accelerated from 2018 to 2015 as part of the reprioritization
2 efforts occurring within the Capital Planning Group discussed earlier.

3 **(2) *Ladd Canyon Gate Station Upgrade.***

4 The Ladd Canyon Gate Station (also known as the Union Gate Station) is a
5 reconstruction of the existing gate station that interconnects with Williams NW Pipeline. It will
6 increase the capacity of the station and upgrade outdated facilities and equipment. This
7 additional capacity is needed to serve an existing capacity deficit at this site. It will also allow
8 Avista to reinforce additional loads in the area when the last phase of the Pierce Road La Grande
9 Reinforcement is completed in 2017.⁷⁸

10 CUB takes issue with the timing of this project, although conceding that the project might
11 be needed in the future.⁷⁹ CUB also takes issue with a portion of the cost (approximately
12 \$200,000), and whether service to an interruptible customer (an asphalt paving customer) drove
13 the timing of the investment.⁸⁰ As explained by Company Witness Webb, the current capacity of
14 this gate station is a limiting factor today on Avista's ability to serve customers in the Ladd
15 Canyon/Union area on a design heating degree day.⁸¹ And, as previously noted, a design heating
16 degree day has occurred as recently as 2013 in the Company's Oregon service territories.⁸²

17 The peak load requirements on this gate station on a design heating degree day are 40.9
18 mcfh, while the capacity of the gate station is only 37.2 mcf. This translates into a "clear capacity
19 deficit, as the peak load requirement on a design heating degree day exceeds the capacity of the
20 legacy station."⁸³

⁷⁸ (AVISTA/1500, Webb/18, lines 17-23)

⁷⁹ (CUB/100, McGovern-Jenks/16, lines 7-11)

⁸⁰ (Ibid.)

⁸¹ (AVISTA/1500, Webb/19, lines 3-9)

⁸² (Ibid.)

⁸³ (AVISTA/1500, Webb/19, lines 11-14)

1 As explained by Company Witness Webb, “. . . the majority of the 750 customers in the
2 town of Union are at risk of loss of service in the event of an extended cold period approaching a
3 design heating degree day, because of the physical capacity shortfall of the old gate station.”⁸⁴
4 Nor will it do to simply interrupt other customers in order to alleviate design day deficiencies, as
5 suggested by CUB.⁸⁵ CUB’s suggestion ignores the fact that the load studies performed to
6 model the Company’s gas distribution system on a design day consider only firm load.
7 Accordingly, “Avista’s design heating degree day models presume that all interruptible
8 customers have already been interrupted, and only firm loads are being served,” as explained by
9 Mr. Webb.⁸⁶ He noted that capacity deficits, therefore, cannot be alleviated through
10 interruption.⁸⁷ Exhibit AVISTA/1504 (Webb) shows the placement of the gate station and the
11 impact on “customers at risk” in both Union and Elgin.⁸⁸

12 It is not true, as suggested by CUB, that service to the asphalt paving customer in the area
13 drove the need for the station upgrade.⁸⁹ As explained by Company Witness Webb, “there was
14 an existing need already and, therefore, this project needed to be completed ahead of the Pierce
15 Road project, in order to alleviate the existing gate station capacity deficiency.”⁹⁰ Regardless of
16 the paving customer, there was “a need for the completion of this project, and the acceleration of
17 the project by less than a year is not at all unreasonable,” as observed by Mr. Webb.^{91/92}

⁸⁴ (Id. at page 19, lines 18-21)

⁸⁵ (See CUB/100, McGovern-Jenks/13, lines 13-14)

⁸⁶ (AVISTA/1500, Webb/20, lines 3-9)

⁸⁷ (Ibid.)

⁸⁸ In addition to addressing the existing design day capacity deficiency, the upgrade will also enable a planned high pressure reinforcement to improve the capacity and reliability of natural gas service to the town of Elgin. (AVISTA/1500, Webb/20, lines 10 – /21, line 6) Currently the Elgin area is served solely by the existing La Grande Distribution Network which only has one gate station. By the time natural gas in the system reaches Elgin, the pipeline pressure has fallen to less than 35 psig, in a distribution system that starts at approximately 240 psig and has a design criteria of 100 psig upon reaching Elgin. (Ibid.)

⁸⁹ (CUB/100, McGovern-Jenks/9, lines 20-21)

⁹⁰ (AVISTA/1500, Webb/22, lines 5-9)

⁹¹ (Ibid.)

⁹² The demand of the asphalt paving customer did, however, result in the temporary lease of a skid-mounted gate station from Williams NWP in order to offer increased capacity to serve that load as well as other customers in

1 Nor does it make sense to suggest, as does CUB, that the station should not be funded by
2 other customers, because of its erroneous belief that it was “clearly for the benefit of the Paving
3 Customer.”⁹³ A gate station is a “system resource”, akin to distribution substations in an electric
4 utility.^{94/95} As a “system resource,” it provides benefits to all customers served downstream from
5 the substation, by means of increased reliability. Company Witness Webb was firm on this point:

6 . . . Given that there was an existing design heating degree day deficiency
7 exclusive of consideration of the Paving Customer, the contention that this gate
8 station upgrade is being completed for the sole benefit of the Paving Customer is
9 incorrect.⁹⁶

10 Lastly, CUB takes issue with the additional cost of approximately \$200,000 more to
11 complete the project (originally estimated at \$1.45 million and to be completed at \$1.65
12 million).⁹⁷ The original project estimate of \$1.45 million was based on project quotes received
13 from Williams NWP. It was later learned that additional permitting would be required from the
14 Oregon State Historic Preservation Office, requiring an additional expense of approximately
15 \$170,000 related to third party consultants and filing fees.⁹⁸ Moreover, additional costs were
16 subsequently incurred to complete the FERC 7C certificate permitting process.⁹⁹ These
17 additional costs used up the contingency that was built into the project and increased costs by an
18 additional \$180,000. None of this was imprudent or otherwise detracts from the need for the
19 project.¹⁰⁰

the area; this, however, was a temporary solution, as set forth in the conditions of the agreement with Williams
NWP, subject to a more permanent solution. (AVISTA/1500, Webb/21, lines 9-15)

⁹³ (CUB/100, McGovern-Jenks/11, line 13)

⁹⁴ (AVISTA/1500, Webb/23, lines 15-18)

⁹⁵ A gate station contains facilities to filter, meter, odorize, heat, reduce pressure, and remotely monitor the gas
entering Avista’s distribution system. (AVISTA/1500, Webb/23, lines 1-2) As such, gate stations serve as the
connection point between interstate transmission pipelines and the greater distribution network. (Id. at page 23,
lines 15-16).

⁹⁶ (Id. at page 24, lines 1-3)

⁹⁷ (Exhibit CUB/100, McGovern-Jenks/15, line 17 - /16, line 2)

⁹⁸ (AVISTA/1500, Webb/25, lines 10-17)

⁹⁹ (Ibid.)

¹⁰⁰ (Id. at page 26, lines 5-9)

1 To conclude, in the case of both the East Medford Project and the Ladd Canyon Project,
2 the Company prudently elected to accelerate the projects in order to address current capacity
3 deficiency requirements that were otherwise putting customers “at risk” under design day
4 conditions. The safety and reliability of service to our customers remain paramount in Avista’s
5 planning.

6 **C. Bonus Depreciation.**

7 NWIGU/CUB proposed an adjustment to reduce rate base and revenue requirement
8 related to bonus depreciation and the Associated Accumulated Deferred Federal Income Tax
9 (ADFIT). Accordingly, they would remove \$7.541 million of rate base for ADFIT related to the
10 recognition of bonus depreciation and the additional tax depreciation for 2015 and 2016 plant
11 additions. This serves to reduce the Company’s filed revenue requirement by approximately
12 \$805,000.^{101/ 102} The additional ADFIT being proposed by Mr. Gorman is for the recognition of
13 bonus depreciation that may be available to Avista for 2015 and 2016 plant additions.¹⁰³

14 As explained by Company Witness Falkner,¹⁰⁴ bonus depreciation was not included for
15 2015 capital additions, because currently there is no federal approval of bonus tax depreciation
16 for the 2015 tax year. Accordingly, the Company did not incorporate any bonus depreciation for
17 the 2015 capital additions in this case, or for the 2015 calendar year quarterly estimated tax
18 payments.¹⁰⁵ Avista is required to estimate its 2015 federal tax expense and make quarterly

¹⁰¹ (See NWIGU-CUB/100, Gorman/66-67)

¹⁰² Mr. Gorman's total proposal related to state income tax (SIT) and bonus depreciation was \$2.02 million (SIT of \$1.22 million and \$0.805 million Bonus Depreciation). The \$667,000 in Table 2 above reflects the difference between the \$2.02 million and the agreed-upon SIT adjustment in the Stipulation of \$1.353 million.

¹⁰³ Bonus depreciation is a tax deduction the Company is allowed to take on its federal tax return for capital investment the Company has made during the tax year which serves to reduce taxable income, and therefore, reduces the amount of taxes the Company pays. Bonus depreciation is similar to accelerated tax depreciation in that regard.

¹⁰⁴ (AVISTA/1600, Falkner/2, lines 6-16)

¹⁰⁵ (Ibid.)

1 deposits so that by December 15, 2015, the entire 2015 estimated tax liability has been paid.¹⁰⁶
2 Taxable income is forecasted by using only known, approved tax additions – it does not include
3 the effect of tax provisions that have not been approved, such as a possible bonus depreciation
4 deduction for 2015.¹⁰⁷

5 Mr. Gorman, however, includes bonus depreciation based on his assumption that the
6 bonus depreciation tax provision will be extended and available for Avista to use for its 2015
7 capital additions. Even if Mr. Gorman is correct, it is still not appropriate to reduce rate base
8 because Avista has not otherwise had the benefit of lower tax payments to the IRS during 2015.
9 As explained above, Avista is required to estimate its 2015 federal tax expense and make
10 quarterly payments during 2015; and indeed, Avista has already made three of its four tax
11 deposits. Even if bonus depreciation deduction is approved in late December of this year, Avista
12 will still have already made all of its estimated tax payments without including bonus
13 depreciation.¹⁰⁸ Finally, if bonus depreciation is ultimately approved for 2015, the Company can
14 make a refund request from the IRS in 2016, however, the Company would still not receive any
15 refund until mid-March 2016, at the earliest, as explained by Mr. Falkner. Accordingly, the
16 Company has not had the benefit of lower tax payments to the IRS during 2015, nor will it have
17 such a benefit before rates are placed into effect in this case.

18 Ironically, Commission Staff and other parties have opposed rate base additions after the
19 date new retail rates go into effect in this case, and yet they argue that it is appropriate to reduce
20 rate base for bonus depreciation, even though the benefit would not be received (if it is received
21 at all) until after rates go into effect in this case.¹⁰⁹

¹⁰⁶ (AVISTA/1600, Falkner/3 line 3)

¹⁰⁷ (Id. at page 3, lines 1-6)

¹⁰⁸ (Id. at page 3, lines 17-21 through page 4, line 1)

¹⁰⁹ (Id. at page 4)

1 **III. STAFF IMPROPERLY REDUCES THE COMPANY’S PENSION EXPENSE BY**
2 **IMPUTING A HIGHER EXPECTED RETURN ON ASSETS (EROA)**

3 Staff proposes to reduce the Company’s pension expense by \$348,000, in order to reflect
4 the difference between using a 7% Expected Return On Assets (EROA) and the 5.3% EROA
5 utilized by the Company.¹¹⁰ In so doing, Staff questions the Company’s “de-risking,” whereby
6 the Company shifted the asset allocation from 31% fixed income to 58% fixed income in May of
7 2014.

8 The Company has presented the Reply Testimony of Ms. Shelly J. Heier, who is
9 employed by Verus Advisory, Inc., as President, Chief Operating Officer, and Senior Consultant.
10 Verus provides investment consulting services to institutional investors, including public and
11 corporate defined benefit plans, endowments, foundations and health care institutions.¹¹¹ Verus
12 (previously known as Wurts & Associates, Inc.) advises approximately 130 clients with
13 aggregate assets of \$118 billion.

14 The purpose of Ms. Heier’s testimony is to provide the Commission with an independent
15 evaluation of Avista’s pension investment strategy, demonstrating that it is prudent and
16 reasonable and in the best interests of its customers, thereby supporting the 5.3% EROA
17 assumption for 2015.¹¹² Ms. Heier had advised the Board of Directors on shifting the asset
18 allocation from 31% fixed income to 58% fixed income in May of 2014. That was the result of a
19 longer term strategy the Board originally adopted in 2010 to reduce the risk that the pension plan
20 creates for the Company, its customers, and its employees. In her testimony, Ms. Heier provides
21 a history of the risk-mitigation strategy employed by the Company.¹¹³ She explains that after the

¹¹⁰ (STAFF/800, Bahr/11-12)

¹¹¹ (AVISTA/1300, Heier/1, lines 6-10)

¹¹² (Id. at page 2)

¹¹³ (Id. at page 4)

1 pension plan experienced its second major drop in funded status in a decade, the Finance
2 Committee began to evaluate Liability-Driven Investing (LDI) in early 2010.

3 Liability-driven investing, (“LDI”), is an asset management approach in which the assets
4 are invested in a manner such that the investment return patterns – cash flow yield and/or capital
5 gains – are similar to the patterns of the liabilities. To the extent that these investment return and
6 liability patterns are closely aligned, when external events such as interest rate fluctuations or
7 equity market swings occur, the assets and liabilities would move in a similar direction and
8 magnitude.¹¹⁴

9 Avista’s pension expense tripled from 2000 to 2001 as a result of the equity market
10 decline experienced in that one year. The plan experienced similar results in 2009, with pension
11 expense doubling year over year, as a result of the 2008 mortgage crisis. In the words of Ms.
12 Heier, “This impact on expense was a detriment to shareholders and customers of Avista, and
13 such low-funded levels increases risk to beneficiaries.” Therefore, Avista’s Finance Committee
14 and staff sought education and strategies to mitigate such wild swings in funded status and
15 pension expense.”¹¹⁵

16 Accordingly, the Finance Committee of the Board reviewed various pension risk
17 management options, which ranged from varying levels of capital LDI to third-party risk transfer
18 and annuitization. Detailed studies were conducted by Verus (then Wurts & Associates), the
19 actuary TowersWatson and the asset manager PIMCO, in order to assess the impact of
20 alternative asset allocation policies on funded status volatility, pension expense and contributions
21 over time.¹¹⁶ In combination, these fiduciaries evaluated the change in forecast funded status

¹¹⁴ (See AVISTA/1300, Heier/6, lines 2-7)

¹¹⁵ (Id. at page 10, lines 14-17)

¹¹⁶ (Id. at page 10, line 23 – page 11, lines 1-2)

1 variability across alternative asset allocations, and found that adding LDI would result in reduced
2 funded status volatility driven by interest rate movements.

