BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 325

In the Matter of	)
	)
AVISTA CORPORATION, dba	)
AVISTA UTILITIES,	)
	)
Request for a General Rate Revision.	)
	)

OPENING TESTIMONY OF MICHAEL P. GORMAN

ON BEHALF OF

NORTHWEST INDUSTRIAL GAS USERS ("NWIGU")

March 1, 2017

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017. I am employed by the firm of Brubaker & Associates, Inc. ("BAI"), regulatory and economic consultants with corporate headquarters in Chesterfield, Missouri. My qualifications are provided in NWIGU Exhibit No. 101.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. I am testifying on behalf of Northwest Industrial Gas Users ("NWIGU"). NWIGU members include diverse industrial and commercial interests that purchase sales and transportation services from Avista Corporation dba Avista Utilities ("Avista" or the "Company").

Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY?

A. Yes. I am sponsoring NWIGU Exhibit No. 101 through NWIGU Exhibit No. 103.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. In my testimony, I will address two issues. First, I will address the Company's claimed revenue deficiency of $8.5 million for its Oregon retail operations. Second, I will address the Company's proposed spread of the revenue increase across rate classes, in relationship to its class cost of service study. The Company proposes a class cost of service study based on a Long-Run Incremental Cost of Service Study ("LRIC Study") and gas margin revenue allocation.

The fact that I do not address other issues should not be interpreted as tacit approval of the Company's position or those of other parties.

Q. PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS CONCERNING THE COMPANY'S CLAIMED REVENUE DEFICIENCY.

A. The Company's claimed revenue deficiency is overstated by at least $1.08 million for the reasons described below. Other parties may propose adjustments to the Company's revenue deficiency that should be considered. As such, the Commission should not construe my adjustments to the Company's revenue requirement as acceptance of all positions which I have not addressed.

Q. PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS CONCERNING THE COMPANY'S PROPOSED SPREAD OF THE REVENUE DEFICIENCY ACROSS RATE CLASSES.

A. My findings and conclusions concerning the Company's proposed spread of the revenue deficiency are summarized as follows:

1. Though distribution rates based on a modified LRIC Study that allocates system main costs to classes on a design day demand basis would properly move all class distribution rates to cost of service, NWIGU supports the Company's proposed class margin revenue allocation since it makes a gradual movement to cost based rates for all classes and does not subject any one class to rate shock.

2. While I support the Company's proposed spread of the revenue deficiency in this case, I do not support its class cost of service study. For the reasons outlined below, I believe the class cost of service study under-allocates costs to the Residential and General Service classes, and over-allocates costs to higher load factor classes such as the Large General Service and Transportation classes.

Q. PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS CONCERNING THE COMPANY'S CLASS COST OF SERVICE STUDY.

A. My findings and conclusions concerning the Company's class cost of service study are summarized as follows:

1. The results of the Company's LRIC Study indicate that the current distribution rates, on a relative margin-to-cost basis, for several classes result in those classes paying more than their respective allocated cost of service and, therefore, are deserving of a decrease in current distribution revenues.

2. If system main costs were allocated on a design day demand basis as opposed to the peak and average basis as recommended by the Company, the LRIC Study would

indicate that certain classes are even further away from cost of service than the Company's LRIC Study results indicate.

II. REVENUE REQUIREMENT ISSUES

Q. PLEASE DESCRIBE THE COMPANY'S CLAIMED REVENUE DEFICIENCY IN THIS PROCEEDING.

A. The Company's claimed revenue deficiency is summarized in the direct testimony of Jennifer S. Smith. As shown on Ms. Smith's Exhibit No. 501, page 2, the Company is requesting an increase in Oregon non-gas revenues of $8.5 million. The issues I take with the Company's claimed revenue deficiency are shown below in Table 1.

TABLE 1

Revenue Requirement Issues
($000)

Description	Amount
Claimed Deficiency	$8,539
Adjustments:	
Rate of Return	$971
Restricted Stock Units	$109
Total Adjustments	$1,080

As shown in the table above, the Company's claimed revenue deficiency of $8.539 million is overstated by at least $1.080 million. This overstatement is due to the issues described in the table above. Each of these issues will be described below.

