Dissenting Opinion of Commissioner Jones

A. Overall Comments

1. Our decision must result in fair, just, reasonable and sufficient rates based on the evidentiary record in the proceeding. In contrast to the Majority opinion, I believe Avista has adequately carried its burden in justifying need for additional revenue based on a thorough and comprehensive attrition analysis. I believe that other parties have an obligation to respond to the Company’s analysis with equal rigor and detail and if a party does not support an attrition analysis it undertake a revenue requirement analysis such as a modified historical test year or hybrid approach in order to justify its end result. In this proceeding, I believe that Staff is the only party that has responded with a legitimate attrition analysis which complements its modified historical test year approach and results in a reasonable revenue requirement.

2. Unlike the Majority opinion, I believe that the use of a modified historical test year method does not result in fair, just, reasonable, and sufficient rates for the Company. Avista naturally makes this argument in both its direct and rebuttal cases and demonstrates with some analytical rigor why this is so. I share Avista’s view that in an era of relatively low load growth and high capital expenditures, the Company faces a fundamental, almost structural, mismatch between revenues, operating and maintenance expenditures (O&M), and capital expenditures (capex). Staff clearly agrees with the Avista’s arguments on these fundamental conditions and therefore agrees that an attrition adjustment is necessary, through a complementary modified historical test year analysis that is calculated at the end of such historical review.

3. Avista and the Staff largely agree on the mechanics of an attrition analysis, particularly the use of linear regression and the 2007-15 timeframe as a common historical period for their trending analysis. They differ however on important inputs and assumptions such as the critical escalation factor for O&M expenses, and several other factors. Overall, I prefer the approach that Staff has taken in this proceeding, especially on the O&M escalation factor and Staff’s preference for a weighted average during the historical period of Avista data using ECI and PPI indices. Although it differs slightly from the O&M escalation factor the Commission used in the previous rate proceeding, I believe Staff’s overall approach is well grounded in both theory and fact and should be approved while Avista’s specific proposal should be rejected.

4. In addition to the attrition issue, I believe it is important to respond to the evidentiary record in this case and render my best judgment on other key issues. In particular, I agree with Staff on having just one rate adjustment during an 18-month period in which new
rates are effective, rather than Avista’s proposal to establish two separate rate periods for rate increases and a potential adjustment for power costs. I think rate stability and gradualism are more persuasive on this point.

Additionally, I believe that Advanced Metering Infrastructure (AMI) is another key issue on which we should offer guidance. Specifically, I think Avista’s position is superior to Staff since it appears to me that Staff performed no real analysis regarding the economics of the AMI issue, and effectively took the convenient route of merely stating that any determination on AMI was premature. I agree with Avista’s proposal to allow an after-attrition adjustment for 2016 AMI capital expenses already incurred by contract, an adjustment which I understand is slightly less than $5 million.

Accordingly, I believe that Avista has met its burden of proof and there is ample evidence in the proceeding to render a reasoned decision on revenue requirements. In my view, that is what the Hope and Bluefield standards require of us and we should do nothing less. While the Commission may differ with various parties on the end result of various issues, my colleagues and I are obligated to review all the evidence in detail, exercise our informed judgment, and render a more specific decision on the multitude of issues comprising the authorized revenue requirement of the Company. Accordingly, although the Majority Opinion is rejecting the Company’s filing largely on a burden of proof argument on attrition, I believe it is important to respond to the evidentiary record in this case and render my best judgment on key issues.

The Majority Opinion spends a disproportionally large part of its arguments on recounting the history of Avista rate cases over the past 15 years. While this makes for interesting reading, I don’t believe that this historical narrative is directly on point and not relevant to the evidentiary record in this case. We should focus our analysis and use our informed judgment to determine the specific elements of the revenue requirements in this case. The Majority Opinion appears to use this historical narrative of Avista rate cases to buttress its arguments that the Company did not meet its burden of proof, resulting in the dramatic denial of any revenue increase in this case. I respectfully disagree with that approach.

Accordingly, having reviewed the record and actively participating in the proceeding, I believe the Staff position is the most reasonable. Staff’s attrition analysis would yield additional revenue of $25.6 million for electric operations and $2.1 million for gas operations. Because I differ with Staff on a few key points my revenue requirement would be slightly higher, but the end-result is comparable. Although these numbers have
not been thoroughly vetted by the Company and Staff, the effect of my positions on attrition and post-attrition adjustments, over an 18-month period, would yield a revenue increase to the Company of about $26 million for electric and $2.4 million for gas operations. I believe these to be reasonable end-result numbers for the 18-month stay-out period based on the totality of evidence and arguments proffered in the proceeding.