3 As explained by Ms. Heier, in 2010, the Finance Committee determined to implement
4 LDI “conservatively at first,” given the funded status was still at a relatively low level. As such,
5 the plan’s existing asset allocation policy was maintained, but the duration of the fixed income
6 portfolio was lengthened to match the duration of the liabilities.¹¹⁷

7 Subsequently, in May of 2012, Verus presented additional analysis to support future steps
8 toward implementing an LDI strategy.¹¹⁸ By December of 2013, the funded status had improved
9 to 96% due to increased contributions, strong asset returns and an increase in interest rates.¹¹⁹
10 Finally, in May of 2014, the Finance Committee evaluated the sensitivity of the Plan’s funded
11 status to both interest rate movements and equity market volatility. The 2014 analysis performed
12 by Verus¹²⁰ contained a recommendation to move to either a 45% LDI portfolio or a 58% LDI
13 portfolio. The reduced funding status variability achieved with the 58% LDI portfolio, however,
14 was a primary consideration, as explained by Ms. Heier. This was deemed to be “the optimal
15 portfolio as it achieved the greatest minimization of funded status volatility and did not
16 materially change forecast contributions or pension expense,” as explained by Ms. Heier.¹²¹

17 Nor is LDI unique to Avista. There is considerable precedent for such a “de-risking”
18 strategy in corporate pension plans across all industries. According to Ms. Heier, it is estimated
19 that liability-driven investment strategies (i.e., “de-risking” strategies) have been adopted by a
20 large portion of plan sponsors. In 2013, SEI surveyed 130 corporate plan sponsors and found that

¹¹⁷ (Id. at page 11, lines 10-13)

¹¹⁸ (See AVISTA/1303)

¹¹⁹ (Id. at page 12, lines 4-5)

¹²⁰ (AVISTA/1302, Heier/11-13)

¹²¹ (Id. at page 15, lines 4-6)

1 57% utilized an LDI strategy.¹²² Moreover, in the 2014 *Chief Investment Officer* magazine, it
2 surveyed 124 plan sponsors and found that 77% have implemented LDI. Finally, in 2013,
3 Greenwich Associates surveyed 1,277 institutional plan sponsors, of which 276 were corporate
4 funds. Of those 276 corporate funds, 42% had already established a “dynamic de-risking
5 strategy.”¹²³

6 In 2014, TowersWatson also released a report on the pension plans of the Fortune 1000
7 companies which found that, in the aggregate, plan “sponsors of frozen plans [like Avista’s]
8 invested more than half their total assets in conservative, lower-variance investment instruments,
9 such as cash and debt, whereas sponsors of plans where some or all workers continued to accrue
10 benefits seemed inclined to take on riskier investments.” (See AVISTA/1306) Moreover, they
11 found that “sponsors with better-funded pensions held less in public equities and more in debt,
12 than their less well-funded counterparts.”¹²⁴

13 By way of example, several companies adopted EROA similar to Avista’s as a result of
14 pursuing a de-risking approach. NV Energy (Berkshire Hathaway Energy) reduced its EROA in
15 2014 to 5.3% (from 6.5% in 2013), and Northwestern Energy reduced its EROA to 5.8% in 2014
16 (from 7.0% in 2013).^{125/126}

17 In summary, Avista was prudent in retaining recognized experts to evaluate its pension
18 plan funding strategies. It proceeded very patiently and deliberately in that regard, beginning in
19 May of 2010, and through a series of analyses and consultations, decided in 2014 to further “de-
20 risk” its plan assets. This decision was not made casually or without the benefit of sound expert
21 advice. Moreover, Avista is by no means alone in pursuing such an LDI “de-risking” strategy.

¹²² (See AVISTA/1304, Heier/3)

¹²³ (See AVISTA/1305, Heier/1)

¹²⁴ (AVISTA/1306)

¹²⁵ (AVISTA/1309)

¹²⁶ (AVISTA/1310)

1 This will also help mitigate the risk of future spikes in pension plan funding obligations. While
2 Staff would prefer to see a higher EROA (7%) than assumed by the Company, it does so without
3 the benefit of the type of independent expert analysis conducted by Avista’s consultants.

4 Company Witness Thies also provides additional context for the Company’s pension plan
5 allocation strategy. He describes the pension’s purpose and how the Company has managed it to
6 maintain reasonable costs. He describes how the investments are managed, with particular focus
7 on asset allocation and the linkage between pension assets and the pension obligations supported
8 by those assets.¹²⁷ As previously noted, a deliberate shift was implemented in 2014 toward a
9 more significant allocation toward fixed income investments. She recommended that Avista
10 materially increase the fixed income allocation from the existing 31% level to either a 45% or a
11 58% level, depending on the Board’s preference for the “de-risking” pace. Ultimately, the Board
12 chose to move to a 58% fixed income allocation after considering the sensitivity on the funded
13 status of each alternative. The sensitivity criteria included: (a) duration of assets in comparison to
14 duration of the pension liability; (b) potential increases in interest rates; and (c) the potential
15 downside to equity risk.¹²⁸ Accordingly, it changed from 31% to 58% in two steps during 2014,
16 first by moving to a 45% intermediate level of fixed income, before completing the transition to
17 58%.¹²⁹ The asset allocation strategy was linked, in large part, to the pension plan’s funded
18 status, as well as other factors such as the pension plan now being closed to new non-union
19 employees effective January 1, 2014.¹³⁰

20 These decisions were made in the context of volatility in expected pension plan returns
21 that had been experienced by the Company and the industry at large. As noted by Mr. Thies,
22 year-by-year actual returns compared to expected annual returns varied dramatically: Actual

¹²⁷ (See AVISTA/1100, Thies/10)

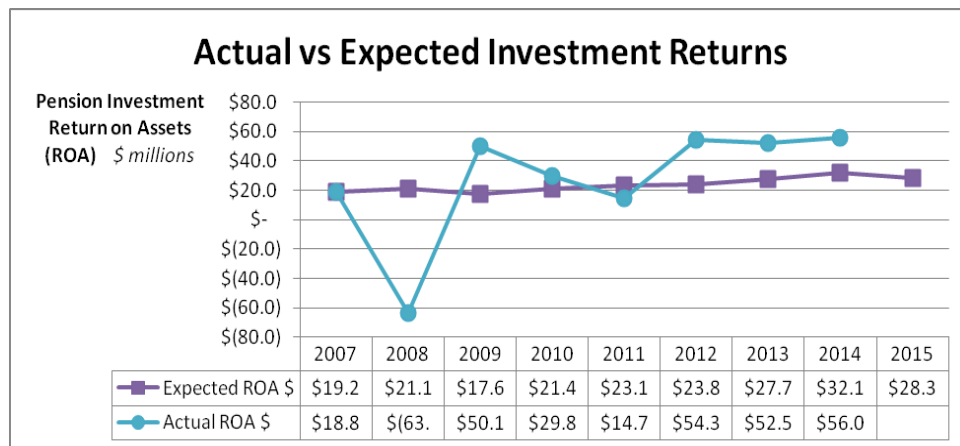
¹²⁸ Id. at page 20, lines 10-17.

¹²⁹ Id.

¹³⁰ (AVISTA/1100, Thies/20)

1 returns ranged from \$84.7 million unfavorable in 2008 to \$30.5 favorable in 2012 (for a spread
 2 of \$115 million).¹³¹ Accordingly, the Company sought strategies that would reduce the volatility
 3 and expected returns, which supports the objective of reducing volatility in net periodic benefit
 4 cost. As explained by Mr. Thies, “less cost volatility is a benefit to utility customers since the
 5 annual costs are a component of retail utility rates.” The illustration below¹³² shows the actual
 6 versus the expected investment returns for the period 2007-2014, demonstrating the volatility
 7 experienced by the Company.

8 **Illustration No. 3:**



9
 10 Mr. Thies also provided an illustration¹³³ of a level of pension cost in plan contributions
 11 for the same period:

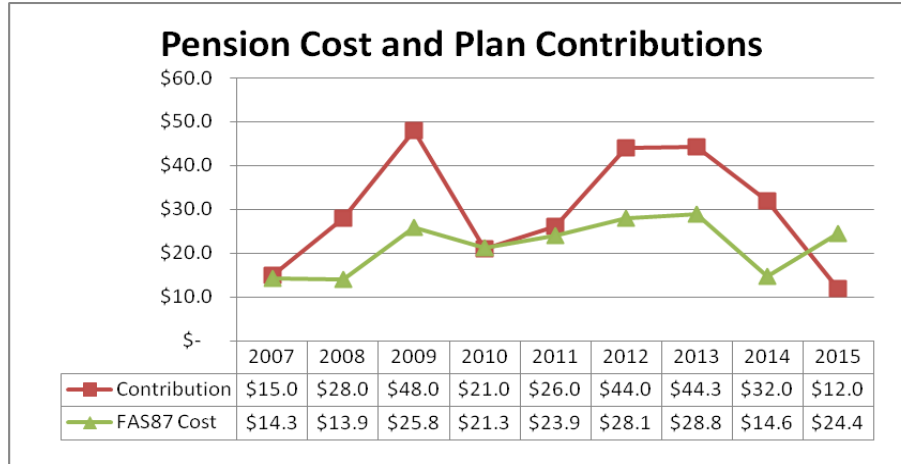
¹³¹ Id. at page 15, lines 5-9.

¹³² (AVISTA/1100, Thies/15)

¹³³ (AVISTA/1100, Thies/14)

1

Illustration No. 4:



2

3 As shown above, from 2007 to 2015, the pension expense ranged from a low of \$13.9 million in
 4 2008 to a high of \$28.8 million in 2013. Indeed, in a single year between 2008 and 2009, there
 5 was an increase from \$13.9 million to \$25.8 million – nearly doubling the 2008 net periodic
 6 cost.¹³⁴

7 The funded status of the plan has improved to 85.0% at the end of 2014. This should be
 8 compared with a funding status of 53.9% as a result of market losses in 2008.¹³⁵ It should be
 9 remembered, however, that the funded status was also aided by strong market performance after
 10 2008 – returns that cannot expect to be continued.¹³⁶

11 Staff Witness Bahr asserts that the Company’s EROA revision is “absurd” considering
 12 that the Company has earned returns on its pension assets of 15.77%, 12.46% and 12.4% from
 13 2012 through 2014.¹³⁷ It is simply “unrealistic”, however, to expect double digit returns to
 14 continue. As explained by Mr. Thies, the Company’s expected return looks forward over a 10-
 15 year horizon, and its expected 5.3% return on assets for 2015 is supported by independent market
 16 outlook analysis and methodologies, and the specific circumstances directly related to Avista’s

¹³⁴ (AVISTA/1100, Thies/13, lines 13-17)

¹³⁵ (Id. at page 16, lines 1-8)

¹³⁶ (Id. at page 16)

¹³⁷ (STAFF/800, Bahr/11, lines 10-12)

1 pension plan regarding factors such as the funded status, and the fact that the plan is now closed
2 to new, non-union employees.

3 **IV. AVISTA’S PROPOSED COST OF CAPITAL IS SUPPORTED BY THE EVIDENCE**

4 **A. The Commission Should Approve a 9.9% ROE**

5 The Company has proposed a 9.9% fair rate of Return on Equity (“ROE”), with a capital
6 structure reflecting a 50% equity component. In support of its position, the Company sponsored
7 the testimony of Mr. Adrien McKenzie, Vice President of FINCAP¹³⁸ and Mr. Mark Thies,
8 Senior Vice President, Chief Financial Officer and Treasurer of the Company.¹³⁹ Mr. McKenzie
9 based his ROE recommendations on the results of the Discounted Cash Flow (“DCF) model, the
10 Empirical Form of Capital Asset Pricing Model (“ECAPM”), and an equity risk premium
11 approach based on allowed ROEs for gas utilities, which are all methods that are commonly
12 relied on in regulatory proceedings. His recommended 9.9% ROE was evaluated taking into
13 account the specific risks of Avista’s jurisdictional utility operations in Oregon. He also tested
14 his conclusions against alternative checks of reasonableness, which included applications of the
15 traditional Capital Asset Pricing Model (“CAPM”) referenced to expected rates of return and
16 allowed ROEs, and application of the DCF model to a select group of low risk, non-utility
17 firms.^{140/141}

18 As noted, Mr. McKenzie’s ROE recommendations were based on the results of three
19 primary methods (the DCF Model, the ECAPM, and the Risk Premium Approach). The cost of
20 common equity estimates produced by these three primary analyses are attached as Appendix A

¹³⁸ (AVISTA/300, McKenzie)

¹³⁹ (AVISTA/200, Thies)

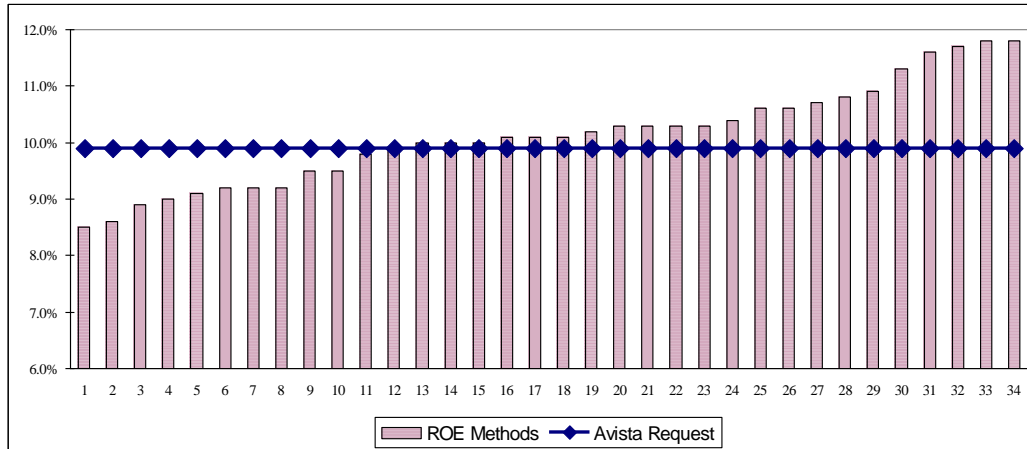
¹⁴⁰ (AVISTA/300, McKenzie/3, lines 7 - /4, line 2)

¹⁴¹ As noted by Mr. McKenzie, a fair and reasonable ROE is “integral in meeting sound regulatory economics and the standards set forth by the U.S. Supreme Court in the Bluefield and Hope cases.” (AVISTA/300, McKenzie/4, lines 7-15) See Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n, 262 U.S. 679 (1923) and Fed. Power Comm’n v. Hope Nat’l Gas Co., 320 U.S. 591 (1944). A utility’s allowed ROE should be sufficient to: (1) fairly compensate the utility’s investor, (2) enable the utility to offer a return adequate to attract new capital on reasonable terms, and (3) maintain the utility’s financial integrity. (Id.)

1 to this Brief.¹⁴² The illustration below presents the 34 cost-of-equity estimates presented in
2 Attachment A in rank orders attesting to the reasonableness of Avista’s 9.9% ROE request.¹⁴³

3 **Illustration No. 1:**

4 **RESULTS OF ANALYSES VS. AVISTA REQUEST**



6
7
8 Mr. McKenzie concluded that the 9.9% recommended ROE was a “conservative estimate” of
9 investors’ required ROE for Avista. The cost-of-equity for Avista’s gas operations is in the 9.5%
10 to 10.8% range, or 9.6% to 10.9% after incorporating an adjustment to account for the impact of
11 common equity flotation costs.¹⁴⁴ Avista, however, is requesting a fair ROE of 9.9%, which falls
12 below the 10.25% mid-point of Mr. McKenzie’s recommended range. According to Mr.
13 McKenzie, “considering capital market expectations and the economic market requirements
14 necessary to maintain financial integrity and support additional capital investment even under
15 adverse circumstances, it is my opinion that 9.9% represents a conservative ROE for Avista.”¹⁴⁵

16 Finally, in addition to the primary and alternative analyses used by Company Witness
17 McKenzie, he also accounted for “flotation costs.” This recognizes that when equity is raised
18 through the sale of common stock, there are costs associated with “floating” the new equities
19 (e.g., legal, accounting, and printing costs, as well as fees paid to compensate brokers for selling

¹⁴² (See AVISTA/301, McKenzie Sch. AMM-1)

¹⁴³ (AVISTA/300, McKenzie/6)

¹⁴⁴ (Id. at page 6, line 33 – page 7, line 2)

¹⁴⁵ (Id. at page 7, lines 3-9)

1 the stock to the public).¹⁴⁶ He employed a “bare bones” cost of equity adjustment to account for
2 issuance costs, consisting of 10 basis points in evaluating the fair ROE range for Avista.¹⁴⁷

3 **B. The Use of a Fifty Percent (50%) Common Equity Component of the Capital**
4 **Structure is Supported by the Evidence.**

5 Company Witness McKenzie employed a common equity ratio of 50% as a reasonable
6 level of capitalization for Avista. He found that the common equity ratio implied by Avista’s
7 capital structure falls within the range of capitalizations maintained by the proxy group of
8 utilities based on data at year-end 2014, as well as near-term expectations.¹⁴⁸ Indeed, he observed
9 that the 50% common equity ratio falls below the 51.4% average for the proxy group of gas
10 utilities at year-end 2014. Moreover, the equity ratio falls well short of the 55.9% equity ratio
11 based on Value Line’s expectations for these utilities over the near term.¹⁴⁹ He concludes that
12 Avista’s requested capitalization “is consistent with the Company’s need to maintain its credit
13 standing and financial flexibility as it seeks to raise additional capital to fund significance system
14 improvements, refinance existing debt, and meet the requirements of the service territory.”¹⁵⁰

15 As of December 31, 2014, Avista’s common equity percentage for its Oregon jurisdiction
16 was 50.4%.¹⁵¹ More recently, as of September 30, 2015, the actual common equity component
17 was 50.75%.¹⁵² Both of these exceed the 50% equity ratio proposed by the Company in this
18 case.¹⁵³ By way of further reference, Avista’s currently authorized common equity ratio is 51%,
19 arising out of the resolution of Docket No. UG-284 in April of 2015.

