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IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION DBA AVISTA UTILITIES FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE IN IDAHO.	)))))))	CASE NO. AVU-E-15-05 AVU-G-15-01

DIRECT TESTIMONY OF RANDY LOBB IN SUPPORT OF THE STIPULATION AND SETTLEMENT

IDAHO PUBLIC UTILITIES COMMISSION

NOVEMBER 13, 2015

Q. Please state your name and business address for the record.

A. My name is Randy Lobb and my business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed?

A. I am employed by the Idaho Public Utilities Commission as Utilities Division Administrator.

Q. What is your educational and professional background?

A. I received a Bachelor of Science Degree in Agricultural Engineering from the University of Idaho in 1980 and worked for the Idaho Department of Water Resources from June of 1980 to November of 1987. I received my Idaho license as a registered professional Civil Engineer in 1985 and began work at the Idaho Public Utilities Commission in December of 1987. I have analyzed utility rate applications, rate design, tariff filings and customer petitions. I have testified in numerous proceedings before the Commission including cases dealing with rate structure, cost of service, power supply, line extensions, regulatory policy and facility acquisitions. My duties at the Commission include case management and oversight of all technical Staff assigned to Commission filings.

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to describe the proposed comprehensive settlement in this case and explain Staff's support.

Q. Please summarize your testimony.

A. The proposed Stipulation and Settlement (the "Settlement") provides an electric rate increase on January 1, 2016 of $1.7 million (0.69%) and a natural gas rate increase of $2.5 million (3.49%). It also provides for a Fixed Cost Adjustment (FCA) mechanism for both electric and gas service to track recovery of Commission authorized fixed costs and either surcharge for shortfalls or credit for over collection on an annual basis.

After comprehensive review of the Company's Application, thorough audit of Company books and records and extensive negotiation with parties to the case, Staff supports the proposed Settlement. Staff believes that the Settlement, supported by all parties to the case is in the public interest and should be approved by the Commission.

Background

Q. Please describe Avista's original filing.

A. Avista made its original filing on May 13, 2015 requesting authority to increase its rates by $13.2 million (5.2%) and $3.2 million (4.5%) for electric and gas service, respectively, effective January 1, 2016. The Company also requested to increase its rates by an additional $13.7 million (5.1%) and $1.7 million (2.2%) for electric and gas service, respectively, effective January 1, 2017. The Company proposed a capital structure of 50/50 and a return on common equity of 9.9%.

The Company proposed to spread the revenue increase in both years to electric and gas customer classes using a 25% move and a 33% move toward cost of service, respectively. Residential customer charges would increase from $5.25 to $8.50 and from $4.25 to $8.00 per month for electric and natural gas service, respectively.

Finally, the Company proposed an FCA for both gas and electric service to track monthly recovery of fixed costs on an annual basis in between rate cases. If cost recovery was below that authorized by the Commission, then customers would receive a surcharge. If cost recovery exceeded that authorized by the Commission, customers would receive a credit.

Settlement Overview

Q. Please summarize the proposed Settlement.

A. The proposed Settlement specifies a rate increase of $1.7 million (0.69%) and $2.5 million (3.49%) for electric and natural gas service, respectively, effective January 1, 2016. It also specifies a 50/50 debt to equity capital structure, a 5.34% cost of debt and a 9.5% return on common equity.

Besides specifying capital structure, equity return and the debt cost for both electric and gas service, the Settlement also specifies a variety of expense and investment adjustments. The electric and gas revenue adjustments fall primarily into three categories: 1) eliminate test year proforma expense and investment beyond December 31, 2015; 2) modify miscellaneous test year expenses; and 3) lengthen amortization periods for deferred accounts. Electric revenue requirement is further adjusted by continuing Palouse Wind expense recovery through the Power Cost Adjustment (PCA) mechanism rather than through base rates.

The revenue increase will be spread to each electric and gas customer class based on a 25% and 33% move toward class cost of service, respectively, as originally proposed by the Company. Electric residential energy rates will increase by a uniform percentage to generate the additional revenue. The basic charge for residential electric customers will remain at $5.25 per month while the basic charge for residential gas service will increase from $4.25 to $5.25 per month. The remaining increase will be spread uniformly to commodity rates.

The Settlement also establishes an FCA for 3 years for both electric and natural gas service to track and defer over or under collection of Commission authorized fixed costs on an annual basis. The Settlement describes a variety of FCA requirements including treatment of new and existing customers and annual reporting.