**B. Differences with the Majority opinion on Attrition**

9. I believe that the use of a specific attrition adjustment to a company’s revenue requirement is simply another “tool in the regulatory toolbox” that we should be able to use in a flexible manner in general rate cases. In the most recent Avista rate proceeding, we specifically rejected application of the “exceptional circumstances” condition to justify our acceptance of the Company’s attrition analysis and, in my view, promoted its relevance and placement as yet another tool comparable to other regulatory methods traditionally used to deal with regulatory lag. As the Majority Opinion states as well, these include ratemaking tools such as end-of-period (EOP) rate base, the flexible use of CWIP (during periods of substantial generation plant investment), and the use of multi-year rate plans with escalations based on a K-factor, an approach which is essentially a variation of attrition analysis.

10. To date, Avista is the only regulated Washington utility that has taken up the Commission’s challenge, established in a 2011 Puget Sound Energy (PSE) general rate proceeding, to come forward with substantive, comprehensive attrition analyses and subject them to the cross-examination and vetting in a general rate case.

11. I recognize the Majority opinion’s concern with Avista’s management of capital expenditures and what they allege is a lack of justification that such expenditures are beyond the control” of utility management. I oppose, however, the drastic remedy they intend, namely the complete rejection of all elements of the Company’s petition following a time-consuming and robust adjudication of these issues.

12. Unlike my colleagues, I do not believe it is our duty to attempt to micro-manage the capex and O&M expenditures of Avista and attempt to substitute our judgment for the Company’s management. In its Opinion, the Majority states its desire that Avista “moderate” its capital investments in areas like transmission, distribution, generation, and other infrastructure in the future. Yet it offers little specific guidance on evidence in this record on which areas to reduce spending, and the potential impacts on aging infrastructure, technology impacts, and likely impacts on the reliability and compliance
issues in the distribution grid. Instead, I believe our role should be more of a high-level review of the methodology, cost-effectiveness, and internal controls applied by management and the Board of Directors. The role of the Commission and Staff should be to ensure that proper information is submitted to us timely, that our questions are answered, and that proper governance mechanisms and management controls are put in place to manage such expenditures. In this proceeding, Company witnesses including Mr. Morris, Mr. Norwood, and Mr. Thies have set forth in their testimonies the methods by which they manage and control costs, both operating and capital costs, some of which are specified below for capital projects. Other parties did not challenge or rebut these internal management processes. Accordingly, although developing a bright-line test for what is “beyond the control” of the Company may be interesting, I believe that Avista did meet its burden of proof in this case in a reasonable way.

13 Staff’s witness Mr. Hancock testified that the Avista’s capex expenditures were largely beyond the control of the Company. No other Staff witness offered testimony on the merits of the Company’s Asset Management Plan or for overall capital expenditures and the internal budget and management control processes in place and discussed in the Company’s testimony. Although Staff has indicated that it wishes to develop an “econometric model” that assesses such expenditures and develops tangible metrics and benchmarks (other than the traditional SAIDI and SAIFI for reliability purposes), no such study or set of metric was developed and submitted for the record in the proceeding. Accordingly, it is my view that any argument for adopting such an approach here should not be given any weight or importance at this time (perhaps the Commission could take up such an approach in an all-utility workshop sometime in the future).

14 In addressing Mr. Hancock’s attrition analysis, the Majority Opinion takes certain comments out of context at hearing, and draws too fine a line on certain of his statements both on the trending analysis and the beyond the control argument. Mr. Hancock, in response to questions from me, admitted that the assessment of beyond the control is a complex subject and that his role was primarily to carry out a full attrition analysis by the numbers, as Mr. McGuire did in the previous Avista proceeding. He states clearly that that load growth is basically “flat”, that O&M expenditures continue to grow, and legitimate capital expenditures continue to be substantial as well. He also points out that a modified historical test year will not produce sufficient results, and that Avista will continue to experience attrition during the rate year. This produces the precise mismatch that an attrition analysis is meant to address.
Mr. Hancock expresses confidence in the accuracy of the historical numbers, his more granular analysis of trending, and most important, the use of statistically significant techniques to arrive at an approximation of expenses and plant-in-service during the rate year. It does not do justice to his robust analysis to state that this is merely an “appearance” to what might be reasonable to be in service during that period. The Commission continues to reserve its right of prudency, and this does not amount to what some call a pure “future test year.” This is the same attrition analysis that the Commission has used and referred to in previous Avista proceedings and specifically approved in the last case. In summary, I believe his analysis is thorough and robust, and consistent with what we have reviewed in the past in Avista cases. I am simply using my informed judgment, based on this portion of the record, in concluding that his analysis meets the Commission’s standards and produces a reasonable revenue requirement.