¹⁴⁶ (AVISTA/300, McKenzie/51, lines 7-14)

¹⁴⁷ (Id. at page 53, lines 4-22)

¹⁴⁸ (AVISTA/300, McKenzie/10, line 15 - /11, line 7)

¹⁴⁹ (Ibid.)

¹⁵⁰ (Ibid.) (See also AVISTA/301, McKenzie/Schedule AMM-2 for the equity ratios for firms in both proxy groups (Gas Group and the Combination Group).

¹⁵¹ (AVISTA/200, Thies/15, lines 13-15)

¹⁵² (AVISTA/1100, Thies/3, line 15)

¹⁵³ Currently the Commission has before it the Second Partial Settlement Stipulation in the Portland General Electric case (Docket No. UE-294), calling for a 50% common equity ratio. Similarly, in Cascade’s pending case, a Settlement Stipulation was filed in Docket No. UE-287 in which a 51% equity ratio was agreed-upon.

1 Staff Witness Muldoon proposes a 49.86% equity capital structure (which, when
2 rounded, is largely consistent with the Company’s 50% equity component).¹⁵⁴ Witness Gorman,
3 on behalf of CUB and NWIGU, however, proposes a much lower 48.5% equity component.¹⁵⁵ In
4 support of his recommendation, however, Mr. Gorman points to capital structures approved in
5 different jurisdictions as a primary reference. As explained by Company Witness Thies, it is not
6 appropriate to co-opt a capital structure from the Company’s Washington jurisdiction to support
7 his recommendations.

8 At the outset, he fails to recognize that short-term debt is included in the capital structure
9 calculations in Washington, but has not historically been included by the Oregon Commission.
10 This was recognized by Mr. Muldoon, on behalf of Staff, when he observed that his capital
11 structure “excludes elements not historically considered long-term debt by the Commission” and
12 that his recommended long-term debt portion of the capital structure “excludes short-term
13 debt...consistent with ORS 757.415(3).”¹⁵⁶ Furthermore, it is inappropriate for Mr. Gorman to
14 remove investments funded by common equity that are not otherwise related to utility plant and
15 equipment. As explained by Mr. Thies:

16 From a rating agency standpoint, customers benefit from the equity provided by
17 these investments in the subsidiaries. “Moody’s and Standard & Poor’s (S&P)
18 reflect these investments in the Company’s overall financial ratios, which
19 correspondingly improves Avista Corp.’s ratios. Stronger credit rating ratios can
20 lead to higher credit ratings, which can lead to lower costs for customers.”¹⁵⁷

21 Other errors are apparent in Mr. Gorman’s calculation. For example, goodwill is presented on the
22 Company’s Securities and Exchange Commission (SEC) consolidated balance sheet but is
23 encompassed in the investment-from-subidiaries’ line item, and has already been removed from
24 the capital structure by Avista in this case. As explained by Mr. Thies, by removing goodwill,

¹⁵⁴ (STAFF/200, Muldoon/1, lines 13-15)

¹⁵⁵ (CUB-NWIGU/100, Gorman/2, lines 6-7 and /3, lines 6-9)

¹⁵⁶ (STAFF/200, Muldoon/3, lines 6-9)

¹⁵⁷ (AVISTA/1100, Thies/5, line 23 - /6, lines 1-4)

1 Mr. Gorman is essentially removing the same amount twice.¹⁵⁸ Furthermore, the Company does
2 not include its investment in AERC¹⁵⁹ in its capital structure (approximately \$94 million as of
3 June 30, 2015); however, Mr. Gorman reduces the Company's equity for this investment in a
4 subsidiary that was never originally included in the Company's proposed equity to begin with.¹⁶⁰

5 In conclusion, the Commission should accept the Company's 50% equity component of
6 the capital structure, which is similar to Staff's recommendation, and should reject Witness
7 Gorman's recommendations.

8 **C. The ROE Recommendations of Staff Witness Muldoon Are Based on Flawed**
9 **Analysis.**

10 Staff Witness Muldoon recommended an ROE based on the results of applications of the
11 multi-stage DCF Model. In doing so, he utilized a three-stage method spanning a 30-year time
12 horizon: The first stage extended from 2015 through 2019 and assumed that cash flows for each
13 firm in its proxy group would be equal to the annual dividend per share projections published by
14 Value Line; the second stage, from 2020 through 2024, utilized annual cash flow estimates under
15 the assumption that individual growth rates for his proxy firms would converge to that of the
16 overall economy; and a third stage, from 2025 through 2044, assumed that all of the proxy group
17 firms would experience dividend growth equal to the projected growth in GDP over that time
18 period.¹⁶¹ Based on this information, he recommended an ROE range of 8.76% to 9.45%, and
19 selected the mid-point of 9.11% as his ROE recommendation.¹⁶²

¹⁵⁸ (AVISTA/1100, Thies/6, lines 14-18)

¹⁵⁹ AERC is a subsidiary of Avista that holds the operating electric properties of AEL&P in Juneau, Alaska.

¹⁶⁰ (Ibid.)

¹⁶¹ (STAFF/200, Muldoon/17, lines 4-7)

¹⁶² (Id. at page 4)

1 **(1) *Mr. Muldoon’s Recommendations Fail to Meet Regulatory Standards.***

2 As discussed above, any established ROE must ultimately satisfy the requirements of
3 Hope and Bluefield. It is the end result reached, not the method used, that will ultimately
4 determine whether an ROE is just and reasonable.¹⁶³

5 At the outset, it should be recognized that the ROEs proposed by Mr. Muldoon falls far
6 short of the average returns authorized for other gas utilities in the table excerpted from
7 Company Witness McKenzie’s testimony:

**TABLE 1
AUTHORIZED ROE - GAS UTILITIES**

Q4 - 2014	10.28%
Q1 - 2015	9.47%
Q2 - 2015	9.43%
Q3 - 2015	<u>9.75%</u>
Average	9.73%

8
9
10 The foregoing table presents the average allowed ROEs for gas utilities reported by
11 Regulatory Research Associates (“RRA”) over the last four quarters.¹⁶⁴ The average authorized
12 ROE over the last four quarters of 9.73% is well above the 9.11% proposed by Mr. Muldoon.
13 Moreover, even using the average authorized ROEs for the firms used in Mr. Muldoon’s own
14 proxy groups reveals an average authorized ROE of 9.96% - again well above his
15 recommendation.¹⁶⁵ Therefore, even the allowed ROEs for the utilities that Mr. Muldoon
16 otherwise characterizes as “a close proxy for Avista” indicate that his recommended ROE is
17 vastly understated. He even acknowledges that the results of his analysis “are low compared with
18 regulated U.S. utilities’ authorized return on equity capital.”¹⁶⁶

¹⁶³ See Coakley v. Bangor Hydro-Electric Co., Opinion No. 531, 147 FERC ¶61,234 at page 144 (2014).

¹⁶⁴ (AVISTA/1200, McKenzie/5, lines 1-2)

¹⁶⁵ (See AVISTA/1201, McKenzie, Schedule AMM-15, page 1)

¹⁶⁶ (STAFF/200, Muldoon/29, lines 7-10)

1 Even aside from authorized ROEs, the average expected earned ROE for Mr. Muldoon's
2 own proxy group is 10.7%.¹⁶⁷ This prompted Company Witness McKenzie to observe:

3 These book return estimates are an 'apples to apples' comparison to Mr.
4 Muldoon's ROE recommendation. If Avista is only allowed the opportunity to
5 earn a 9.11% return on the book value of its equity investment, as recommended
6 by Mr. Muldoon, while other comparable utilities are expected to earn an average
7 of 10.7%, the implications are clear – Avista's investors will be denied the ability
8 to earn a return that is comparable to those available from investments with
9 comparable risk.¹⁶⁸ (emphasis added)

10 Moreover, Mr. Muldoon's effort to reconcile his recommendation with the 9.5% ROE
11 established in Avista's last general rate case (Docket No. UG-284) is unavailing. Since the time
12 that Mr. Muldoon filed testimony in support of the 9.5% ROE under the settlement in Docket
13 No. UG-284, yields on utility bonds corresponding to Avista's Baa rating have increased
14 approximately 103 basis points; as observed by Company Witness McKenzie, considering the
15 inverse relationship between equity risk premiums and interest rates, this "implies a current ROE
16 for Avista on the order of 10.0%."¹⁶⁹

17 **(2) *Mr. Muldoon's Selection of His Proxy Group is Questionable.***

18 There are a number of issues associated with Mr. Muldoon's selection of his proxy group.
19 First of all, he arbitrarily eliminated companies if less than 80% of the total assets were
20 attributable to regulated operations.¹⁷⁰ In the process, however, he did not demonstrate how this
21 subjective criterion translates into differences in the investment risks perceived by investors.¹⁷¹
22 In doing so, Mr. Muldoon would exclude all but three of the companies included by Value Line
23 in its natural gas utility industry group based on his "subjective test."¹⁷² There is no sound basis

¹⁶⁷ (See AVISTA/1201, McKenzie, Schedule AMM-16, page 1)

¹⁶⁸ (AVISTA/1200, McKenzie/8, lines 1-7)

¹⁶⁹ (Id. at page 13, lines 14-18)

¹⁷⁰ (STAFF/200, Muldoon/20)

¹⁷¹ (Id. at pages 20-23)

¹⁷² (AVISTA/1200, McKenzie/15, lines 12-14)

1 to arbitrarily narrow the proxy group in such a way; moreover, by narrowing the proxy group to
2 only three potential gas distribution utilities, he increases the potential for measurement error.¹⁷³

3 Secondly, he arbitrarily excludes any company that has been involved in a merger-related
4 transaction at any time during the past four years.¹⁷⁴ This ignores the fact, however, that
5 analytical methods used to estimate the cost of equity (including the multi-stage DCF Model
6 favored by Mr. Muldoon) are “forward-looking and based on investors’ future expectations, not
7 on data over an arbitrary four-year historical period.”¹⁷⁵ Finally, he elects to focus on water
8 utilities in his proxy group, rather than combination electric and gas utilities portrayed in
9 Company Witness McKenzie’s testimony. Mr. Muldoon argues that these water utilities
10 somehow provide “a better fit for Avista’s profile than the Company’s peers.”¹⁷⁶ In doing so,
11 however, he has presented no evidence that would indicate that the investment community would
12 view water companies as a superior benchmark to combination utilities when evaluating an
13 investment in Avista.^{177/178}

14 **(3) Mr. Muldoon’s Application of a Multi-Stage DCF Approach Relying on Long-**
15 **Term GDP Growth is Flawed.**

16 The DCF Model need not, and should not, focus on a long-term growth estimate over a
17 horizon of 30 years and beyond; instead, it should match growth estimates with investors’

¹⁷³ (Id. at page 15, line 14 - /16, line 2).

¹⁷⁴ (See STAFF/202, Muldoon/20)

¹⁷⁵ (AVISTA/1200, McKenzie/16, lines 10-11)

¹⁷⁶ (STAFF/200, Muldoon/41, lines 9-10)

¹⁷⁷ Indeed, even Moody’s has explicitly excluded water utilities from its common ratings methodology:

This methodology pertains to regulated electric and gas utilities and excludes the following types of issuers, which are covered by separate rating methodologies: Regulated Networks, Unregulated Utilities and Power Companies, Public Power Utilities, Municipal Joint Action Agencies, Electric Cooperatives, Regulated Water Company, and Natural Gas Pipelines.

(Moody’s Investors Service, “*Regulated Electric and Gas Utilities*,” *Ratings Methodology* (December 23, 2013) (emphasis added).

¹⁷⁸ Mr. Muldoon even includes the York Water Company in his proxy group, which is the smallest regulated utility in the water industry prompting Company Witness McKenzie to observe that “the investment community is unlikely to regard this small water company as a potential substitute for an investment in Avista’s common stock, and further undermines Mr. Muldoon’s reference to water utilities in his analysis.” (AVISTA/1200, McKenzie/18, lines 18-20)

1 expectations. These expectations do not make reference to long-term GDP growth in evaluating
2 expectations for individual common stocks, including those in the utility industry. As explained
3 by Company Witness McKenzie, such a “very long horizon” is misplaced.¹⁷⁹ Company Witness
4 McKenzie highlights the shortcomings of the multi-stage DCF Model:

5 While the complexity of multi-stage DCF models may impart an aura of accuracy,
6 the fact remains that the investment community does not look to 20-year GDP
7 growth rates ten years hence when evaluating an investment in one of
8 Mr. Muldoon’s comparable utilities, and investors’ current view of gas utilities
9 does not anticipate a series of discreet, clearly defined stages. As a result, there is
10 no discernible transition that would support use of the multi-stage DCF
11 approach.¹⁸⁰

12 The present value of cash flows “in the far distant future is so small as to be largely irrelevant to
13 investors, who are more rationally concerned with company-specific performance in the next
14 several years, than with capital GDP growth in some future decade,” as explained by Mr.
15 McKenzie.¹⁸¹

16 Furthermore, long-term GDP growth rates are not commonly referenced in the industry
17 as a guide to future expectations for specific firms such as gas utilities. Indeed, Value Line does
18 not even mention trends in GDP in its evaluation of the firms in the gas, electric or water utility
19 industries. Were GDP growth out to the year 2044 and beyond relevant to investors’ evaluation
20 of utility common stocks, one would assume that Value Line or other security analysts would at
21 least give passing mention to this fact – but they do not.^{182/183}

¹⁷⁹ Company Witness McKenzie acknowledges that there are times when a multi-stage DCF Model could fit investors’ expectations. Indeed, Mr. Muldoon refers to this Commission’s decision in Docket No. UE-115 (2001) as support for his reliance on the three-stage DCF Model. It should be recognized, however, that the Commission, at the time, specifically highlighted the significance of the “ongoing restructuring of the electric industry,” in the 2001 time period. (See Order No. 01-777 at page 27 (2001). Subsequently, widespread deregulation has waned in the industry and there is no evidence that his three-stage model fits the expectations that investors currently build into their utility stock prices.

¹⁸⁰ (AVISTA/1200, McKenzie/21, lines 4-9)

¹⁸¹ (Id. at page 23, lines 1-4)

¹⁸² (McKenzie/22, line 19 - /23, line 4)

¹⁸³ Indeed, Professor Myron J. Gordon, who originated the DCF approach, concluded that reference to a generic long-term growth rate, such as Mr. Muldoon advocates, was unsupported. See “The Cost of Capital to a Public Utility,” MSU Public Utilities Studies, at page 100-01 (1974).