Q. Are there any other provisions included in the proposed Settlement?

A. Yes. The Settlement also specifies base power supply expenses for use in the PCA mechanism, extension of electric and natural gas rebates and an agreement for the parties to meet and confer on low income weatherization programs and low income consumption data.

Settlement Process

Q. What was the process that lead to the all-party Settlement?

A. After the Company's initial filing on May 13, 2015, the Commission issued a Notice of Application and set an intervention deadline of June 29, 2015. Five parties intervened in the case: 1) Clearwater Paper, 2) Consumer Action Partnership of Idaho (CAPAI), 3) Idaho Conservation League, 4) Idaho Forest Group and 5) Snake River Alliance.

Avista, Staff and the intervening parties then conferred and set a schedule that included settlement workshops, filing dates for direct and rebuttal testimony and a date of November 23, 2015 for a technical hearing. Parties convened a workshop on September 18, 2015 to discuss case settlement.

Through extensive discussions and give and take on a variety of issues that included over 23 revenue requirement adjustments, class cost of service, revenue spread, rate design, multi-year rate plans and fixed cost adjustment mechanisms, the parties came to tentative agreement. Over the next month, the parties agreed to language culminating in the proposed Settlement and Stipulation filed on October 19, 2015.

Staff Investigation

Q. What type of investigation did Staff conduct to evaluate the Company's rate increase request?

A. There were fifteen Utilities Division Staff assigned to extensively review the Company's application and identify issues in preparation for litigation at hearing. Staff conducted two weeks of onsite audits, submitted 156 production requests, and reviewed rate increase requests filed by the Company in other state jurisdictions.

Staff identified twenty three adjustments to the Company's requested revenue requirement, evaluated and developed annual power supply expense for the PCA, compared and contrasted past and present class cost of service models and assessed the need for an FCA mechanism. Staff prepared a revenue requirement and established positions on all of the major issues in preparation to file direct testimony on October 21, 2015.

Q. How did Staff prepare for the settlement workshop?

A. Staff prepared for the settlement workshop by preparing for testimony in the litigated case. Staff developed its revenue requirement adjustments and positions on various issues for presentation at the workshop in conjunction with preparing testimony for hearing.

Q. What is Staff's settlement objective?

A. The objective of settlement is to achieve an outcome that is better for customers than what otherwise could be achieved through a litigated case. Successful settlement from Staff's perspective is to convince the Company and other parties to accept the majority of Staff revenue adjustments and positions as part of the proposed Settlement rather than risk losing those issues at hearing.

Q. Does the Settlement achieve those objectives?

A. Yes, I believe that it does. Of the 23 electric revenue requirement adjustments that Staff identified, roughly 17 were encorporated either totally or partially in the Settlement. Rather than an increase of $13.2 million as proposed by the Company, the Settlement specified an electric increase of only $1.7 million. On the gas side, 14 of 16 adjustments were fully or partially included in the Settlement reducing the increase from $3.2 million to $2.5 million.

Q. What type of revenue requirement adjustments were proposed by Staff and included in the Settlement?

A. Besides a reduction in return on common equity, the adjustments generally fall into three categories: 1) eliminate test year proforma expense and investment beyond December 31, 2015; 2) modify miscellaneous test year expense; and 3) lengthen amortization periods for deferred accounts.

Q. What effect did equity return have on revenue requirement?

A. The Company had originally proposed a return on common equity of 9.9% while the Settlement specifies a return of 9.5%. Staff notes that the lower return is consistent with return on equity established in Avista's Washington jurisdiction and Staff believes it is within a reasonable range for Avista's financial situation and represents a reasonable compromise in this case.

The return on equity adjustment reduced electric revenue requirement by $2.44 million and natural gas revenue requirement by $415,000. Capital structure and cost of debt remain as originally proposed by the Company.

Q. What effect did limiting the test year proforma period have on revenue requirement?

The Company's original proposal included a multi-year rate increase with budgeted expense and capital additions included through December 31, 2017. The Settlement specifies a single year rate increase on January 1, 2016 with expense and investment included through December 31, 2015. The Settlement specifically reduces electric test year revenue requirement by $3.9 million to reflect reduced levels of actual 2015 capital investment and removes planned capital additions in 2016.

The Settlement further removes nearly $1 million in electric revenue requirement for insurance, information services and technology and non-executive labor expense increases planned for 2016. Adjustment for these items on the gas side reduced revenue requirement by $333,000. Staff maintains that limiting test year proforma expense and investment to December 31, 2015 better reflects known and measurable costs actually incurred by the Company and is consistent with past Commission Order (No. 30772).