While the issues outlined in Table 1 above address the Company's claimed revenue deficiency, I am not presenting this as an exhaustive list of all reasonable adjustments to the Company's claimed revenue deficiency. Other parties may propose adjustments that are reasonable and my limitation for addressing specific issues of this proceeding should not be interpreted as acceptance of the Company's revenue requirement adjustments other than those listed in my testimony.

Q. PLEASE DESCRIBE YOUR PROPOSED ADJUSTMENT TO THE COMPANY'S REQUESTED RATE OF RETURN.

A. The Company's requested rate of return includes a return on common equity of 9.9%. The Company's proposal for this return on equity is a substantial increase to the 9.4% authorized return on equity awarded to Avista in its Oregon jurisdiction just 12 months ago. The Company's request for an increase in its authorized return on equity is simply not justified in this proceeding, and does not reflect the reality that capital market costs have not changed dramatically since Avista's last rate case.

Q. WHAT WILL BE THE IMPACT ON AVISTA'S REVENUE REQUIREMENT IF THE AUTHORIZED RETURN ON EQUITY WAS MAINTAINED AT 9.4% CONSISTENT WITH AVISTA'S LAST OREGON NATURAL GAS RATE CASE?

A. As shown on my NWIGU Exhibit No. 102, adjusting the Company's rate of return to reflect a 9.4% return on equity, consistent with Avista's last rate case, would lower its claimed revenue deficiency by $971,000.

Q. WHY DO YOU ASSERT THAT THE COMPANY'S COST OF CAPITAL HAS NOT CHANGED SINCE ITS LAST RATE FILING?

A. I reached this conclusion based on several facts. First, authorized returns on equity for local distribution companies ("LDC") nationwide have not changed materially in the last four quarters. As shown in Table 2 below, the quarterly average industry authorized returns on equity for LDCs have consistently maintained a level of approximately 9.4% to 9.6%. This is consistent with what the Oregon Commission found to be a reasonable return on equity for Avista in its last rate case, Docket UG 288.

TABLE 2

Natural Gas
Authorized Returns on Equity

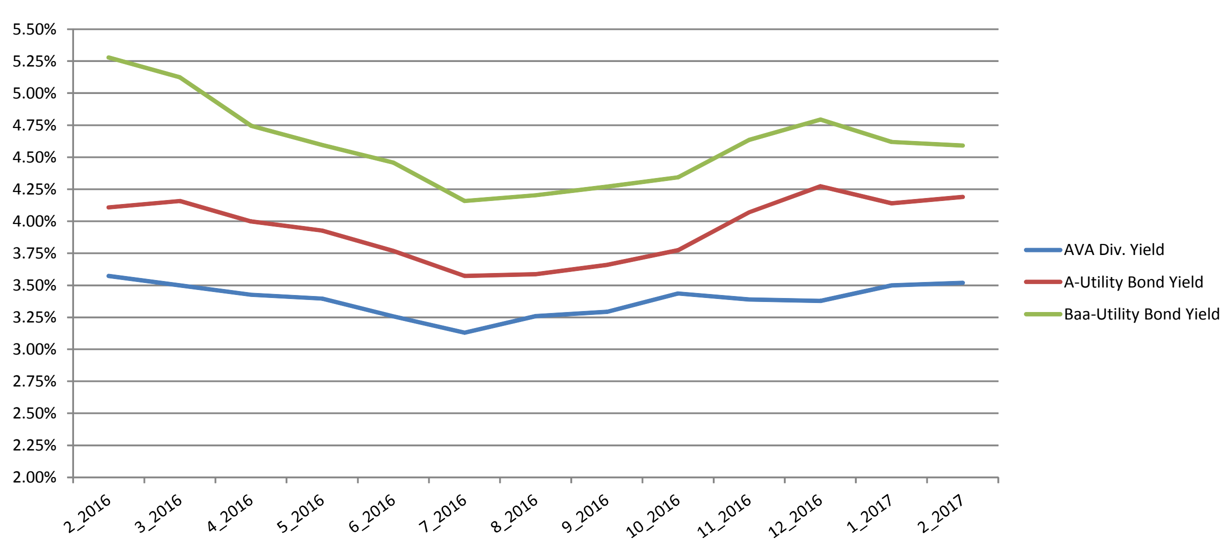
2016	Return on Equity
Q1	9.48%
Q2	9.42%
Q3	9.47%
Q4	9.60%

Source: *RRA Major Rate Case Decisions, Quarterly Update*, January 18, 2017.