1 Furthermore, there were computational errors otherwise affecting Mr. Muldoon’s multi-
2 stage DCF analysis. While he assumed a first-stage period of 2015-2019, his analysis actually
3 incorporated historical dividend payments based on data for 2014. And, of course, historical
4 dividend payments during past periods are irrelevant. Secondly, his analysis failed to incorporate
5 growth in dividend cash flows between 2018 and 2019, with his assumed dividend payments
6 being equal in those two years. Thirdly, he failed to reflect the impact of a two-for-one stock
7 split on the market price for South Jersey Industries, Inc., resulting in an understated estimate of
8 the cost of equity for the Company under his multi-stage DCF Model.¹⁸⁴

9 Even if one were to utilize Mr. Muldoon’s proxy group, there are alternative ways of
10 applying the multi-stage DCF Model that otherwise confirm the reasonableness of the 9.9% ROE
11 requested by Avista. Company Witness McKenzie, in his Exhibit AVISTA/1201,
12 Schedule AMM-17, presents the results of a multi-stage DCF analysis patterned after the
13 methodology previously accepted by the OPUC in its Order No. 01-777, which was cited by
14 Mr. Muldoon in his testimony. There, this Commission accepted a three-stage DCF Model using
15 Value Line’s forecast of dividends for the coming year for the first stage, a second stage based
16 on the growth rate applied by Value Line’s 3-5 year dividend projections, and a terminal growth
17 rate based on the $br + sv$ sustainable growth rate that is consistent with theoretical assumptions of
18 the DCF Model.¹⁸⁵ The average cost of equity implied by this approach is 9.8%, after making
19 Mr. Muldoon’s own recommended adjustments for financial risk and flotation costs.¹⁸⁶ This is
20 quite close to Avista’s 9.9% requested ROE.

21 Mr. Muldoon also arbitrarily removes an equal number of high and low estimates when
22 evaluating DCF results. The fact that there are “low-end outliers” that fail the test of

¹⁸⁴ (See AVISTA/1200, McKenzie/26, line 10 - /27, line 3)

¹⁸⁵ (AVISTA/1200, McKenzie/27, lines 7-13)

¹⁸⁶ (Id. at page 28, lines 5-7)

1 reasonableness “says nothing about the validity of estimates at the upper end of the range of
2 results,” and provide no basis to arbitrarily discard an equal number of values from the top end of
3 the range.¹⁸⁷

4 **(4) Mr. Muldoon’s CAPM Application is Otherwise Unreliable as a Credible**
5 **Benchmark.**

6 As explained by Mr. McKenzie, as is true with the DCF Model, the CAPM Model is a
7 forward-looking model based on expectations of the future.¹⁸⁸ It is designed to reflect the future
8 expectations of actual investors in the market. However, Mr. Muldoon’s application of the
9 CAPM approach was based entirely on backward-looking historical data over 85 years of
10 history.^{189/190} Moreover, FERC, itself, has rejected the historical CAPM approach relied on by
11 Mr. Muldoon and adopted the forward-looking CAPM application proposed by Mr. McKenzie in
12 this proceeding.¹⁹¹

13 Moreover, the 4.50% market risk premium cited by Mr. Muldoon is not an accurate
14 description of what was actually reflected in the complete historical record. Instead, applied
15 historical risk premiums have ranged from between 6% and 7% for the historical returns from
16 1926 through 2014.¹⁹²

17 Staff Witness Muldoon ignored the results of the Company’s ECAPM analysis, simply
18 because Mr. Muldoon was not personally familiar with the use of this method by the investment
19 community.¹⁹³ Mr. Muldoon, however, ignores the fact that ECAPM is based on the findings of

¹⁸⁷ (AVISTA/1200, McKenzie/28, lines 13-17)

¹⁸⁸ (AVISTA/1200, McKenzie/30, lines 8-9)

¹⁸⁹ (Id. at page 30, lines 12-13)

¹⁹⁰ As noted by Mr. McKenzie, citing to Morningstar:

“The cost of capital is always an expectational or forward-looking concept. While the past performance of an investment and other historical information can be good guides and are often used to estimate the required rate of return on capital, the expectations of future events are the only factors that actually determine cost of capital.”

Morningstar, “Tbbotson SBBI, 2012 “Valuation Yearbook,” at page 21.

¹⁹¹ (See Coakley, supra, at pages 108-119)

¹⁹² (AVISTA/1200, McKenzie/32, lines 7-18)

¹⁹³ (STAFF/200, Muldoon/37, lines 8-9)

1 studies reported in the financial literature and endorsed, e.g., by the Staff of the Maryland Public
2 Service Commission and considered in the very decision referenced in Mr. Muldoon’s own
3 testimony. (See Public Service Comm’n of Maryland, Order No. 85374, Case No. 9299, at
4 page 78 (February 22, 2013); cited at STAFF/200, Muldoon/43.)

5 **(5) *Staff’s Criticisms of McKenzie’s Risk Premium Method are Unfounded.***

6 Staff Witness Muldoon suggests that historical spreads between stock returns and U.S.
7 Treasury Bonds may be subject to distortion because the Federal Reserve has driven interest
8 rates to anomalously low levels through their monetary policy actions.¹⁹⁴ This, however, does not
9 detract from Mr. McKenzie’s risk premium results. First of all, Mr. McKenzie’s risk premium
10 approach was based on average yields for public utility bonds, not on U.S. Treasury Bond yields
11 as suggested by Mr. Muldoon.¹⁹⁵ Next, contrary to Mr. Muldoon’s suggestion, Mr. McKenzie’s
12 study does not depend on an assumed cost-of-risk premium over time; rather, Mr. McKenzie’s
13 risk premium accounts for the fact that risk premiums vary with changes in interest rates.¹⁹⁶
14 Thirdly, Mr. McKenzie did account for the decrease in the equity risk premium that would be
15 implied by expectations of higher bond yields as the Federal Reserve moves to normalize its
16 monetary policies.¹⁹⁷ It is simply incorrect to suggest that, because past projections of higher
17 bond yields have not yet become a reality, investors now expect the current low rate environment
18 to persist.¹⁹⁸ Indeed, Mr. McKenzie pointed to the “irony” that “Mr. Muldoon apparently has no
19 qualms about relying on predictions of GDP 10-30 years into the future, but balks at considering
20 independent forecasts for interest rates over the next five years.”¹⁹⁹

21 **(6) *Mr. Muldoon’s Assumptions About Comparative Risk are Unsupported.***

¹⁹⁴ (STAFF/200, Muldoon/34)

¹⁹⁵ (AVISTA/1200, McKenzie/35, line 19 - /36, line 6)

¹⁹⁶ (Ibid.)

¹⁹⁷ (Ibid.)

¹⁹⁸ (Id. at page 37, lines 10-15)

¹⁹⁹ (Ibid.)

1 Interestingly enough, Mr. Muldoon relies heavily on the fact that Avista has made
2 “frequent rate filings” as support for his proposition that Avista is less risky than his peer
3 group.²⁰⁰ Quite to the contrary, as pointed out by Mr. McKenzie, “a recurring shortfall between a
4 utility’s cost of providing service and the revenues it collects through rates that generally
5 motivates repeated rate case filings is far more likely to be viewed by investors” more “as a
6 challenge than an advantage.”²⁰¹ Indeed, as recently acknowledged by Value Line:

7 Frequent regulatory activity is nothing new for Avista. Due to the effects of
8 regulatory lag, the utility’s earned return on equity has been unimpressive for
9 many years. So, the Company must file rate cases in order to place its capital
10 spending in the rate base and recover higher operating and maintenance expenses.

11 (The Value Line Investment Survey (October 30, 2015)).²⁰² This prompted Mr. McKenzie to
12 observe that “Mr. Muldoon’s conclusion that frequent rate case filings are evidence of a
13 ‘unique’, lower risk exposure is diametrically opposed to the views of the investment
14 community.”²⁰³

15 Mr. Muldoon provides no support whatsoever for his proposed reduction in ROE that he
16 attributes to Avista’s “very frequent [general] rate cases.”²⁰⁴ There is no substantiation for his
17 lowering of Avista’s ROE by 20 basis points on that basis.

18 Moreover, a comparison of objective risk measures does not suggest that Avista is less
19 risky than its peer group of utilities. Mr. McKenzie’s Exhibit No. 1201, Schedule AMM-19
20 presents a risk evaluation which shows that the BBB corporate credit rating assigned to Avista
21 by S&P falls below every one of the companies in Mr. Muldoon’s peer group. Similarly,
22 Avista’s Baa-1 rating from Moody’s also indicate higher risk than the A3 rating corresponding to
23 Mr. Muldoon’s proxy group, as does its relative Safety Ranking, which is Value Line’s principle

²⁰⁰ (STAFF/200, Muldoon/6, lines 17-18)

²⁰¹ (Avista/1200, McKenzie/38, lines 5-7)

²⁰² (Avista/1200, McKenzie/39, lines 1-5)

²⁰³ (Id. at page 39, lines 6-8)

²⁰⁴ (STAFF/200, Muldoon/42)

1 risk measure.²⁰⁵ All of the foregoing indicate that investors would likely conclude that the overall
2 investment risks for Avista are generally greater than those of Mr. Muldoon's proxy group.²⁰⁶

3

4 **D. The Analysis of NWIGU/CUB Witness Gorman Understates Avista's ROE.**

5 Mr. Gorman, on behalf of NWIGU and CUB, provided an analysis supporting an ROE in
6 the range of 8.9% to 9.6%, with a mid-point of approximately 9.3%.²⁰⁷ Mr. Gorman's
7 recommendation was based on his application of the constant growth and multi-stage forms of
8 the DCF Model, and application of the CAPM based on historical realized rates of return, and a
9 risk premium approach based on allowed rates of return for natural gas and combination utilities.
10 He applied these methods to essentially the same proxy groups utilized by Company Witness
11 McKenzie (but did eliminate two companies due to involvement in mergers and acquisitions).²⁰⁸

12 Mr. Gorman's analysis understates Avista's ROE. He applies inconsistent and incorrect
13 approaches to reach his final recommendation. To begin with, his constant growth DCF results
14 are biased downwards because he includes "outliers" in his calculations and fails to otherwise
15 incorporate readily-available and widely-followed analyst growth rates. His multi-stage DCF
16 analysis mistakenly assumes that investor growth expectations are capped by forecasts for
17 growth in the U.S. economy. His CAPM analysis is not credible because it is based almost
18 exclusively on historical data and fails to correct for an observed bias in the CAPM results, while
19 otherwise ignoring the impact of company size on expected returns. And finally, Mr. Gorman's
20 risk premium analysis is flawed because he rejects the well-documented, inverse relationship
21 between equity risk premiums and interest rate levels (equity risk premiums increase when

²⁰⁵ (Avista/1200, McKenzie/39, line 21 - /40, line 11)

²⁰⁶ (Ibid.)

²⁰⁷ (See NWIGU-CUB/100, Gorman/65, lines 5-6)

²⁰⁸ (AVISTA/1200, McKenzie/42, lines 11-17)

1 interest rates are lower and decrease when interest rates are higher). Finally, he fails to include
2 the impact of flotation costs as a necessary cost of issuance.²⁰⁹

3 Turning first to the discounted cash flow model, Mr. Gorman failed to remove outliers
4 from his final constant growth DCF results. He fails to recognize that DCF estimates that are
5 implausibly low or high should be eliminated when evaluating the results of this method in order
6 to pass the “fundamental tests of reasonableness and economic logic.”²¹⁰ Even more
7 significantly, Mr. Gorman did not include EPS growth rate estimates from Value Line in his
8 analysis.²¹¹ As explained by Mr. McKenzie, Value Line is readily available and is widely
9 followed by investment professionals as a source of expected growth rates and should not be
10 ignored.²¹²

11 Mr. Gorman’s multi-stage growth DCF analysis, should be rejected entirely. As
12 explained by Mr. McKenzie, there is “no merit to Mr. Gorman’s claim that each company’s
13 growth would converge to the maximum sustainable growth rate for a utility company...of
14 4.6%.”²¹³ There simply is “no link between Mr. Gorman’s GDP growth rate ceiling and the
15 actual expectations of investors in the capital markets, which are the determining factor in any
16 analysis of a fair ROE.”²¹⁴ Indeed, the values for Mr. Gorman’s own proxy firms indicate that
17 utilities can and do achieve long term growth that exceeds his presumed sustainable growth
18 ceiling.²¹⁵ This creates an “artificial constraint” and does not recognize that investors view the
19 potential for certain companies to grow faster than the overall economy.²¹⁶

²⁰⁹ (AVISTA/1200, McKenzie/43, lines 1-19)

²¹⁰ (Id. at page 44, lines 4-8)

²¹¹ He did, however, use Value Line as an underlying source for many of his calculations, such as to compute the annualized dividend and sustainable growth terms for his DCF Models and the average Beta for his CAPM studies. (AVISTA/1200, McKenzie/44, line 17 - /45, line 4)

²¹² (Ibid.)

²¹³ (AVISTA/1200, McKenzie/45, lines 17-20)

²¹⁴ (AVISTA/1200, McKenzie/45, line 22 -/46, line 2)

²¹⁵ (See AVISTA/1200, McKenzie/46, lines 10-19)

²¹⁶ (Ibid.)

1 Nor is Mr. Gorman’s view that individual company growth is capped by GDP growth
2 supported by expectations in the utility industry, especially given the fact that the industry has
3 entered into a long-term cycle of significant capital spending on infrastructure, as explained by
4 Mr. McKenzie.²¹⁷ Mr. Gorman’s multi-stage DCF cost of equity analysis is also beset by
5 computational errors that bias the results. For example, Mr. Gorman’s use of the internal rate of
6 return calculation assumes that annual cash flows are received at the end of each year which, as
7 explained by Mr. McKenzie, is inconsistent with the periodic dividend payments that investors
8 receive over the course of a year.

9 Mr. Gorman’s CAPM analysis also has several shortcomings, being based almost
10 exclusively on historical data – even though the analysis should be forward-looking to
11 accomplish its objective. Moreover, he fails to correct for an observed bias in his result and his
12 analysis ignores the impact of company size on expected returns.

13 The Company and Mr. Gorman take a fundamentally different approach. While
14 Mr. Gorman suggests that his analysis is “forward-looking,” his CAPM was actually based
15 almost entirely on historical data, as he himself explained:

16 I estimated the expected return on the S&P 500 by adding an expected inflation
17 rate to the long-term historical arithmetic average real return on the market.
18 (emphasis added) (Gorman at page 40)

19 In so doing, as was true with Mr. Muldoon, Mr. Gorman’s use of historical returns in the CAPM
20 is utterly inconsistent with the underlying presumptions of the model, as explained by Mr.
21 McKenzie.²¹⁸ The CAPM analysis should reflect expectations of actual investors in today’s
22 capital market, rather than looking backwards to a risk premium based largely on historical
23 data.²¹⁹

²¹⁷ (Id. at page 47, lines 1-9)

²¹⁸ (AVISTA/1200, McKenzie/50, lines 1-19)

²¹⁹ (Ibid.)