Q. What test year expenses where actually reduced from the Company's proposal?

A. The second category of adjustments reflects a $688,000 reduction in electric revenue requirement and a $279,000 reduction in gas revenue requirement to reduce proposed expense recovery in rates. The parties agreed to a variety of adjustments that Staff believes reflected more appropriate levels of expense.

Injuries and damage expenses were reduced for both electric and gas operations to reflect average expenses incurred over the last 6 years. Officer incentives were removed and non-officer incentives were reduced to reflect 100% rather than a 102% payout. Other miscellaneous administration and general expenses were reduced for such items as insurance expense for directors and officers, a legal expense error, abnormally high cleanup expenses incurred in 2014, Board of Director expense allocated to shareholders and miscellaneous account 930 expenses.

Q. What impact did extended amortization of deferral balances have on stipulated revenue requirement?

A. The third category of adjustments extended deferral balance amortization periods to reduce test year revenue requirement by $788,000 and $168,000 for electric and gas service, respectively. Staff maintained that amortization periods for project Compass and Lake Spokane project deferrals should be set at 4 years rather than 2 years as proposed by the Company. The parties agreed to 4 years for the purpose of settlement.

Q. Were there other revenue requirement adjustments included in the Settlement that did not fit into the three categories?

A. Yes. The Settlement included an electric expense adjustment of $3.5 million for the Palouse Wind project. Expenses and benefits associated with this project are currently include for recovery in the Company's PCA mechanism. The Settlement specifies that Palouse Wind expenses will continue to be recovered in the PCA rather than included in base rates as originally proposed by the Company.

Q. Why does Staff believe it is appropriate to continue PCA treatment of Palouse Wind expense?

A. Staff maintains that the Palouse Wind project was never acquired to meet loads in Idaho. It was acquired to comply with Resource Portfolio Standards in Washington State. While the project does generate energy and provide some value to Idaho customers, the cost for Avista to purchase the project output exceeds the value of the energy generated. Consequently, Staff believes that Company shareholders should share in the annual economic loss created by the project. Avista disagrees with Staff's position but accepts the stipulated treatment for purposes of this case. The net customer benefit of continued PCA treatment of Palouse Wind expense is approximately $350,000 or the Company's 10% share of $3.5 million that would be eliminated with base rate treatment.

Revenue Spread and Rate Design

Q. Please explain the Settlement with respect to class cost of service and revenue spread.

A. The Company's original application in this case included class cost of service studies for both electric and natural gas service. Those studies both showed that residential and small commercial customers were paying less than their appropriate cost of service and large high load factor customers were paying more than their appropriate cost of service. The Company consequently proposed moving electric customers 25% toward cost of service and gas customers 33% toward cost of service.

While no party specifically agreed with the methodology used in the Company's cost of service study, all parties agreed that the study results generally indicated whether customer classes were above or below cost of service. Therefore, all parties accepted the Company's proposed incremental move toward cost of service.

Staff fully reviewed the Company's class cost of service studies submitted in this case and those submitted by the Company in prior cases. Staff agrees for the purposes of this case that cost of service trends support the incremental move as proposed in the Settlement. The resulting percentage increase by customer class is shown on page 15 of the Settlement.

Q. How does the Settlement specify that rates will change?

A. The Settlement specifies that the volumetric energy rate will increase by a uniform percentage for all customer classes and residential basic charges will remain at $5.25 per month. The basic charge for natural gas residential customers will increase from $4.25 per month to $5.25 per month with a uniform percentage increase in the volumetric energy rate for the remaining revenue requirement balance.

The revenue requirement for all other gas service schedules will be applied as a uniform percentage increase in the volumetric energy rate.

Staff supports the increase in the natural gas basic charge for residential customers that equals the current electric basic charge for residential customers. Staff also believes the uniform percentage increase in volumetric energy charges is appropriate in this case given the small overall increase in revenue requirement.

Q. Could you please describe the electric and natural gas rebate extension?

A. Yes, electric customers are currently receiving an annual rebate through December 31, 2015 of approximately $2.8 million for 2013 earnings sharing approved by the Commission in Case No. AVU-E-14-05. The Settlement specifies that the $2.8 million annual rebate will continue through December 31, 2017 using $5.6 million in 2014 revenue sharing.

The natural gas rebate of approximately $1.2 million annually for 2013 revenue sharing and unused energy efficiency balance is also set to expire on December 31, 2015. The Settlement specifies that $0.2 million in 2014 revenue sharing will be used to partially offset the $1.2 million rebate that will expire on January 1, 2016.