Second, observable market evidence clearly shows that capital market costs for utility companies have not increased since Avista's last rate case. This is illustrated in Figure 1 below in a comparison of yields for utility bonds rated "A" and utility bonds rated "Baa" since 2016.

FIGURE 1

Change in Yields Since Avista Oregon's Last Gas Rate Case



As this graph clearly illustrates, observable market evidence shows that capital costs for utilities have not materially changed since Avista was last awarded a 9.4% return on equity.

III. RESTRICTED STOCK UNITS

Q. DID THE COMPANY INCLUDE INCENTIVE COMPENSATION FOR EXECUTIVES IN ITS CLAIMED REVENUE DEFICIENCY?

A. Yes. The Company included restricted stock unit ("RSU") costs in its claimed revenue deficiency. This increased its cost of service in the test year by $109,000.

Q. IS INCLUSION OF RSUs IN THE PROJECTED REVENUE REQUIREMENT REASONABLE?

A. No. RSUs are incentive compensation that are designed to tie the economic interests of shareholders with those of utility employees. Specifically, in Avista Corporation's May 12, 2016 proxy statement, where it sought board and shareholder approval of incentive compensation, it described its RSUs and the objective of them as follows:

> *Restricted Stock Units*
> The company awards RSUs to improve retention and link compensation to the value of the Company common stock. For all NEOs and other executive officers other than our CEO, the vesting of RSUs is time-based, and the RSUs vest and shares are issued in three equal annual increments, provided the executive remains employed by the Company on the last day of each year of the three-year period. Divided equivalents on time-based RSUs accrue and are paid in cash if and when the underlying RSUs vest. If the related RSUs are forfeited, the accrued cash dividends are also forfeited.

The RSU incentive compensation is designed to link employees' and shareholders' economic interests. Linking employees' economic interests with those of shareholders based on share return value creates significant economic incentives for employees to enhance stock price or financial performance of the Company. Financial performance of the Company can be improved by filing rate cases to enhance earnings and cash outlooks for the Company, and seeking rider mechanisms for recovery of certain cost components, all of which are tied to seeking higher compensation from customers to recover the Company's cost of service. Financial improvement is not tied to efficiency improvements alone, but is also largely based on efforts to increase charges to retail customers. For these reasons, the primary beneficiaries of financial performance goals are shareholders and the employees whose economic interests are linked to shareholders.

Because shareholders are the primary beneficiary of the RSU incentive compensation, they should pay the RSU costs. Customers do not specifically benefit by aligning the financial interests of employees with those of shareholders. Rather, shareholders are the primary beneficiary. Therefore, I recommend eliminating the incentive compensation component which is designed to align financial interests of employees with those of shareholders. Short-term incentive compensation goals which align with quality of service or employee safety, on the other hand, do benefit customers. Therefore, I am not proposing to eliminate short-term incentive goals from the Company's cost of service in this proceeding.

IV. PROPOSED REVENUE ALLOCATION

Q. HAVE YOU ALSO REVIEWED THE COMPANY'S PROPOSED CLASS REVENUE ALLOCATION?

A. Yes. I have reviewed Exhibit No. 903 of Company Witness Mr. Patrick Ehrbar's direct testimony which summarizes the Company's proposed class revenue allocation. I have summarized Mr. Ehrbar's analysis of present margin revenue, margin revenue at proposed rates, and cost of service in Exhibit NWIGU/103.