1 Turning now to his analysis of the risk premium approach, Mr. Gorman chose to
2 arbitrarily ignore all data available prior to 1986, thereby introducing a subjective bias that
3 otherwise taints his analysis and artificially lowers his results. In addition, and more importantly,
4 he failed to incorporate the inverse relationship between interest rates and equity risk premiums
5 in his analysis of historical authorized rates of return.²²⁰ That is to say, when interest rates are
6 relatively high, the equity risk premiums are lower, and when interest rates are relatively low,
7 equity risk premiums are greater.²²¹ Given that interest rates are currently lower than the average
8 used over Mr. Gorman’s study period, current equity risk premiums should be relatively higher –
9 something which his analysis ignores entirely.²²² Mr. McKenzie corrected Mr. Gorman’s two
10 risk premium studies to simply account for the inverse relationship between interest rates and
11 risk premiums. In doing so, he derived the current cost of equity estimate for Avista of 10.00%
12 using Treasury yields, or 10.05% based on public utility bond yields.²²³

13 Finally, Mr. Gorman rejects a flotation cost adjustment even though Avista has and will
14 continue to invest significant amounts of equity capital to serve the public – and in doing so, will
15 incur issuance costs. As explained by Mr. McKenzie, the earnings base of any equity that is
16 issued is permanently reduced by the amount of past flotation costs. Accordingly, legitimate
17 costs of providing utility service will be excluded for ratemaking purposes and will further
18 undermine the Company’s ability to earn its authorized rate of return.²²⁴

19 **E. In Conclusion, Avista’s Weighted Cost of Equity, As Proposed, is Consistent With**
20 **That Recently Approved by State Regulators.**

21 As noted above, Mr. McKenzie has sponsored testimony supporting the reasonableness
22 of a proposed 9.9% ROE, together with a proposed equity layer of 50%, all of which would

²²⁰ (AVISTA/1200, McKenzie/55, line 10 – 56/, line 20)

²²¹ (Ibid.)

²²² (Ibid.)

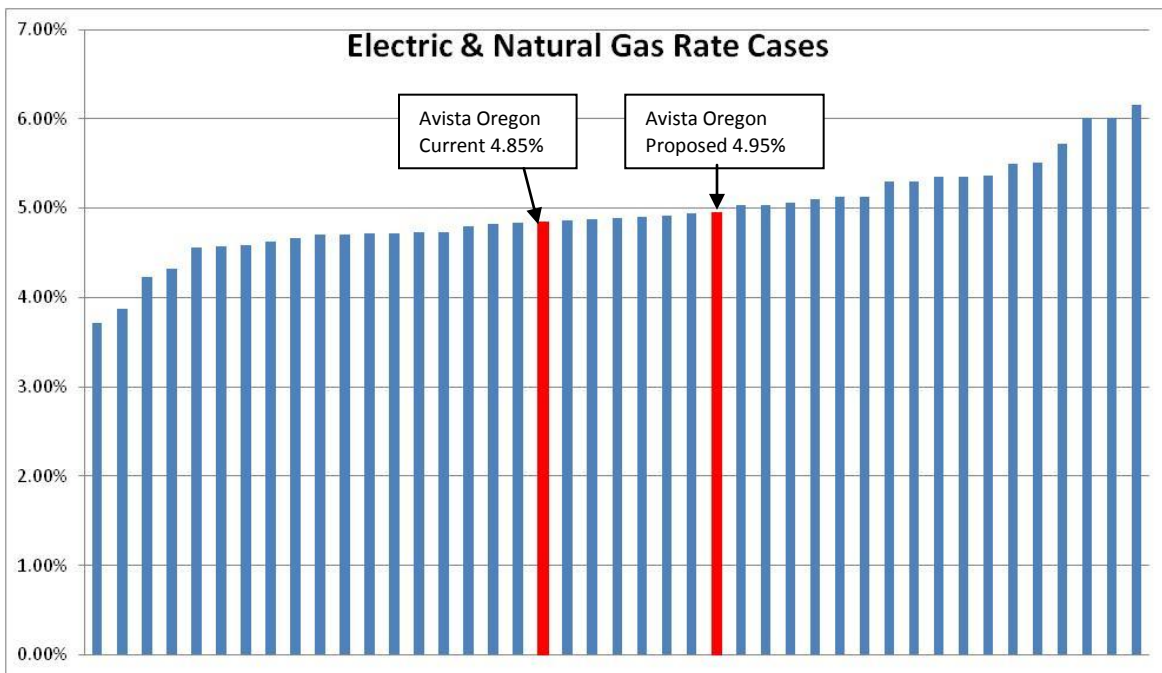
²²³ (See AVISTA/1201, Schedule AMM-21)

²²⁴ (AVISTA/1200, McKenzie/59, lines 7-18)

1 properly balance safety and economy for customers, while providing Avista with an opportunity
 2 to earn a fair and reasonable return and provide access to capital markets under reasonable terms
 3 on a sustainable basis. These proposals result in a “weighted cost of equity” of 4.95% (9.9% x
 4 50%). The following bar charts, excerpted from Mr. Thies’ Direct Testimony²²⁵ show the
 5 weighted cost of equity approved by state regulators for investor-owned utilities across the
 6 country for the period from July 1, 2014 through March 31, 2015. As such, the data represents all
 7 of the Commission decisions that specify an ROE and equity ratio for utilities during that nine
 8 month period. Avista’s current authorized weighted cost of equity of 4.85% (51% equity ratio x
 9 9.5% ROE) is also shown.

10 **Illustration No. 5:**²²⁶

11 **Weighted Cost of Equity: Electric and Natural Gas Rate Cases**



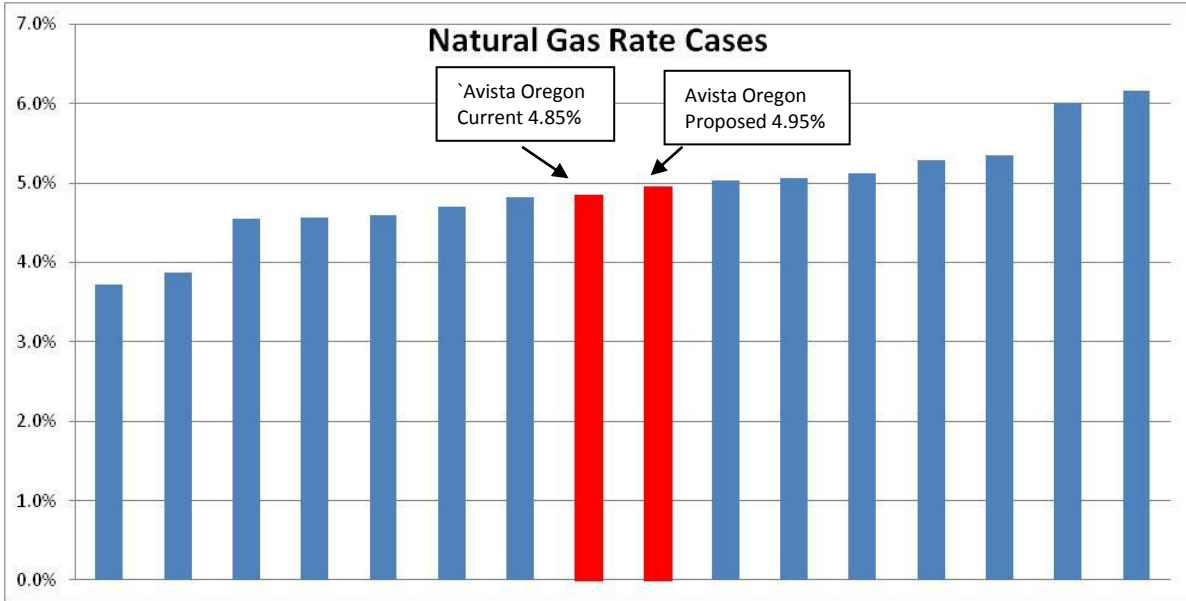
12 ²²⁵ (AVISTA/200, Thies/23)

13 ²²⁶ *Source: SNL Financial. Rate Cases finalized July 1, 2014 through March 31, 2015.

Items added (red bars): 1) Avista’s April 2015 approved return from the Oregon Commission and 2) Avista’s proposed return in the current filing. (See AVISTA/200, Thies/23, lines 2-11)

Illustration No. 6:²²⁷

Weighted Cost of Equity: Natural Gas Rate Cases



As shown, Avista’s proposed weighted cost of equity of 4.95% is in the middle of the range of these weighted cost of equity numbers.

As shown in the lower portion of Avista/1201, Schedule AMM-19 excerpted below, Avista’s investment risks are also higher than other Oregon-jurisdictional utilities. Avista’s credit ratings and Value Line Safety Rank imply greater risk than for other Oregon-jurisdictional utilities.

Oregon-Jurisdictional Utilities	Issuer Ratings		Value Line		
	S&P	Moody's	Safety Rank	Financial Strength	Beta
	Northwest Natural Gas	A+	A3	1	A
Pacificorp	A-	A3	NMF	NMF	NMF
Portland General Electric	BBB	A3	2	B++	0.80
Average	A-	A3	2	B++	0.75
Avista Corp	BBB	Baa1	3	A	0.80

227 *Source: SNL Financial. Natural Gas Rate Cases finalized July 1, 2014 through March 31, 2015.

Items added (red bars): 1) Avista’s April 2015 approved return from the Oregon Commission and 2) Avista’s proposed return in the current filing. (See AVISTA/200, Thies/23, lines 14-20)

1 This further suggests an ROE for Avista that is certainly not less than that recently established or
2 proposed for other Oregon jurisdictional utilities, as shown below:

Oregon Jurisdictional Utilities

Company	Case Identification	Date of Approval	Cost of Equity	Common Equity Ratio
Avista Corp - Proposed	D-UG-288	Pending	9.90%	50.00%
Cascade - Filed Settlement	D-UG-287	Pending	9.55%	51.00%
Portland General Electric	D-UE-294	11/3/2015	9.60%	50.00%
Portland General Electric	D-UE-283	12/4/2014	9.68%	50.00%
PacifiCorp	D-UE-263	12/18/2013	9.80%	52.10%

3

4 **V. THERE IS NO BASIS FOR A DISALLOWANCE OF PROJECT COMPASS COSTS**

5 **A. Introduction: Positions of the Parties.**

6 Avista’s “legacy” customer service and work management system was originally placed
7 into service in 1994, and through continuing efforts to refresh and expand its capabilities, it
8 remained in service for 20 years. Avista began its efforts to replace the system in 2010 and in
9 2012, after selecting primary vendors, it prepared an initial implementation plan and capital
10 budget.²²⁸ In June of 2014, the Company extended its in-service date (the “Go-Live”) from July
11 2014 to early 2015, with a corresponding increase in the amount of the initial budget estimate.
12 The final addition to the budget estimate was made in November of 2014 and the system was
13 successfully implemented on February 2, 2015.

14 Staff Witness Johnson contends that \$27 million (System) of the cost required to
15 successfully implement Project Compass was excessive, and that the Company should not be
16 allowed to recover half of that amount (\$13.5 million) from its customers (Oregon allocated

²²⁸ Avista chose Oracle’s “Customer Care and Billing” system (“CC&B”), and the “Maximo” Work and Asset Management Application (“Maximo”) sold by IBM. The firm EP2M was selected as the primary installation contractor for CC&B, and IBM was hired to install its Maximo system. (AVISTA/1701, Kensok/6, lines 21-29).

1 share is \$1.175 million).^{229/230} The entirety of the evidence presented by Ms. Johnson to support
2 her proposed write-off is an excerpt of the testimony of a Staff member of the Washington
3 Utilities and Transportation Commission (WUTC), David Gomez, which was filed in connection
4 with Avista’s pending electric and natural gas rate cases in Washington (Docket Nos. UE-
5 150204 and UG 150205). In her testimony, Ms. Johnson summarizes MR. Gomez’ testimony as
6 follows:

7 The testimony of WUTC witness Gomez sets forth extensive discussion regarding
8 one of the contractor’s, EP2M/Five Point/Ernst & Young, performance of its
9 obligations under the contract (see Staff/304, pages 52 and 53 showing Docket
10 UE-15-150204/UG-150205, Testimony of David C. Gomez, pages 52-53). Staff
11 examined Mr. Gomez’s concerns that Avista failed “to recognize, evaluate,
12 identify, document and mitigate the possible risks to Project Compass resulting
13 from the apparent conflict of interest arising from Five Point’s acquisition of
14 EP2M less than six months after award of a contract” and “the Company’s lack of
15 documentation of the prudence of its decision, above alternatives, to enter into an
16 Extension Agreement with Ernst & Young for the added resources needed to
17 complete Project Compass”. After evaluating and considering the WUTC
18 witness’s testimony, Staff concluded that Avista had contributed to the cost
19 overruns of Project Compass and should be held partially responsible. (Emphasis
20 added) (STAFF/300, Johnson/3, line 20 - /4, line 10)

21 Staff Witness Johnson, however, provides no analysis of her own, simply electing to rely
22 on the testimony of a staff member (Mr. Gomez) of the WUTC that was filed in connection with
23 Avista’s current electric and natural gas rate cases in Washington.^{231/232}

24 While Staff Witness Johnson stated that she had evaluated and considered the testimony
25 of Mr. Gomez before the WUTC, she otherwise provided no indication of what her evaluation
26 revealed, or the evidence that she found particularly persuasive in Mr. Gomez’s testimony before
27 the WUTC. Interestingly enough, Staff Witness Johnson only provided brief excerpts of

²²⁹ (See STAFF/300, Johnson/3, lines 15-17)

²³⁰ Staff’s total proposed adjustment is \$1.243 million which includes the effects of the removal of 50% of bonuses paid to employees who worked on Project Compass.

²³¹ Indeed, no other party in the Company’s Washington rate case recommended any disallowance related to Project Compass. And Avista’s recently-filed pending settlement agreement with all parties in its current rate case before the Idaho Public Utilities Commission (IPUC), reflects full recovery of Avista’s investment in Project Compass, including the bonuses paid to employees related to the successful completion of the Project.

²³² (AVISTA/1700, Kensok/5, lines 17-21)

1 Mr. Gomez's testimony (not the entirety) and failed to include any of the exhibits sponsored by
2 Mr. Gomez. Accordingly, we are left with snippets of testimony from Mr. Gomez - a witness in
3 another jurisdiction and in another case. There was no independent analysis whatsoever provided
4 by Staff Witness Johnson.

5 In the interest of conveying a more complete picture, the Company has submitted the
6 Reply Testimony of Mr. Jim Kensok, who is the Vice-President and Chief Information and
7 Security Officer (CISO) of Avista. He was charged with overseeing the development and
8 implementation of Project Compass.²³³ Mr. Kensok also sponsors, as an exhibit, his Rebuttal
9 Testimony filed in response to Mr. Gomez's Washington Staff Testimony in the Company's
10 pending general rate case in Washington.

11 Before proceeding, Avista would like to remind the Commission that the issue of Project
12 Compass has previously been before it.²³⁴ Avista has provided extensive explanation and
13 documentation of Project Compass in its last two general rate cases in Oregon: Docket Nos. UG-
14 246 and UG-284. On August 15, 2013 (Docket No. UG-246), Avista witness Mr. Larry La Bolle
15 sponsored testimony and exhibits explaining and supporting Project Compass. In Docket
16 No. UG-284, filed on September 2, 2014, Avista witness Mr. Jim Kensok sponsored testimony
17 and exhibits with updated information on the Project, including an increase in the expected cost,
18 and a delay in the Go-Live date of the Project to the first quarter of 2015. This testimony of
19 Mr. Kensok clearly explained why Project Compass required more time and dollars than
20 originally estimated to successfully complete the Project.

²³³ (AVISTA/1700, Kensok/1, lines 3-21)

²³⁴ (See Docket No. UG-284, STAFF/102 Gardner and Muldoon/24, lines 1-8)

1 Furthermore, the settlement agreement, supported by all parties, in Docket No. UG-284,
2 and the OPUC Staff testimony²³⁵ supporting that settlement agreement, recommended recovery
3 of the costs associated with Project Compass, including the increased costs associated with the
4 delay in the Go Live date.²³⁶ In that case (UG-284), Witness Ms. Johnson was identified as being
5 assigned to review capital additions to rate base, which included Project Compass.²³⁷ An excerpt
6 of OPUC Staff’s testimony related to Project Compass is as follows:

7 In particular, Staff reviewed the prudence of major investments including the
8 Customer Information System (CIS) project (Expenditure Requisition (ER) 5138).
9 Staff reviewed the CIS project during 2014. The Company states that the in-
10 service date for the CIS is early February 2015. Avista will provide an attestation
11 from an officer of the Company when the CIS is completed and functioning. From
12 Staff’s perspective, the Company’s decision to pursue this project was prudent
13 and should be allowed into rate base per the Stipulation terms. (Emphasis added)
14 (Docket No. UG-284, Exhibit No. Staff/102, Gardner/ page 24, lines 1-8)

15 The Settlement Stipulation in that Docket UG-284 reflected full recovery of the costs associated
16 with Project Compass known at that time, and OPUC Staff’s testimony immediately above
17 supported full recovery, with the knowledge that the costs were higher than originally estimated,
18 and the Go Live date was postponed until “early February 2015.”