My assessment of the evidence submitted in this proceeding is that the Company’s asset management process and overall capital expenditures are reviewed thoroughly with proper internal methodologies applied for overall cost, relevant function, and cost-effectiveness. I point specifically to the testimony of Avista witness Ms. Rosentrater (HLR-1T, HLR-6 and HLR-9T), describing in detail the Company’s “Electric Distribution System 2016 Asset Management Plan”; a detailed 88 page document the provides both the rationale and methodology for measuring how such asset investments enhance the reliability and efficiency of the Company’s distribution system. In particular, I point to two elements of the plan that support the Company’s capex proposals: (1) the wood pole management program setting forth a methodology for pole replacement and minimum inspections every 20 years of each pole; and (2) the distribution transformer change-out program that manages change-out of inefficient transformer to newer ones conforming to current codes and assessing the risk of containing PCB-containing oil that could potentially leak. These are just two examples of a comprehensive asset management program that is not only oriented just toward SAIDI and SAIFI metrics, but is also one that is routinely discussed with Commission Staff informally at least once a year. Unfortunately, despite this, Staff offers scant detailed testimony on Avista’s asset management program to challenge the rationale and costs of these investments. Overall, I believe that Avista’s Asset Management Plan is well developed and sufficiently vetted as a means to maintaining a reliable, modernizing distribution grid that complies with the most recent engineering standards.

In support of my position, I point to Avista witness Ms. Schuh who offers substantive direct (KKS-1T) and rebuttal (KKS-9T) testimony on the Company’s total proposed
capital investments in 2017 and for the first six months of 2018. Her testimony addresses
the need for capital additions that include the Spokane River Projects, AMI, General
Plan, AFUDC, and certain updates to the Company’s capital additions initiated since its
original filing. Regarding the treatment of the Spokane River projects, Staff offers a $17
million after-attrition adjustment for these projects, the Company proposes a $67.1
million attrition adjustment for the totality of such investments. I concur more with
Avista’s approach here given our past treatment for hydroelectric upgrades at facilities
such as Noxon. Company Witness Mark Thies in his direct testimony (MTT-1T)
describes in detail, as he has in previous Avista cases, the internal management processes
that review the capital investments, both on a yearly and a five-year planning basis. The
review process is led by a Capital Planning Group (CPG) that receives requests from the
various operating divisions, which are then vetted with Company Officers and then sent
to the Finance Committee of the Board of Directors. He states than the Company does
dhave to prioritize such investments and that, in recent years, it has chosen to defer certain
capex investments for a variety of reasons but that such a rejection or deferral must be
reasonable and prudent from an a reliability and asset management perspective.

18 I am generally persuaded by Avista’s arguments that it is necessary to continue to invest
in its distribution system to replace aging infrastructure, replace older equipment as it
fails to perform to specifications, and to adopt new technologies which are “smarter” and
capable of more real-time adaptation in certain substations and feeders in its evolving
distribution system. In general, I believe it is more important to maintain a safe, reliable
and technologically modern distribution for Avista and its customers, than denying them
any cost recovery or ability to earn a return on such assets.

19 Avista has demonstrated over the years, including evidence submitted here, its ability to
innovate in the distribution grid, to obtain federal funding for co-shared technology
projects such as distribution upgrades in Spokane and smart grids in Pullman (federal co-
shared ARRA funding), and to respond to severe outages such as the 1996 ice storm and
the November 2016 windstorm. I see no need for the Commission to change course now,
and to deny its ability to earn a return on legitimate capex in this proceeding. In fact, I
believe that regulatory consistency from the previous Avista proceedings obliges us to be
consistent in application of our previously articulated principles with respect to attrition
and maintain this course for the Company’s proposed expenditures in both O&M and
capes. Parties may argue the fine points of how well that has been achieved in this case
and may differ, but I think there is no question that the Company has met its burden of
proof and justified a specific attrition adjustment.
C. AMI Investments

I believe it is important to offer some guidance to Avista on its cost-benefit analysis for AMI, as compared to the previous proceeding and address some of the detailed testimony by both the Company and Public Counsel. This is one of the biggest issues in the case and one which we have an obligation to assess and address in detail. Unfortunately, Staff and ICNU offered no substantive testimony on the Company’s contentions regarding the merits of AMI investment. I recognize that the Company has signed six contracts related to this extensive project with a proposed capex of $166 million, and that the metering and meter management contract was not signed until the end of September, 2016. While this may be too far into the rate-effective year for full consideration, there is evidence in the proceeding that other contracts were signed in the spring of 2016 providing ample time for Staff and other parties to vet them in the record.