Staff believes that use of revenue sharing funds to prolong rebates that would otherwise expire or to mitigate a portion of an expiring rebate is appropriate. Customers are entitled to these funds and Staff supports the rate stabilizing effect that occurs from including them in the Settlement.

Fixed Cost Adjustment

Q. What is an FCA mechanism?

A. An FCA mechanism is designed to track fixed cost (Company costs that do not change with energy consumption) recovery and either surcharge for under recovery or rebate for over recovery on an annual basis. The mechanism decouples fixed cost recovery from energy consumption to assure that fixed costs are recovered no matter how much energy is consumed.

Q. Please explain the Company's proposed FCA mechanism.

A. The Company proposed a permanent electric and natural gas FCA based on a Commission approved level of fixed cost recovery per customer, known as the Fixed Cost Adjustment Revenue-Per-Customer. The proposal included two Rate Groups, Residential and Non-Residential. The Residential Rate Group included Schedule 1 for the electric FCA and Schedule 101 for the natural gas FCA. The Commercial Rate Group for the electric FCA included Schedules 11, 12, 21, 22, 31, 32. The Commercial Rate Group for the gas FCA included Schedules 111 and 112. Each Rate Group had a distinct Fixed Cost Adjustment Revenue-Per-Customer.

The Company proposed an annual filing for each rate group to recover or rebate the appropriate deferred revenue amount over a 12-month period (January-December). The surcharge/rebate reconciles monthly differences between fixed costs allowed to be collected on a per-customer basis, and the non-weather normalized actual fixed costs collected. The deferred revenue under/over collection would then be separately surcharged or rebated to each customer group through the Company's proposed electric tariff Schedule 75 or the natural gas tariff Schedule 175.

Q. Is the stipulated FCA mechanism identical to the Company's original proposal?

A. No. The parties have only agreed to a 3-year pilot, with a review following the end of the second full year. This will allow Staff and other parties an opportunity to evaluate the mechanism and determine whether it is functioning as intended. The mechanism can be modified or discontinued if it is found to be operating improperly. In order to facilitate on-going review, the Company agreed to provide quarterly reports showing the monthly deferrals by rate group, what the deferrals would have been if tracked by rate schedule, use and revenue-per-customer for existing and new customers, and other summary financial information.

The Company had proposed to use the FERC interest rate on the unamortized FCA balancing accounts. Instead, the Parties have agreed to calculate the accrued interest based on the Customer Deposit Rate, which is consistent with prior Commission Orders.[1]

While the Company's original proposal did not include a cap on annual surcharges, the Parties have agreed that FCA surcharges in any given year cannot exceed 3%. The cap will be applied by rate group with any unrecovered balances carried forward to future years for recovery. Staff believes the cap is necessary to prevent large annual surcharges if weather or economic conditions vary significantly in a particular year.

The FCA mechanics proposed in the Settlement are nearly identical to the Company's proposal. The only difference is that Fixed Cost Adjustment Revenue-Per-Customer for new customers added after the test period will be less than that for existing customers.

Q. Why should Revenue-Per-Customer differ for new and existing customers in the FCA?

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[1] Based on Order No. 33187 in Case No. GNR-U-14-12, the deposit rate for 2015 is 1.0%. The rate is updated annually.

A. The Parties agreed that the Fixed Cost Adjustment-Revenue-per-customer for new electric customers will exclude fixed production and transmission costs. For new natural gas customers, recovery of costs related to fixed production and underground storage would also be excluded. This disparate treatment will limit fixed cost recovery for new customers in between rate cases to fixed costs that are more certain to occur.

Staff maintains that certain types of investments are "lumpy" and may not actually be required to serve new customers in between general rate cases. Rather than assume these costs are incurred for automatic recovery in the FCA, they are removed from new customer revenue and only those incremental costs directly related to serving new customers are included.

The new customer investment issue is further highlighted when the FCA reconciles the monthly difference between fixed costs allowed to be collected on a per-customer basis and fixed costs actually collected. As the number of customers increase between rate cases, the total fixed costs allowed to be collected increases beyond the amount reviewed and authorized by the Commission. An FCA should not become a substitute for general rate case filings, whereby the Company requests rate treatment for investments actually incurred. Staff believes limiting FCA recovery to specific types of fixed costs better assures that costs recovered through the FCA are actually incurred to serve a new customer.