19 Interestingly enough, even though Staff had previously determined in 2014 that \$98.6
20 million had been prudently incurred (and, in fact, is already reflected in rates), Ms. Johnson is
21 now alleging that only a lesser amount of \$78.9 million was prudently incurred – reflecting a
22 reduction, in and of itself, of \$19.7 million.²³⁸

23 Even though she asserts, at page 3 of her testimony that “Staff considers that [\$27
24 million] to be an excessive cost overrun amount for this project,” she provides no supporting

²³⁵ In Docket No. UG-284 OPUC Staff presented joint testimony, filed by Ms. Gardner and Mr. Muldoon (Docket No. UG-284, STAFF/102, Gardiner and Muldoon/24, lines 1-8) supporting the all-party settlement agreement.

²³⁶ In November 2014 the estimate to complete Project Compass was increased to approximately \$107 million, and the final actual cost to complete the Project was approximately \$107 million. This updated information, including support for the change, was provided by the Company in its original filing in this Docket.

²³⁷ (AVISTA/1700, Kensok/8, lines 8-23)

²³⁸ (AVISTA/1700, Kensok/9, lines 17-19)

1 analysis or documentation that supports her conclusion, during the course of her four pages of
2 testimony devoted to this issue. Finally, at page 3 of her testimony, she asserts that “Avista
3 should have had better cost controls in place that would have kept the cost overruns to a
4 minimum,”²³⁹ again, without providing any support for this statement. Nowhere does she
5 identify and explain the type of cost controls that she believes should have been in place - and
6 that were not put in place.

7 As noted, in its Washington dockets, the Company had presented the Rebuttal Testimony
8 of Mr. Kensok.²⁴⁰ (A copy of that testimony is furnished in this proceeding as
9 Exhibit AVISTA/1701.) Mr. Kensok is the Company’s Vice President and Chief Information and
10 Security Officer. Mr. Kensok has experience in the direct application and management of
11 Information Services over the course of his 32 year information technology career.²⁴¹ Over the
12 last 17 years of his career with Avista, he has overseen the Information Services Department,
13 performing a variety of management roles, directing and leading information technology and
14 systems planning, operations, system analysis, complex communication networks, cyber
15 security, contract negotiations and data management.²⁴² For Project Compass, in particular, he
16 served as a member of the Executive Steering Committee for the Project, which was established
17 to ensure appropriate executive oversight of Project Compass.²⁴³

18 The evidence provided by Mr. Kensok demonstrates that: (1) the project timeline and
19 costs were reasonable and prudent; (2) Avista made prudent decisions with respect to managing
20 all agreements involving Five Point²⁴⁴; (3) the increased project cost and delay was not caused

²³⁹ (STAFF/300, Johnson/3, lines 19-20)

²⁴⁰ (AVISTA/1701, Kensok)

²⁴¹ (*Id.*, at page 1, lines 10-12)

²⁴² (*Ibid.*)

²⁴³ (*Id.*, at page 2, lines 10-22)

²⁴⁴ As discussed below, Five Point was hired by the Company in June of 2011 to provide support in the areas of documenting Avista’s system requirements used in the Request for Proposals process for selecting the new computer applications and key installation vendors, and assisting in the review of proposals.

1 primarily by Five Point; (4) the Company made prudent decisions managing the performance of
2 Five Point (and its successor, Ernst & Young); and (5) employee bonuses were directly related to
3 the successful completion of the project, and were administered pursuant to a detailed plan.²⁴⁵

4 There is one salient fact that is disputed by neither Staff Witness Johnson nor WUTC
5 Witness Gomez: The project was successfully launched on February 2, 2015 and has performed
6 very well since that time.²⁴⁶

7 In short, the Company made a conscious decision to extend the project by seven months
8 in order to ensure that all of the applications were ready to perform as intended, and that the
9 necessary testing and “dress rehearsals” to ensure a successful launch could occur. And that
10 effort paid off.

11 **B. The Project Timeline and Costs Were Reasonable and Prudent.**

12 It is important to understand that estimating the cost of replacing a large, enterprise-wide
13 customer information system with many applications, by its very nature, involves uncertainties at
14 the outset. In the Company’s 2013 report, “Overview of Avista’s Project Compass”²⁴⁷ this
15 difficulty in estimating costs during the initial stages was squarely addressed:

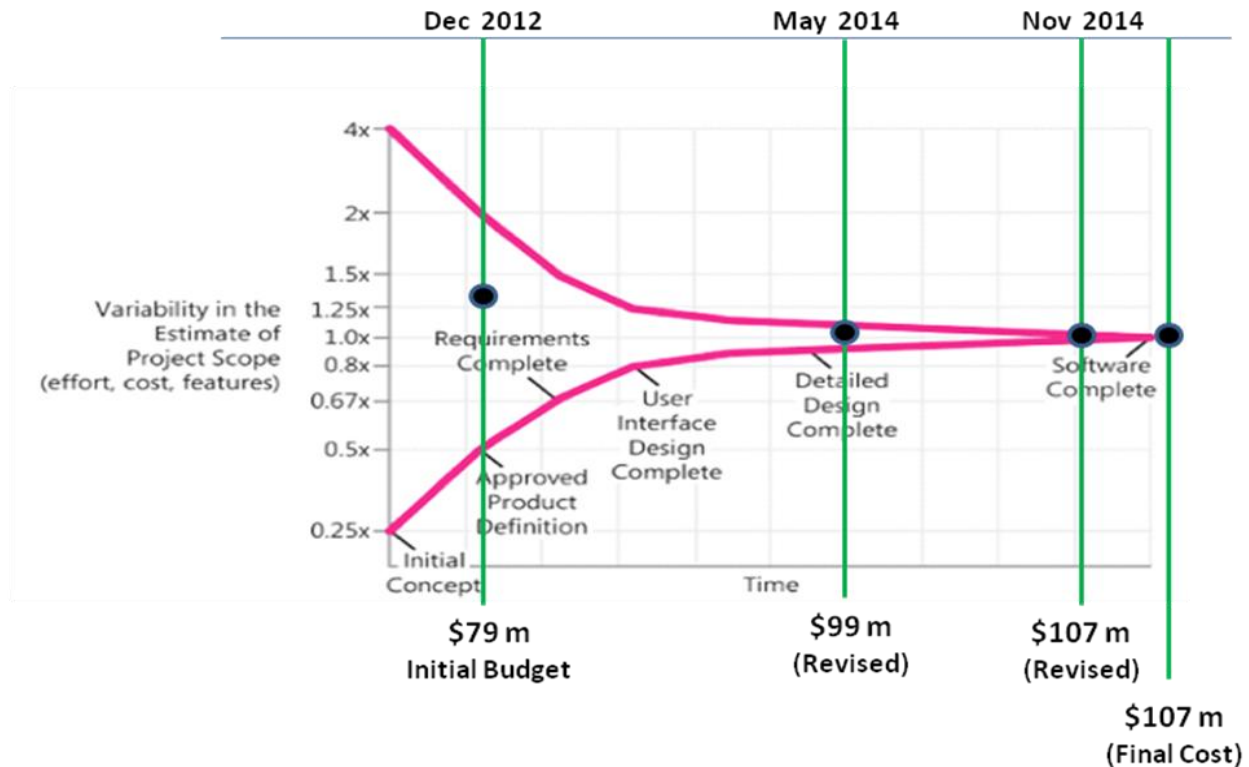
16 Early in the scoping of a software project, particular details of the application
17 being designed/installed, a detailed knowledge of the Company’s specific
18 business requirements, details of solution sets, the management plan, identifying
19 staffing needs, and many other variables are simply unclear. Accordingly,
20 estimates of the potential cost of the project are highly variable. As these sources
21 of variability continue to be investigated and reduced, the project uncertainty
22 decreases; likewise, so does the variability and estimates of the project cost. This
23 phenomenon, widely discussed in the literature, and often associated with author
24 Steve McConnell, is known as the “Cone of Uncertainty” . . . (Emphasis
25 supplied).²⁴⁸

²⁴⁵ (AVISTA/1701, Kensok/7, lines 6-15)

²⁴⁶ (Id., at page 6, lines 23-25)

²⁴⁷ (AVISTA/1702)

²⁴⁸ (AVISTA/1702, Kensok/37, 38)



1

2 This “Cone of Uncertainty” was also depicted at page 16 of Mr. Kensok’s testimony.²⁴⁹

3 As shown above, the preliminary initial estimate was \$79 million during the initial project

4 assessment phase. At that point, the variability in the estimate of project costs could have ranged

5 as high as “two-times the budget that was estimated at that point, or a total of \$157.8 million,” as

6 explained by Mr. Kensok.²⁵⁰ Next, in May of 2014, the Company’s budget was revised to \$98.6

7 million after the detailed designs were completed (and, again, the degree of variability that could

8 have been assigned to the predicted final cost at that point could have been expected to be about

9 10% - for a total cost of \$108.5 million).²⁵¹ The final cost of the project was approximately \$107

10 million when implemented.²⁵² Simply put, it is to be expected that initial budget estimates for a

11 project of this size and scope would be subject to revision as the project was refined and designs

12 were completed. Certainly the end result was not unreasonable.

²⁴⁹ (AVISTA/1700, Kensok/16)

²⁵⁰ (*Id.* at page 16, lines 18-26)

²⁵¹ (*Id.* at page 17, lines 1-9)

²⁵² (*Ibid.*)

1 In its June 2014 report titled “Revised Timeline And Budget Forecast – Avista’s Project
2 Compass,” (AVISTA/1703, Kensok/7-8), some of the factors influencing the complexity of the
3 project were explained:²⁵³

4 While it’s common for a business to install one major system at a time, such as a
5 customer service, financial management, supply chain or asset management system, the
6 Company is installing two major systems simultaneously (CC&B and Maximo Asset
7 Management). Avista is required to implement both new applications because our Legacy
8 system contains a customer service module and work and asset management module that
9 are highly integrated, mainframe-based, and both in need of replacement. As described
10 above, this effort requires not only that these two systems be custom integrated, but that
11 together, they be integrated with the approximately 100 other applications and systems
12 required to perform the Company’s integrated business operations.
13

14 Not surprisingly, the ultimate complexity of the project, and the resulting effort to complete,
15 were greater than initially estimated.²⁵⁴

16 **C. Avista Was Prudent In Managing Its Relationship With Five Point.**

17 As noted, Mr. Gomez was critical of Avista’s management of one of its vendors – Five
18 Point. Five Point was hired by the Company in June of 2011, to provide support in the areas of
19 documenting Avista’s system requirements used in the Request for Proposals process for
20 selecting the new computer applications and key installation vendors, and assisting in the review
21 of proposals.

22 Nevertheless, Mr. Gomez imagined that a “conflict of interest” somehow arose when
23 Five Point acquired EP2M, inferring that the Company’s vendor selection and contracting
24 processes may have been negatively impacted as a result. He appears to erroneously assume that
25 Five Point was somehow involved in the contract negotiations between Avista and EP2M. That
26 is simply not the case. Avista’s employee team was in these negotiations to select vendors – not

²⁵³ (See AVISTA/1703, Kensok/7, 8, 14).

²⁵⁴ Mr. Kensok cited two examples of added complexity and effort: First the need to upgrade the version of the Company’s ARC GIS (computer mapping) application to provide Maximo data compatibility, and the added coding for substantial extensions required to support the Company’s comfort-level-billing and credit and collections activities. (AVISTA/1703, Kensok/13).

1 Five Point.²⁵⁵ Moreover, as noted above, the Company first learned of the acquisition by Five
2 Point of EP2M several months after its decision to select EP2M as a contractor. In any event, the
3 Company’s customers were protected from any potential conflict of interest by the “rigorous and
4 objective processes established for developing vendor proposals, evaluating and scoring
5 proposals, making final vendor selections, and in negotiating the final contracts, purchase
6 agreements and purchase prices,” as testified to by Mr. Kensok.^{256/257/258} Nowhere did Mr.
7 Gomez challenge or otherwise dispute the actual vendor selection processes used and
8 documented by Avista or otherwise assert that these processes were less than comprehensive and
9 objective.²⁵⁹

10 At the end of the day, we are only left with Mr. Gomez’s sheer speculation about any
11 potential conflict of interest. The evidence of record belies that. The ultimate evaluation and
12 selection of EP2M by Avista was made on the merits, without any undue influence of a third
13 party.

14 **D. The Actions of Five Point Were Not the Primary Cause for Revised Project Costs or**
15 **Delays.**

16 Mr. Gomez claimed that the performance of Five Point was the “primary contributor” to
17 the additional time and costs required to successfully complete the project.²⁶⁰ Company Witness
18 Kensok explained why that was not the case. The greater complexity of the project, and the
19 associated increased effort, required more time for many different Avista employee teams and
20 project vendors – not just Five Point – to complete their work.²⁶¹ Five Point was not even

²⁵⁵ (AVISTA/1700, Kensok/13, line 8)

²⁵⁶ (Id., page 13, lines 11-14)

²⁵⁷ See AVISTA/1702, Kensok/27-36 for comprehensive description of these processes.

²⁵⁸ Over 81 pages in the attachments to the Company’s 2013 report “Overview of Avista’s Project Compass” (AVISTA/1702, Kensok), were devoted to describing the process documentation, including information such as rating criteria, weightings, scores and Avista’s team selections.

²⁵⁹ (AVISTA/1700, Kensok/13, line 19 - /14, line 1)

²⁶⁰ (STAFF/304, Johnson/1, lines 8-11)

²⁶¹ (AVISTA/1700, Kensok/22, lines 6-8)

1 involved at all with the several activities that required the extension to February 2015 for
2 completion:

3 The remaining four activities, Field Activities, Meter Data Synchronization,
4 Maximo Data Conversion, and ARC GIS 10.2 Upgrade, did not require the
5 participation of Five Point in any way. The progress made on these activities was
6 not impacted by, or dependent on the performance of Five Point. And, in addition,
7 these four activities, which did not involve Five Point, required more time and
8 budget to complete than the original estimate, and were not ready for
9 implementation on the original Go-Live date in July 2014.²⁶²

10 In the final analysis, as explained by Mr. Kensok, the “additional time and cost required to
11 complete the project were not primarily due to the performance of Five Point, alone.”²⁶³

12 **E. The Company Was Prudent in Retaining Five Point and Ernst & Young to**
13 **Complete the Project.**

14 It was Mr. Gomez’s facile assertion, arrived at without the benefit of a true understanding
15 of the dynamics of the Project, that the Company should have immediately ceased payments to
16 Five Point under its contract when it first noted that Five Point was not completing its
17 deliverables according to the schedule.²⁶⁴ In doing so, Mr. Gomez believed this would have
18 forced Five Point to meet its deliverables schedule and thereby avoid the need to extend the
19 timeline and budget.²⁶⁵

20 Five Point was not alone among the major contractors working with Avista on this
21 Project. Avista worked with all of its contractors and entered into revised contracts and change
22 orders with the majority of its vendors as the project developed. That was to be expected as the
23 scope of the work became better defined.²⁶⁶ Indeed, Mr. Kensok provided a list of change
24 requests showing increased costs for 25 of the contract companies who supported Project

²⁶² (AVISTA/1701, Kensok/21, lines 17-26)

²⁶³ (Id., at page 22, lines 6-7)

²⁶⁴ (STAFF/304, Johnson/5)

²⁶⁵ (AVISTA/1701, Kensok/23, lines 3-7)

²⁶⁶ (AVISTA/1701, Kensok/27, lines 11-15)

1 Compass; Five Point was not alone in that regard.²⁶⁷ And yet, Mr. Gomez singled out only the
2 performance of Five Point. In doing so, he conjures up arguments over “conflict of interest” that
3 are not supported by evidence.