As shown in this exhibit, Mr. Ehrbar's proposed spread of the revenue deficiency in this proceeding largely moves all classes closer to the Company's estimate of cost of service. Importantly, while he does reflect a movement to cost of service, the General Service class is still priced below Mr. Miller's estimated cost of service for this rate class. While he proposes margin revenue for the Residential class that is slightly above his calculated cost of service, if the cost of service study was corrected for the allocation of demand related main costs, it would likely indicate that the Residential class proposed rates are priced below actual cost of service.

Q. DO YOU BELIEVE THAT MR. EHRBAR'S PROPOSED REVENUE SPREAD IN THIS PROCEEDING IS REASONABLE?

A. Yes. While Mr. Ehrbar is proposing to recover the claimed revenue deficiency from the Residential and General Service classes, his proposed spread of that increase is reasonable and consistent with cost of service.

Q. IS IT IMPORTANT TO MOVE CLASSES TOWARD COST OF SERVICE IN RECOVERING A REVENUE DEFICIENCY?

A. Yes.

Q. HOW DO YOU RESPOND TO THE COMPANY'S PROPOSED CLASS MARGIN REVENUE ALLOCATION?

A. Moving class revenue allocations to their respective indicated cost of service would result in class distribution rates that better reflect cost causation for all classes. Distribution rates that reflect cost causation for all customers would send proper price signals to all customer classes. The movement to cost-based rates would also put the Company in a better position to collect each respective class cost of service from all of its customer classes and help to eliminate revenue subsidies between rate classes. That being said, NWIGU recognizes the need to gradually move classes to cost based rates so that no class experiences rate shock. Though the Company's proposed margin revenue allocation does not completely move all rates to cost of service, NWIGU supports the

Company's proposed margin revenue allocation since it makes a gradual movement to cost based rates and does not subject any class to rate shock.

Q. DO YOU AGREE WITH MR. EHRBAR'S ESTIMATED CLASS COST OF SERVICE STUDY IN THIS PROCEEDING?

A. No. While I agree with his proposed spread because it moves classes closer to cost of service, I do take issue with many aspects of the Company's class cost of service study. Importantly, there are corrections to the class cost of service study I believe are necessary, which would also have the effect of showing the Residential and General Service classes are further below cost of service as compared to present margin revenue than what the Company shows. Corrections in the cost of service study would show that Mr. Ehrbar's proposed revenue spread in this proceeding is even more necessary and is reasonable to adjust the Residential and General Service rate schedules to Avista's cost of service.

V. CLASS COST OF SERVICE

Q. HAVE YOU REVIEWED THE RESULTS OF THE LRIC STUDY PERFORMED BY THE COMPANY?

A. Yes, I have reviewed the results of the Company's LRIC Study. The results indicate that the current distribution rates, on a relative margin-to-cost basis, for several classes result in those classes paying more than their respective allocated cost of service and, therefore, are deserving of a decrease in current distribution revenues. This is shown at Company witness Joseph D. Miller's Exhibit No. 801, page 1 of 3. On the basis of relative margin to cost at present rates, the classes whose current distribution rates collect more margin revenue than their proposed cost of service indicates in the Company's cost of service study include Large General Service (Schedule 424), Interruptible Service (Schedule

440), Seasonal Service (Schedule 444), and Transportation Service (Schedule 456). The Company's study also indicates that the current distribution rates paid by the General Service (Schedule 420) class under collects its respective proposed cost of service. The Residential Service class (Schedule 410) is slightly above parity on a relative margin-to-cost basis.

Q. DO YOU DISAGREE WITH ANY ALLOCATION WITHIN THE COMPANY'S LRIC STUDY?

A. I disagree with the Company's proposed allocation of system main related plant investment costs.

Q. PLEASE EXPLAIN YOUR DISAGREEMENT.

A. The Company separated allocated system main related plant investment costs into both capacity-related and commodity-related investment components. The peak and average ratio was used by the Company to separate the system main investment into the respective capacity and commodity components. According to the Company, the peak and average ratio is intended to reflect a balance between the way the system is designed (to meet peak demand) and the way it is utilized on an annual basis (throughput based on gas usage that occurs during all conditions, not only on peak conditions). I disagree with this approach because the peak and average methodology does not best reflect cost causation on the Company's system.