Overall, I believe that the CBA (cost-benefit analysis) of the AMI project in this proceeding has become more refined and detailed compared to analysis presented in the previous proceeding on this issue. I now believe the Company has produced a comprehensive analysis of the AMI project, including a $20 million contingency that properly addresses all of the potential quantifiable benefits in six major categories, as well as discussion of non-quantifiable benefits such as environmental externalities and the social cost of carbon which are inherently difficult to quantify. The Company’s CBA is also more candid than the analysis produced in the previous rate proceeding, clearly showing that the overall benefits over the life of the project ranges from a negative of $18 million (including the $20 million contingency) to a positive $64 million.

As to the benefits of AMI, I largely concur with the Company’s contentions regarding end-use energy efficiency, conservation voltage reduction (CVR), efficiency of outage management, outage duration, and other specific benefits. I largely disagree with Public Counsel’s witness Ms. Alexander and believe that she takes an overly negative and cautious approach on the quantifiable benefits of the investment. For example, she argues that the Company has used unproven national or generic data on the benefit analysis for conservation voltage reduction (CVR), but Ms. Rosentrater demonstrates persuasively that for the Pullman project co-funded with ARRA funds, Avista used actual, feeder-specific data in its analysis. In fact, I believe that for certain benefit cases, Avista is still using an overly conservative approach, especially on the potential to reduce outage durations. I believe the AMI project has been sufficiently vetted with a refined CBA and is sufficiently “in the ballpark” to offer specific guidance in the proceeding, and that its
net cost-benefit analysis, with a $20 million contingency, does not differ that significantly from Ms. Alexander’s analysis.

23 In contrast to the Company’s evidence, I am disappointed in Staff’s lack of detailed testimony on the detailed cost benefit analysis in this case, and the lack of a rigorous review of the AMI investments. I don’t believe that it is “premature” to engage in such analysis. In fact, in my view, simply adhering to a rigid prudency standard or a used and useful standard is insufficient and borders on irresponsible for an investment of this magnitude. The only party to fully challenge Avista’s cost benefit analysis is Public Counsel’s witness Ms. Alexander. The Majority Opinion characterizes my views as harsh and inappropriate, but I think it is entirely legitimate to point out a lack of engagement by Staff in reviewing the detailed cost-benefit study in this case. Staff, as pointed out above, certainly did that for another major element of this case, the attrition analysis. It is true that the Company ultimately bears the burden to prove its case, but without robust engagement by the Parties, especially Staff, it does not provide a full analysis as the Commission renders its final judgment. I am simply stating my desire, in the second consecutive Avista proceeding, to have a more detailed and robust record from the Parties other than the Company.

24 While I think it is too early to make final call on the prudence of each of these AMI investments, especially the gas and electric meter deployment which will commence in the third quarter of 2017, I think we should offer some guidance in this proceeding. Avista has conceded that it is not asking for an overall prudence determination for all of the gas and electric meters to be installed over five years, as well as the meter data collection, head end system, and other components of this complex project. Instead, it is willing to accept prudence determinations in “chunks” as capital is deployed and meters installed in general rate proceeding over the next several years. Company Witnesses Ms. Rosentrater and Mr. Norwood specifically affirm this step-by-step approach on prudence in their rebuttal testimony.

25 Because I support an attrition adjustment, I similarly believe it would be appropriate to provide an after-attrition revenue requirement adjustment in the amount of $4.9 million for the AMI investment, as proposed by the Company. This would reflect the actual capital expenses of approximately $18 million that the Company has incurred in the first and second quarters of 2016 in signing five separate contracts with several vendors (excluding the Itron contract that was signed in late September, 2016). An allowance of this nature would be a reasonable first step while consideration of subsequent capex for
gas and electric meters that are placed in service in 2017 through 2020 can be handled in future rate proceedings.

26 In contrast to an allowance here, if the Majority opinion allows the Company to file a separate petition for deferred accounting as a regulatory asset (FERC Account 182.3), I would support that approach as well. The Commission has already approved such treatment for existing in-service meters that are to be replaced as a regulatory liability using the same FERC Account. In my view, affording similar treatment for the new AMI investment would be fair and reasonable.

D. ROE and Risk Mitigation

27 The Hope and Bluefield tests require us to balance both the interests of the utility investors and the end-use consumers of electricity and natural gas. In doing so, we must focus on the end-results, and not whether the specific method used to support an attrition adjustment or any other methodology gets bogged down in a maze of details surrounding inputs and assumptions.