4 With reference to Five Point, in particular, Avista worked closely with Five Point to
5 “cure” any performance problems (in the same manner as it did with other vendors). As explained
6 by Mr. Kensok, Five Point added staff to its complement of code developers, and Avista and Five
7 Point worked together to improve the processing time being required to complete activities,
8 particularly in the area of defect remediation. Moreover, at the Company’s request, Five Point
9 replaced its project manager, and also moved its key developer to Spokane to work closely with
10 Avista’s employees in reducing the turnaround time for resolving defects.²⁶⁸ Importantly, Avista
11 determined that Five Point had the capability needed to complete the Project, and that the
12 Company was able to work successfully with them to optimize the completion of tasks.²⁶⁹

13 What is undisputed is that the replacement of Five Point would have put Project Compass
14 further behind schedule. And Mr. Gomez did not contest this point. As noted by Mr. Kensok,
15 compared with a decision to continue the project with Five Point, the Committee concluded that
16 any alternative action would have seriously delayed the project and added significantly to the
17 final cost. It was estimated that any delay beyond February 2, 2015, would cost upwards of \$3.6
18 million per month.²⁷⁰ In the final analysis, there is simply no evidence in this record that
19 demonstrates that a different decision by the Company would have delivered Project Compass
20 more quickly, more successfully, or at a lesser cost.

²⁶⁷ (Id. at page 28)

²⁶⁸ (Id. at page 24, lines 1-8)

²⁶⁹ (Id. at page 26, lines 1-5)

²⁷⁰ (Id., at page 26, lines 25-29)

1 **F. Bonuses Paid to Company Employees Were Prudent, Based on a Very Successful**
2 **Effort in Implementing Project Compass.**

3 Finally, Mr. Gomez recommended (as does Staff Witness Johnson) that the bonus
4 amounts paid to Avista employees should not be recovered by the Company. Mr. Kensok
5 described the rationale for the bonus plan²⁷¹ that recognized the significant challenge and effort
6 required to complete Project Compass and the substantial and sustained contribution required of
7 employees over a period of approximately two years. Indeed, when the timeline was extended, it
8 required our employees to maintain the additional high level of intensity through the February
9 2015 implementation date. According to Mr. Kensok, the “continuity that comes with retaining
10 the same employees over a multi-year period, on an effort as complex as Project Compass,
11 warrants a bonus plan to help encourage employees to stay with the Project to the end.”²⁷²

12 It is important to note that this bonus plan²⁷³ was based on objective and measurable
13 benchmarks established at the beginning of the Project. Moreover, the plan was audited by the
14 Company’s internal audit group, and approved by the Company’s senior executives and the
15 Board of Directors. The Executive Steering Committee authorized bonuses being paid based on
16 achievement of defined project benchmarks as required in the plan.²⁷⁴

17 In the end, bonus compensation was appropriate to provide to employees in recognition
18 of their sustained and difficult efforts – many of whom left their assigned jobs to work full time
19 on this project for more than two years. There is no reasonable basis for a disallowance of these
20 costs.

²⁷¹ (AVISTA/1700, Kensok/25, lines 15-19)

²⁷² (Id. at page 25, lines 19-22)

²⁷³ (AVISTA/1701, Kensok/29, lines 18-25)

²⁷⁴ (Id., at page 30, lines 8-9)

1 **VI. THE COMMISSION SHOULD ACCEPT THE COMPANY'S LRIC AND**
2 **RESULTING RATE SPREAD RECOMMENDATIONS**

3 The Company has prepared a Long Run Incremental Cost of Service Study (LRIC) as
4 sponsored by Company Witness Miller.²⁷⁵ Company Witness Ehrbar, in turn, made use of the
5 LRIC Study, in developing the Company's rate spread recommendations.²⁷⁶

6 **A. Each of the LRIC Studies Provide Similar Results in Support of the Proposed Rate**
7 **Spread.**

8 In this case, the Commission has before it not one – but three – long-run incremental cost
9 of service studies prepared by the Company, the Staff and NWIGU. (CUB did not present a
10 study, as will be discussed below.) As testified to by Company Witness Miller, the results of the
11 three independent long-run incremental cost studies provide “consistent and compelling results,”
12 which demonstrate that, at current rates, both residential customers (Schedule 410) and small
13 commercial customers (Schedule 420) are paying less than their relative cost of service.
14 Conversely, while large general (Schedule 424), interruptible (Schedule 440), seasonal
15 (Schedule 444), and transportation (Schedule 456) customer groups exceed their relative cost of
16 service, all to varying degrees.^{277/278}

17 The Company's LRIC Study has evolved over the past several years in a manner that
18 prompted Staff Witness Compton to observe, “Over the years Avista Utilities' (Avista or
19 Company) practices relating to my areas of responsibility [LRIC] have evolved in a mutually
20 acceptable manner – being influenced by various parties, including Staff.”²⁷⁹ Indeed, in the
21 previous two general rate filings of Avista, the Company has made additional refinements that

²⁷⁵ (See AVISTA/1800, Miller)

²⁷⁶ (See AVISTA/1900, Ehrbar)

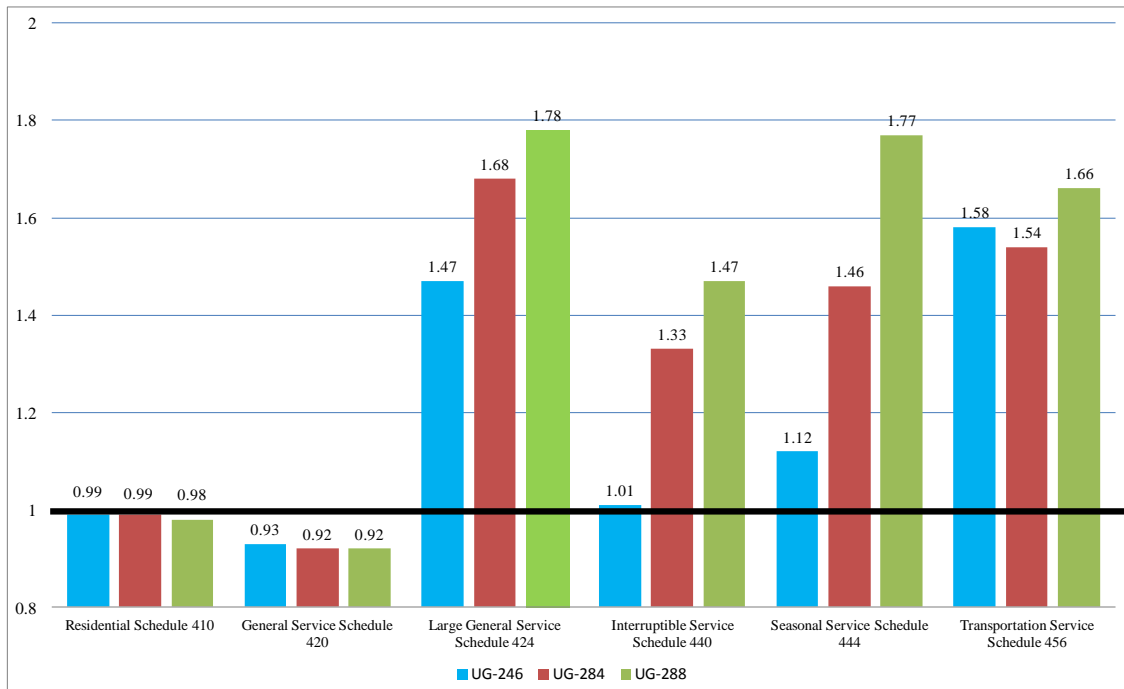
²⁷⁷ (AVISTA/1800, Miller/1, lines 16-22)

²⁷⁸ As explained by Company Witness Miller, a long-run incremental cost of service study is an engineering-economic study which estimates the incremental and annual cost of providing natural gas service to customers segregated into groups by rate schedule. When applied to current results of operations, the study indicates the adequacy of current rates compared to costs. The study provides a guideline for helping inform the appropriate rate spread among rate schedules. (AVISTA/1800, Miller/2, lines 5-10)

²⁷⁹ (STAFF/1300, Compton/2, lines 7-9)

1 were the subject of agreed-upon conditions in the filed Settlement Agreements. Company
 2 Witness Miller discusses the changes to the LRIC that were agreed to by the parties in Docket
 3 No. UG-246, as well as more recently in Docket No. UG-284.²⁸⁰ The following illustration,
 4 excerpted from the testimonies of Company Witnesses Miller and Ehrbar, shows the margin-to-
 5 cost ratios from the Company’s LRIC studies presented in its last three general rate cases (UG-
 6 246, UG-284 and UG-288)²⁸¹:

7 **Illustration No. 1: Margin-to-Cost Ratios from Avista’s Last Three General Rate Cases**



8
 9
 10 As is evident from this illustration, several schedules have consistently shown margin-to-cost
 11 ratios exceeding unity over the Company’s last three general rate filings.

12 The Company has also compared the results of its LRIC Study, in this case, with that of
 13 Staff and NWIGU (CUB prepared none). These results are contained within Table No. 1
 14 excerpted below from Company Witness Miller’s testimony.²⁸²

²⁸⁰ (AVISTA/1800, Miller/3, line 4 – /4, line 3)

²⁸¹ (See AVISTA/1800, Miller/4, lines 10-23)

²⁸² (AVISTA/1800, Miller/6, lines 1-7)

1

Table No. 1: Long Run Incremental Cost Study Results of the Parties

<u>Customer Class</u>	<u>Rate Schedule</u>	<u>Avista</u>	<u>Staff</u>	<u>NWIGU</u>	<u>Staff/NWIGU</u>
Residential	410	0.98	0.98	0.98	0.97
General Service	420	0.92	0.96	0.91	0.95
Large General Service	424	1.78	1.56	2.04	1.79
Interruptible Service	440	1.47	1.31	1.68	1.51
Seasonal Service	444	1.77	1.68	2.32	2.31
Special Contract	447	0.91	0.77	1.64	1.42
Transportation	456	<u>1.66</u>	<u>1.41</u>	<u>1.87</u>	<u>1.59</u>
Total		1.00	1.00	1.00	1.00

2

3

4

5

6

As previously mentioned, CUB did not conduct an independent LRIC Study in this proceeding. As such, it has provided no quantitative analysis in support of its testimony. Rather, it has simply made three general arguments in support of its assertion that the LRIC Study performed by the Company is flawed. These are discussed below:

7

8

(1) CUB Erroneously Suggests that Residential Customers are Not Driving System Upgrades.

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It is CUB’s belief that the increase in capital spending is being largely tied to new infrastructure and growth to serve large customer load growth (Schedules 424, 440, 444, 447 and 456), and that residential customers are not otherwise driving the need for system upgrades.²⁸³ Company Witness Miller explains why this is not the case. In fact, 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. This is demonstrated in the table below, excerpted from Mr. Miller’s testimony.²⁸⁴

²⁸³ (AVISTA/1900, Miller/9, lines 7-10)

²⁸⁴ (AVISTA/1800, Miller/9, lines 13-16)

Table No. 3: Summary of Capital Transfers to Plant Included in this Docket:

<u>Plant Category</u>	<u>Investment (‘000’s)</u>	<u>Percent of Total</u>
Distribution Growth Plant	\$ 6,843	14%
Distribution Plant *	25,452	53%
General Plant/IT	7,712	16%
<u>Compass</u>	<u>8,300</u>	<u>17%</u>
Total	48,307	100%

* Distribution Plant includes reinforcements, safety, pipe replacement, mandated work and storage

In fact, the primary drivers of customer growth from 2014 to 2016 are new residential (Schedule 410) and small commercial (Schedule 420) customer hookups.²⁸⁵ Moreover, large commercial and industrial load is responsible for only a very small portion of increased capital spending as shown in Table No. 4 below.²⁸⁶

Table No. 4: Forecasted Customer Growth Summary (2014 – 2016)²⁸⁷

<u>Customer Class</u>	<u>Rate Schedule</u>	<u>Customer Growth</u>	<u>Percent of Total</u>
Residential	410	1488	93.4%
General Service	420	102	6.4%
Large General Service	424	3	0.2%
Interruptible Service	440	0	0.0%
Seasonal Service	444	0	0.0%
Special Contract	447	0	0.0%
Transportation	456	<u>0</u>	<u>0.0%</u>
Total		1593	100.0%

Furthermore, CUB’s reference to the “Ladd Canyon Station Upgrade” as an example of how larger customers and their growth are driving increase in system costs, is misplaced. As explained by Company Witness Webb, this upgrade occurred irrespective of the need to serve the incremental load of the asphalt paving company.²⁸⁸

²⁸⁵ (AVISTA/1800, Miller/10, lines 1-12)

²⁸⁶ (Id. at p.10, line 19 – Miller/11, line 3)

²⁸⁷ The new customer growth from 2014 -2016 is derived from the load forecast agreed to in the Partial Stipulation.

²⁸⁸ (AVISTA/1800, Miller/11, lines 15-17)

1 **(2) *CUB is Wrong to Suggest that the Useful Life of Investments are Overstated for***
2 ***Industrial Customers.***

3 CUB argues that, unlike residential customers, “if an industrial customer closes up shop
4 for economic reasons or otherwise, it is not a foregone conclusion that another natural gas
5 customer will be able to utilize the facilities that Avista put in place to serve the prior customer at
6 all.”²⁸⁹ Accordingly, CUB believes that the remaining useful life of plant for industrial customers
7 is overstated. Company Witness Miller, however, explained that scenarios in which an industrial
8 customer has entirely closed operations and no other customer has taken service in its place, are
9 extremely rare.²⁹⁰ Indeed, as explained by Mr. Miller, during the last five calendar years (2010-
10 2014) the Company has only experienced three situations where an industrial customer has
11 completely closed service and no new customer has yet to take service at the same location.²⁹¹
12 Moreover, these three customers were from a universe of over 80 industrial customers, and
13 accounted for only 0.4% of industrial load.²⁹²

14 Nor, for that matter, is the Company forecasting a significant number of industrial
15 customer closures in the next five years. In fact, the Company expects relatively stable customer
16 levels over the next five years for rate schedules 424, 440, 444 and 456 as shown in the
17 Company’s Load Forecast prepared by Dr. Forsyth.^{293/294} CUB provided no other analysis of
18 what the useful lives of investments should be for industrial customers.

19 To test CUB’s assertion, in this regard, the Company arbitrarily reduced the useful life of
20 its assets by 50% for the Company’s large rate schedules, in order to determine what the effect

²⁸⁹ (CUB/100, McGovern & Jenks/19, lines 18-22)

²⁹⁰ (AVISTA/1800, Miller/13, lines 8-10)

²⁹¹ (Ibid.)