Q. WHY DOES THE PEAK AND AVERAGE RATIO NOT BEST REFLECT COST CAUSATION ON THE COMPANY'S SYSTEM?

A. While I agree that the Company's system is designed to meet system peak demand as well as to connect its customers to the system, the Company does not utilize annual throughput to actually design its system. Instead, the system is designed to accommodate a peak day. As a result, annual throughput does not reflect how the Company incurs the costs to meet the coincident peak demand of its customers, and therefore, does not best reflect cost causation.

Further, the peak and average methodology is flawed because it double counts the "average" component of demand. Thus, total usage, or average demand, is counted twice in the allocation of demand costs, once in the peak allocation and again in the average demand allocation. The impact of using the peak and average method to allocate distribution main therefore results in an over-allocation of costs to high load factor customers.

While it is appropriate to allocate system main investments on peak demand, as well as on a customer component, it is not appropriate to allocate system main investment costs on a volumetric basis, which is what the peak and average methodology does.

Q. DOES THIS CONCLUDE YOUR OPENING TESTIMONY?

A. Yes, it does.

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EXHIBIT NWIGU/101

QUALIFICATIONS OF MICHAEL P. GORMAN

March 1, 2017

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140, Chesterfield, MO 63017.

Q. PLEASE STATE YOUR OCCUPATION.

A. I am a consultant in the field of public utility regulation and a Managing Principal with the firm of Brubaker & Associates, Inc. ("BAI"), energy, economic and regulatory consultants.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. In 1983 I received a Bachelors of Science Degree in Electrical Engineering from Southern Illinois University, and in 1986, I received a Masters Degree in Business Administration with a concentration in Finance from the University of Illinois at Springfield. I have also completed several graduate level economics courses.

In August of 1983, I accepted an analyst position with the Illinois Commerce Commission ("ICC"). In this position, I performed a variety of analyses for both formal and informal investigations before the ICC, including: marginal cost of energy, central dispatch, avoided cost of energy, annual system production costs, and working capital. In October of 1986, I was promoted to the position of Senior Analyst. In this position, I assumed the additional responsibilities of technical leader on projects, and my areas of responsibility were expanded to include utility financial modeling and financial analyses.

In 1987, I was promoted to Director of the Financial Analysis Department. In this position, I was responsible for all financial analyses conducted by the Staff. Among other things, I conducted analyses and sponsored testimony before the ICC on rate of return, financial integrity, financial modeling and related issues. I also supervised the development of all Staff analyses and testimony on these same issues. In addition, I supervised the Staff's review and recommendations to the Commission concerning utility plans to issue debt and equity securities.

In August of 1989, I accepted a position with Merrill-Lynch as a financial consultant. After receiving all required securities licenses, I worked with individual investors and small businesses in evaluating and selecting investments suitable to their requirements.

In September of 1990, I accepted a position with Drazen-Brubaker & Associates, Inc. ("DBA"). In April 1995, the firm of Brubaker & Associates, Inc. was formed. It includes most of the former DBA principals and Staff. Since 1990, I have performed various analyses and sponsored testimony on cost of capital, cost/benefits of utility mergers and acquisitions, utility reorganizations, level of operating expenses and rate base, cost of service studies, and analyses relating to industrial jobs and economic development. I also participated in a study used to revise the financial policy for the municipal utility in Kansas City, Kansas.

At BAI, I also have extensive experience working with large energy users to distribute and critically evaluate responses to requests for proposals ("RFPs") for electric, steam, and gas energy supply from competitive energy suppliers. These analyses include the evaluation of gas supply and delivery charges, cogeneration and/or combined cycle unit feasibility studies, and the evaluation of third-party asset/supply management agreements. I have participated in rate cases on rate design and class cost of service for electric, natural gas, water and wastewater utilities. I have also analyzed commodity pricing indices and forward pricing methods for third party supply agreements, and have also conducted regional electric market price forecasts.

In addition to our main office in St. Louis, the firm also has branch offices in Phoenix, Arizona and Corpus Christi, Texas.