28 Both the Company and Staff use an attrition adjustment in this case and, just as it has over the most recent proceedings, Avista has proffered an attrition analysis to justify its revenue deficiency as the basis for its need for a rate increase. In principle, an attrition adjustment improves the opportunity for the Company to earn its authorized return on equity (ROE), since it basically equalizes the mismatch between revenues, O&M expenses, and capital expenditures during a rate year.

29 In addition to allowing an attrition adjustment, we have also granted Avista full decoupling for both electric and gas operations, thereby enhancing its ability to earn its authorized ROE. We have used other risk mitigation techniques for Avista in recent cases as well.

30 Unlike the Majority opinion, I believe that adjusting Avista’s ROE is a more appropriate and targeted approach for considering the effects of the risk mitigating allowances we have granted in the past and are under consideration in this proceeding. Rather than rejecting Avista’s rate petition outright on a burden of proof argument, I would authorize an attrition adjustment as described above, subject to a corresponding downward adjustment to its authorized ROE in recognition of the decreased risk the Company faces as a result of continuing with an attrition allowance.
By rejecting the Company’s petition outright the Majority opinion effectively sustains Avista’s authorized capital structure (48.5 percent equity ratio) and ROE (9.5 percent) for the foreseeable future. As explained below, I do not think this is a reasonable result.

There is evidence of Avista over-earning over the past several years, especially on electric operations. Such over-earning could be due to a number of factors including the rate increases we granted the Company in the multi-year rate plan in the 2013 rate proceeding, the effect of decoupling, or the temporary effect of the purchase of the Juneau utility in 2014. On the gas side, the Company has shown consistent under-earning over the 2013-16, timeframe although it did show a spike up in the first quarter of 2016. When questioned at hearing, Company witness Mr. Norwood explained such temporary overearning on the gas side to two potential factors, re-assigning at year-end some of the costs of gas operations among jurisdictions and between gas and electric operations, and to the relatively smaller total amount of gas rate base compared to electric rate base. While not entirely persuasive and while there is non-controverted evidence of over-earning on the electric side, I am persuaded that, on a combined basis for the 2013-2016 period, that Avista has come fairly close to earning its authorized ROE of 9.5 percent.

Given my contention above that previous attrition allowance coupled with other regulatory measures have reduced the Company’s risk, I do believe it is appropriate that we examine the specific evidence in the proceeding produced by the three cost-of-capital witnesses.

In this case, Mr. Gorman argues persuasively for a 9.2 percent ROE, while Mr. Parcell argues for 9.1 percent based on a number of methodologies including two variants of discounted cash flow (DCF), Risk Premium (CE), and CAPM (although both witnesses argue that the utility of CAPM in this low-interest rate environment is weakened by the continued generous monetary policies of the Federal Reserve). Meanwhile, Company witness Mr. MacKenzie argues for an increase in authorized ROE to 9.9 percent, based on a combination of these analyses, and a fairly similar proxy group as Mr. Gorman for his DCF analysis.

At hearing, I was more persuaded by the testimonies and answers to questions from Mr. Parcell and Mr. Gorman and less persuaded by answers offered by Mr. MacKenzie. All three witnesses argued that we should give much lesser weight to the CAPM analyses, mainly due to the continued easy monetary conditions of the Federal Reserve, and that we should place more weight on their analyses using either DCF or Risk Premium or CE.
I do not support Mr. MacKenzie’s argument to use his “upper end” of 9.9 percent ROE, since I believe that the Company has already been slightly over-earning given its actual electric ROE, and that this would result in a revenue requirement that is in excess of the just and reasonable standard. I would instead argue that the methodologies used by Mr. Parcell and Mr. Gorman, namely the constant growth DCF and risk premium, produce a range of results that meet the fair, just and sufficient standard. Both witnesses have argued persuasively that such results should enable Avista to maintain its financial metrics with the credit rating agencies to maintain its current corporate credit rating, and that it is highly uncertain when and how the Federal Reserve will address monetary policy conditions. I agree.

In summary, based on the above, I would lower the authorized ROE for Avista in this case by 20 basis points to 9.30 percent. This would produce an overall pre-tax rate of return (ROR) of about 7.35 percent based on its current capital structure of 48.5% equity, and with weighted debt cost of 5.51 percent. I think this is a fair and reasonable end result that is more targeted and surgical than the Majority opinion’s decision to reject any request for rate relief in this case. More importantly, I believe that my approach, if adopted, would produce end results that satisfy both our state’s statutory standards and Hope and Bluefield.

PHILIP B. JONES, Commissioner