Q. When will the Company file a proposed surcharge or rebate?

A. FCA implementation will commence concurrently with the natural gas and electric rate changes January 1, 2016. On or before July 1, 2017 the Company will file its first proposed rate adjustment surcharge or rebate based on deferred revenue recorded from January 2016 through December 2016. The proposed tariff (Schedule 75 for electric, Schedule 175 for natural gas) included with that filing will show the adjustment as a rate per kWh for electric and a rate per therm for natural gas. This FCA rate will be determined using expected energy sales to surcharge/rebate the appropriate deferred revenue amount over a twelve-month period effective October 1, 2017 for electric (to coincide with the PCA period) and November 1, 2017 for natural gas (to coincide with the Purchased Gas Cost Adjustment period). The annual FCA will be filed consistent with this schedule for the remaining 2 years.

Q. Please explain why an FCA is necessary and how it benefits customers?

A. Historically, Staff has generally supported rate design proposals that keep fixed charges low in order to encourage conservation and allow customers to control their bills. While the Company's fixed costs do not necessarily change with the level of energy consumption, recovery of those fixed costs does. For example, when weather or favorable economic conditions contribute to higher than normal energy or natural gas sales, the Company may over-recover its fixed costs. Conversely, when Demand-Side Management ("DSM") or price signals from certain rate designs cause customers to use less energy or natural gas, the Company may under-recover its fixed costs. Consequently, there's a financial disincentive for the Company to encourage conservation. The table below shows the Company's revenue from fixed charges as a percent of its total fixed costs for each schedule included in the FCA.

Electric	Schedule 1	Schedule 11/12	Schedule 21/22	Schedule 31/32
Fixed Costs	79,710,926	28,188,128	38,749,289	3,969,533
Fixed Charge Revenue	6,484,165	2,463,750	4,835,600	133,576
Fixed Charge % of Fixed Costs	8.10%	8.70%	12.50%	3.40%
Natural Gas	Schedule 101	Schedule 111/112		
Fixed Costs	37,448,841	9,374,373		
Fixed Charge Revenue	4,769,536	1,677,185		
Fixed Charge % of Fixed Costs	12.74%	17.89%		

*Calculated using page 1 of Appendix B and C. For purposes of this table, Distribution and Customer Related Costs, and Common Costs are assumed to be fixed costs. Natural Gas Fixed Costs also include the demand related charges in Schedule 150.

The FCA reduces the financial disincentive to encourage conservation by decoupling a portion of revenue from the Company's energy and gas sales. Consequently, the Company will be at less risk of not fully recovering its fixed costs when it promotes cost-effective DSM programs and/or rate designs that send a price signal to conserve energy or natural gas. If the Company successfully encourages lower energy and gas consumption, Staff believes the FCA will undoubtedly save customers money in the long-run by deferring or eliminating capital costs that might otherwise be required to serve growing load.

Q. What impact might the FCA mechanism have on customers?

A. Staff looked at the last two years to see what the impact would have been had the proposed mechanism been in place. In 2013, residential customers would have received a rebate of 0.79% for electric and 0.02% for gas. For the same time period, commercial customers would have received a rebate of 2.07% for electric and a surcharge of 1.60% for gas. In 2014, residential customers would have received a rebate of 0.05% for electric and a surcharge of 1.17% for gas. For the same time period, commercial customers would have received a rebate of 2.24% for electric and a surcharge of 1.97% for gas.

Staff believes the mechanism will be largely impacted by weather, economic conditions, DSM/conservation, and rate design. For example, if temperatures are relatively mild (warm winters and cool summers), customers could see FCA surcharges. Conversely, if temperatures are extreme (cold winters and hot summers), customers could see FCA credits.

Q. Are there any other provisions in the Settlement?

A. Yes, the Settlement specifies that the parties will collaborate on low income weatherization and low income energy efficiency education. The objective of the collaboration is to identify energy and gas consumption levels of low income customers and identify the proper energy efficiency funding levels in the future.

The Settlement also specifies that the parties will initially meet no later than June 1, 2016 to discuss these issues. Staff fully supports collaboration on the low income energy efficiency issues and looks forward to actively participating in all associated meetings.

Q. Does this conclude your testimony in this case?

A. Yes, it does.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 13TH DAY OF NOVEMBER 2015, SERVED THE FOREGOING **DIRECT TESTIMONY OF RANDY LOBB IN SUPPORT OF THE STIPULATION AND SETTLEMENT,** IN CASE NOS. AVU-E-15-05/AVU-G-15-01, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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