Q. HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?

A. Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of service and other issues before the Federal Energy Regulatory Commission and numerous state regulatory commissions including: Arkansas, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Michigan, Mississippi, Missouri, Montana, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming, and before the provincial regulatory boards in Alberta and Nova Scotia, Canada. I have also sponsored testimony before the Board of Public Utilities in Kansas City, Kansas; presented rate setting position reports to the regulatory board of the municipal utility in Austin, Texas, and Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate disputes for industrial customers of the Municipal Electric Authority of Georgia in the LaGrange, Georgia district.

Q. PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZATIONS TO WHICH YOU BELONG.

A. I earned the designation of Chartered Financial Analyst ("CFA") from the CFA Institute. The CFA charter was awarded after successfully completing three examinations which covered the subject areas of financial accounting, economics, fixed income and equity valuation and professional and ethical conduct. I am a member of the CFA Institute's Financial Analyst Society.

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EXHIBIT NWIGU/102

RATE OF RETURN REVENUE IMPACT

March 1, 2017

Avista

Rate of Return Revenue Impact

Avista Proposed Rate of Return[1]

Line	Description	Weight (1)	Cost (2)	Weighted Cost (3)	Pre-Tax Weighted Cost (4)
1	Total Debt	50.0%	5.75%	2.88%	2.88%
2	Common Equity	50.0%	**9.90%**	4.95%	7.90%
3	**Total**	**100.0%**		**7.83%**	**10.78%**
4	Conversion factor[2]				1.5961

Avista Last Return on Equity[1]

Line	Description	Weight (1)	Cost (2)	Weighted Cost (3)	Pre-Tax Weighted Cost (4)
5	Total Debt	50.0%	5.75%	2.88%	2.88%
6	Common Equity	50.0%	**9.40%**	4.70%	7.50%
7	**Total**	**100.0%**		**7.58%**	**10.38%**

8	Rate Base ($000)[2]	$	243,424
9	Change in Rate of Return		0.40%
10	**Revenue Impact ($000)**	**$**	**971**

Sources:
[1]Avista/201, Thies/Page 2 of 5.
[2]Avista/501, Smith/Page 2 of 13.

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EXHIBIT NWIGU/103

OREGON JURISDICTION – NATURAL GAS
CLASS COST OF SERVICE

March 1, 2017

AVISTA UTILITIES

Oregon Jurisdiction - Natural Gas
Class Cost of Service

Line No.		Oregon TOTAL	Residential Service SCH 410	General Service SCH 420	Large General Service SCH 424	Interruptible Service SCH 440	Seasonal Service SCH 444	Special Contract Service SCH 447	Transportation Service SCH 456
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Distribution Margin Revenue at Present Rates	$ 58,724,000	38,744,000	15,340,000	601,000	491,000	45,000	213,000	3,290,000
2	**LRIC Based Cost of Service (Margin Revenue)**	**$ 67,263,000**	**43,139,505**	**19,453,596**	**523,171**	**462,331**	**36,717**	**335,770**	**3,311,910**
3	Distribution Margin Revenue at Proposed Rates	$ 67,263,000	44,377,728	18,245,272	601,000	491,000	45,000	213,000	3,290,000
4	Proposed Margin Revenue Increase ($) (Line 3 - Line 1)	$ 8,539,000	5,633,728	2,905,272	0	0	0	0	0
5	Proposed Margin Revenue Increase (%) (Line 4 / Line 1)	14.54%	14.54%	18.94%	0.00%	0.00%	0.00%	0.00%	0.00%
6	Current Distribution Margin Revenue to Proposed Cost of Service (Line 1 / Line 2)	0.87	0.90	0.79	1.15	1.06	1.23	0.63	0.99
7	**Relative Margin to Cost at Present Rates (Line 6 / 0.87)**	**1.00**	**1.03**	**0.90**	**1.32**	**1.22**	**1.40**	**0.73**	**1.14**
8	**Relative Margin to Cost at Proposed Rates (Line 3 / Line 2)**	**1.00**	**1.03**	**0.94**	**1.15**	**1.06**	**1.23**	**0.63**	**0.99**