²⁹² (AVISTA/1800, Miller 13, line 12)

²⁹³ (AVISTA/1800, Miller/13, lines 17-19)

²⁹⁴ Dr. Forsyth is in regular communication with the Company’s business managers and account executives in order to assess the Company’s large commercial and industrial customers and the likelihood of material changes relating to their usage and business prospects. All known material changes are then incorporated in the forecasts prepared by Dr. Forsyth. (AVISTA/1800, Miller/13, line 19 - /14, line 3)

1 would be on its LRIC study results.²⁹⁵ Its analysis demonstrated that, even reducing the useful
2 lives of assets by as much as 50%, still supports the Company's rate spread proposal.²⁹⁶

3 **(3) *CUB Erroneously Suggests that the Company's LRIC Study Does Not Reflect***
4 ***an Accurately-Sized System.***

5 CUB suggests that the LRIC Study should not be based on the current costs of the current
6 system, but should look at the forward-looking cost of a new system that is sized to meet current
7 customers' natural gas requirements.²⁹⁷ For reasons explained by Company Witness Miller, this
8 is incorrect. Any LRIC Study should be based on the replacement cost of the actual facilities that
9 will be reflected in the Company's revenue requirements; that is to say, it should reflect the
10 actual marginal replacement costs that the Company expects to incur in the future, rather than a
11 hypothetical replacement of the entire system.²⁹⁸ It is, after all, the system that is in place today
12 that will largely be in place for the foreseeable future. As noted by Company Witness Miller, it is
13 nonsensical to base costs on a hypothetical system that will not, and could not, occur in the
14 future.^{299/300} Here again, beyond proffering a hypothetical argument, CUB provides no
15 quantitative analysis that would assist the Commission in its assessment of the LRIC Studies
16 offered by other parties.

17 **B. The Company's Proposed Rate Spread Makes Necessary Progress Toward**
18 **Achieving Unity.**

19 The Company used the results of the LRIC Study sponsored by Mr. Miller as a "guide" to
20 spread the proposed margin/revenue increase by service schedule. It did so in a manner that
21 results in the margin-to-cost ratios for the various service schedules moving approximately 50%

²⁹⁵ (See Table No. 5: LRIC Margin-to-Cost Ratios, at AVISTA/1800, Miller 15, lines 1-9)

²⁹⁶ (AVISTA/1800, Miller/15, lines 10-12)

²⁹⁷ (Id. at page 15, lines 17-21)

²⁹⁸ (AVISTA/1800, Miller/16, lines 4-7)

²⁹⁹ (AVISTA/1800, Miller/16, lines 7-12)

³⁰⁰ CUB, itself, even seems to acknowledge this when it states, "This line of inquiry may be dismissed as irrelevant because the Company cannot feasibly scratch the entire system and start anew." (CUB/100, McGovern-Jenks/23, lines 3-4)

1 closer to unity (1.00). The following table summarizes the proposed rate spread on both a
 2 margin, and total revenue basis for the Company’s originally-filed revenue increase proposal of
 3 \$8.557 million:³⁰¹

4 **Table No. 1:**

Proposed % Natural Gas Increase by Schedule

Rate Schedule	Increase in Margin Revenue	Increase in Total Revenue
Residential Schedule 410	17.0%	8.9%
General Service Schedule 420	21.4%	9.5%
Large General Service Schedule 424	-7.0%	-1.3%
Interruptible Service Schedule 440	0.0%	0.0%
Seasonal Service Schedule 444	-7.0%	-1.5%
Transportation Service Schedule 456	-7.0%	-6.9%
Overall	16.1%	8.0%

5
 6
 7 The excerpted table below also shows the effect on the margin-to-cost ratios from the proposed
 8 rate spread:³⁰²

9 **Table No. 2:**

Present and Proposed Margin-to-Cost

	<u>Margin-to-Cost at Present Rates</u>	<u>Margin-to-Cost at Proposed Rates</u>
Residential Schedule 410	0.98	0.99
General Service Schedule 420	0.92	0.96
Large General Service Schedule 424	1.78	1.43
Interruptible Service Schedule 440	1.47	1.26
Seasonal Service Schedule 444	1.77	1.41
Transportation Service Schedule 456	1.66	1.33
Overall	1.00	1.00

10
 11

³⁰¹ (AVISTA/1900, Ehrbar/2, lines 10-15)

³⁰² (Id. at p.3, lines 2-8)

1 As previously discussed, and as shown in the table below, the margin-to-cost ratios for all of the
2 Service Schedules have continued moving further away from unity over the Company’s last
3 three general rate cases.³⁰³ Accordingly, now is the time to address this issue.

4 **Table No. 3: Margin-to-Cost Ratios from Avista’s Last Three General Rate Cases**

Rate Schedule	UG-246	UG-284	UG-288
	<u>Margin-to-Cost</u>	<u>Margin-to-Cost</u>	<u>Margin-to-Cost</u>
Residential Schedule 410	0.99	0.99	0.98
General Service Schedule 420	0.93	0.92	0.92
Large General Service Schedule 424	1.47	1.68	1.78
Interruptible Service Schedule 440	1.01	1.33	1.47
Seasonal Service Schedule 444	1.12	1.46	1.77
5 Transportation Service Schedule 456	1.58	1.54	1.66

6
7 Given these results, the Company believes that a 50% movement toward unity is reasonable at
8 this time, and will help to more closely align rates with costs.

9 While CUB objects to any schedule receiving a rate decrease, while other schedules
10 receive increases, there is a sound basis for doing so under these circumstances. The Company
11 recognizes that this Commission, in its Order No. 15-109, at page 5, in Docket No. UG-284
12 recently stated:

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

20 Mr. Ehrbar, on behalf of the Company, explains why “compelling evidence” does exist in this
21 case, however, that warrants rate reductions for certain schedules. As explained above, the
22 Company’s LRIC studies over the past three general rate cases have consistently shown margin-

³⁰³ (Id. at p.4, lines 14-19)

1 to-cost ratios that are continuing to move away from (not toward) unity.³⁰⁴ Accordingly, without
2 Commission support for rate reductions for certain schedules in this case, the rates charged to
3 those schedules will continue to be misaligned based on all three LRIC studies filed in this case.
4 In all three studies (Avista/Staff/NWIGU), similar margin-to-cost ratios were calculated. This
5 was not true in Docket No. UG-284 where the Commission only had before it the Company’s
6 LRIC Study, unsubstantiated by the work of others. Moreover, CUB did not present an LRIC
7 Study in this case contravening the work of Staff, NWIGU or the Company. Accordingly, in this
8 proceeding there is, in fact, substantial and compelling evidence to support rate reductions for
9 certain schedules.³⁰⁵

10 NWIGU in this case supports the Company’s proposed margin revenue allocation, “since
11 it makes a gradual movement to cost-based rates and doesn’t subject any class to rate shock.”³⁰⁶
12 Staff’s rate spread proposal is also very similar to the Company’s rate spread, as explained by
13 Mr. Ehrbar.³⁰⁷

14 The Company does take issue, however, with Staff’s proposal that rate reductions for
15 certain schedules should be limited to no more than a negative 4%.³⁰⁸ The evidence in this case
16 supports rate reductions for certain schedules, providing an appropriate movement toward
17 unity.³⁰⁹

³⁰⁴ (AVISTA/1900, Ehrbar/5, lines 21-23)

³⁰⁵ Furthermore, this Commission has in the past approved rate reductions for certain rate schedules, while otherwise increasing rates for other schedules. It did so in Avista’s 2007 general rate case (Docket No. UG-181) and in its 2013 general rate case (Docket No. UG-246). And, it has done so, with respect to other jurisdictional utilities. In Northwest Natural’s 2012 General Rate Case (Docket No. UG-221), the Commission approved a settlement stipulation that increased base rates for residential and small commercial customers, while providing for a 5% base rate decrease for larger firm and interruptible sales and transportation customers. (AVISTA/1900, Ehrbar/6, lines 15-18) The same held true in Docket No. UE-246, Pacific Power’s 2012 General Rate Case, in which the Commission approved a settlement whereby residential customers received an increase while pumping, small general service, and lighting customers received rate decreases between 4.9%, and 7.0%. (See Docket No. UE-246, Order No. 12-493, Appendix A, p.25)

³⁰⁶ (NWIGU/100, Collins/5, lines 9-11)

³⁰⁷ (AVISTA/1900, Ehrbar/7, line 16 - /8, line 2)

³⁰⁸ (See STAFF/1300, Compton/17)

³⁰⁹ (See AVISTA/1900, Ehrbar/8, lines 7-8)

1 Avista also takes issue with CUB’s assertion that “customers under Schedule 410 pay for
2 98% of their own cost of service [and] this is pretty close to paying exactly the amount that the
3 study says customers should pay.”³¹⁰ It should be remembered, however, that Schedule 410
4 customers provide 65.8% (\$34.9 million) of Avista’s total margin revenue, and Schedule 420
5 customers provide 25.7% (\$13.6 million). Combined, these two Schedules make up 91.5% of
6 total margin revenue (\$48.5 million), and, as explained by Mr. Ehrbar, based on the three LRIC
7 Studies, both Schedules are paying less than their relative cost of service.³¹¹ To put this in
8 perspective, if one were to arbitrarily re-spread even 1% of these Schedules’ margin revenue to
9 all of the other rate schedules, a total of \$485,000 would be reassigned. This would increase rates
10 for Schedules 424, 440, 444, and 456 by 10.7%.³¹² Therefore, even with Schedules 410 and 420
11 being relatively close to unity on a percentage basis, this small percentage below unity can result
12 in significant impacts to customers on other schedules.

13 CUB also incorrectly asserts that Schedule 456 transportation customers are overpaying
14 by only 3%.³¹³ In reaching this conclusion, CUB incorrectly imputes a cost of wholesale natural
15 gas and interstate pipeline transportation to only Schedule 456. CUB then compares the
16 Schedule 456 imputed revenue to only the margin/distribution revenue provided by the other rate
17 schedules. This is not, however, an apples-to-apples comparison because the non-Schedule 456
18 customers do not also have imputed wholesale natural gas and interstate pipeline transportation
19 costs. As explained by Mr. Ehrbar, to compare “an estimated total revenue for one schedule to
20 the margin revenue of the other schedules, and using that comparison for purposes of
21 determining whether or not Schedule 456 is paying their cost of service is completely

³¹⁰ (CUB/100, McGovern-Jenks/26, lines 9-11)

³¹¹ (AVISTA/1900, Ehrbar/8, lines 12-18)

³¹² (*Ibid.*)

³¹³ (CUB/100, McGovern-Jenks/31, line 3)

1 inappropriate.”³¹⁴ Furthermore, CUB’s analysis is flawed because the rates being set in this case
2 are only related to distribution service; whether customers procure their own gas or have it
3 otherwise provided to them by Avista, is completely irrelevant for purposes of determining how
4 distribution system costs should be recovered from customers.³¹⁵

5 CUB also expressed concern with respect to pipeline capacity release revenue, asserting
6 that Avista is not properly allocating capacity release revenue to its service schedules.³¹⁶ CUB is
7 obviously confusing the costs and revenues associated with interstate pipeline capacity and
8 distribution system capacities. The Company simply does not release to other parties capacity on
9 its distribution system.³¹⁷ In off-peak times, Avista does release its contracted for capacity on
10 interstate pipelines, doing so for the benefit of all customers. The costs associated with interstate
11 pipeline capacity are allocated to customers on a per-therm basis in the PGA and the revenue
12 similarly is allocated on a per-therm basis. It is this fundamental misunderstanding of capacity
13 release revenue which apparently “informs CUB’s recommended rate spread.”³¹⁸

14 CUB’s analysis comparing the rates of Avista’s Oregon customers to rates of Avista’s
15 Washington and Idaho customers is also wrong. One cannot simply compare the rates, cost of
16 service results, or other state-specific rate-making components to another state, given the unique
17 service characteristics in each jurisdiction.³¹⁹ As an example, as explained by Mr. Ehrbar, in
18 Washington the average use-per-customer for a residential customer is 68 therms per month,
19 while in Oregon the average is 46 therms. Accordingly, in Washington there is simply a higher
20 level of billing determinants to spread the Company’s costs over, which results in lower rates.

³¹⁴ (AVISTA/1900, Ehrbar/9, lines 14-17)

³¹⁵ (Id., lines 18-21)

³¹⁶ (CUB/100, pp. 31-32)

³¹⁷ (AVISTA/1900, Ehrbar/11, lines 8-10)

³¹⁸ (CUB/100, p.32, lines 16-18)

³¹⁹ (AVISTA/1900, Ehrbar/12, lines 2-9)

1 Finally, the Company disagrees with CUB’s arbitrary proposal whereby “no customer
 2 gets any more than three times the increase of any other class.”³²⁰ Mr. Ehrbar testified to the
 3 arbitrary nature of such a proposal, noting that it is not based on a cost of service/LRIC Study.³²¹
 4 Indeed, the effects of such a rate spread would actually move Schedule 456 from 1.66 to 1.74 on
 5 a relative margin-to-cost ratio – even further away from unity, as explained by Mr. Ehrbar.³²²

6 By way of summary, the following table provides the spread of the Company’s revised
 7 revenue requirement (\$6.7 million) for each service schedule.^{323/324}

8 **Table No. 4:**

Rate Schedule	Reply Revenue Request	Revenue % Change (Margin)	Revenue % Change (Revenue)
Residential Schedule 410	\$4,697	13.7%	7.2%
General Service Schedule 420	\$2,312	17.1%	7.6%
Large General Service Schedule 424	(\$46)	-7.0%	-1.3%
Interruptible Service Schedule 440	\$0	0.0%	0.0%
Seasonal Service Schedule 444	(\$3)	-7.0%	-1.5%
Transportation Service Schedule 456	(\$219)	-7.0%	-6.9%
Overall	\$6,741	12.9%	6.4%

9
10

³²⁰ (CUB/100, p.43, lines 6-8)

³²¹ (AVISTA/1900, Ehrbar/13, lines 1-2)

³²² (Id. at p. 13, lines 2-4)

³²³ (AVISTA/1900, Ehrbar/14, lines 15-20)


³²⁴ It is Avista’s expectation that further rate decreases would not be necessary in the near future for certain schedules, were the Commission to approve the Company’s rate spread proposal in this case. Such an approval will allow the Company to make meaningful progress toward moving all schedules toward unity. Additional progress can be made through the application of either greater or lesser rate (including zero) increases in future proceedings. (AVISTA/1900, Ehrbar/14, line 23 - /15, line 4)

1 **VII. CONCLUSION**

2 For the foregoing reasons, Avista respectfully urges the Commission to approve the
3 requested rate relief, after giving effect to the terms of the Partial Settlement Stipulation. The end
4 result will produce rates that are just, reasonable and sufficient.

5 RESPECTFULLY SUBMITTED this 23rd day of November, 2015.

6 AVISTA CORPORATION
7
8
9

10 By:  _____
11 David J. Meyer
12 VP, Chief Counsel for Regulatory and
13 Governmental Affairs

ROE ANALYSES

Schedule AMM-1

Page 1 of 2

SUMMARY OF RESULTS

	<u>Gas Group</u>		<u>Combination Group</u>	
	<u>Average</u>	<u>Midpoint</u>	<u>Average</u>	<u>Midpoint</u>
DCF				
Value Line	10.3%	10.7%	10.0%	10.1%
IBES	9.5%	10.3%	9.1%	9.2%
Zacks	8.6%	8.9%	9.0%	9.2%
Internal br + sv	9.5%	10.3%	8.5%	9.2%
Empirical CAPM - Current Bond Yield				
Unadjusted	10.1%	10.0%	9.8%	9.9%
Size Adjusted	11.6%	11.7%	10.6%	10.6%
Empirical CAPM - Projected Bond Yield				
Unadjusted	10.4%	10.3%	10.0%	10.2%
Size Adjusted	11.8%	11.8%	10.9%	10.8%
Utility Risk Premium				
Current Bond Yields	10.1%		--	
Projected Bond Yields	11.3%		--	
	<u>Cost of Equity Recommendation</u>			
Cost of Equity Range		9.5%	--	10.8%
Flotation Cost Adjustment				
Dividend Yield		3.2%		3.2%
Flotation Cost Percentage		<u>3.6%</u>		<u>3.6%</u>
Adjustment		0.1%		0.1%
Recommended ROE Range		9.6%	--	10.9%