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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO	))))))))	CASE NO. AVU-E-23-01 CASE NO. AVU-G-23-01 DIRECT TESTIMONY OF DENNIS P. VERMILLION

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

I. INTRODUCTION

Q. Please state your name, employer, and business address.

A. My name is Dennis P. Vermillion, and I am employed as the President and Chief Executive Officer of Avista Corporation (Avista or Company). In that role I also serve as a member of Avista's Board of Directors. I also serve as the Chairman of the Board of Directors for Avista's subsidiary Alaska Electric Light and Power Company. My business address is 1411 East Mission Avenue, Spokane, Washington.

Q. Would you briefly describe your educational background and professional experience?

A. Yes. I received a Bachelor of Science degree in electrical engineering from Washington State University in 1985. I started working for Avista in 1985 and have held numerous positions in energy trading, marketing, risk management, power transmission contracting, and resource planning and coordination. I was appointed as President and Chief Operating Officer of Avista Energy in 2001. I was appointed Vice President of Energy Resources for Avista Utilities in 2007 at the close of the sale of Avista Energy. In 2009, I was appointed President of Avista Utilities, and later in January 2018 was appointed President of Avista Corporation and began serving on Avista Corporation's Board of Directors. On October 1, 2019, I was promoted to the role of President and Chief Executive Officer.

I currently serve as a board member for Western Energy Institute (WEI) and American Gas Association (AGA) and the Avista Foundation. I formerly served on the board of Spokane County United Way and was a past chairman of the Spokane County Campaign.

Q. What is the scope of your testimony in this proceeding?

A. In my testimony I provide an overview of the Company's proposal in this filing for a Two-Year Rate Plan. I start by discussing the overall economic conditions facing Avista, and how those have impacted our operations, our cost management, and this general rate case. I will then summarize the Company's proposal in this filing, and address our continuing capital investment, which continues to be the primary driver behind the Company's most recent general rate cases. I discuss our continued focus on communicating with customers, our overall customer satisfaction, and our customer support programs. Finally, I introduce the other Company witnesses who support this general rate case filing.

A table of contents for my testimony is as follows:

Q. Are you sponsoring exhibits in this proceeding?

A. Yes. I am sponsoring Exhibit No. 1, Schedule 1 which provides a diagram of Avista's corporate structure, and maps showing Avista's electric and natural gas service areas, including natural gas fields, trading hubs and major pipelines.

II. OVERVIEW OF AVISTA

Q. Please briefly describe Avista Utilities.

A. Avista Utilities serves approximately 392,000 retail electric and 362,000 retail natural gas customers in a 30,000 square mile service territory covering portions of Idaho, Washington, and Oregon. As of December 31, 2021, Avista Utilities had total assets (electric and natural gas) of approximately $6.9 billion (on a system basis), with electric retail revenues of $1 billion (system) and natural gas retail revenues of $475 million (system). Avista has approximately 1,800 regular and seasonal employees.

Q. Please describe Avista's current business focus for its utility operations.

A. Our strategy continues to focus on our energy and utility-related businesses, with our primary emphasis on the natural gas and electric utility business. Our strategic initiatives are aligned across four focus areas: our customers, our people, performance, and innovation. We are placing emphasis upon our customer focus as being central to all that we do to ensure our services are safe, responsible, and affordable.

Q. Would you briefly describe efforts the Company is undertaking to drive a better customer experience when working with Avista?

A. Yes. I am very proud of the Company's renewed focus on putting our customers at the center of our business in order to drive a better customer experience. Customer experience is an important concept that we take seriously, as it describes the experiences of our customers when they hear about us or they interact with us directly, via face-to-face interactions, phone calls, texts, online interactions, social media, etc. Customer experience is the sum of all interactions a customer has with Avista – both direct and indirect, and their perception about us (what they see, hear, think, and feel). These interactions may vary depending on who, when, or where they occur and the issue in general. Having clear visibility into each of these interactions will allow us to provide a better customer experience across all our service territories. Therefore, we are putting our customers at the center and building on years of excellent customer satisfaction to provide the customer experience our customers want, when they want it. Illustration No. 1 below provides a summary of how Avista is showing *care* for our customers, the *ease* with which customers can interact with us, how we continue to build ***trust***, and the ***ownership*** each and every employee should have for our customers.

Illustration No. 1 – Customer at the Center

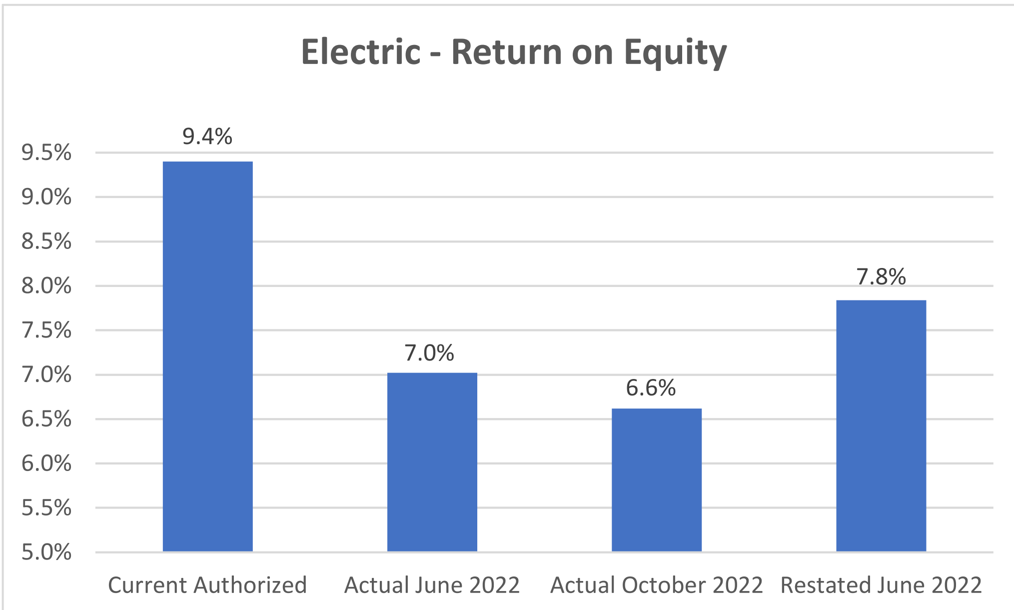
To effectuate this goal, Avista has been continuing its investment in Customer-Facing and Customer-Experience technologies, multiyear programs to improve Avista's interaction with all of our customers, and to provide employees a single reference point to meet the needs of our customers. Further information about these investments is described by Company witness Ms. Hydzik.

III. GENERAL COMMENTS REGARDING OVERALL ECONOMY

Q. Has the Company experienced a steady erosion in earnings since its last rate filing?

A. Yes, it has. The following illustration for Idaho electric operations depicts the erosion in earnings, resulting in returns well below the previously authorized levels (natural gas operations has not seen a similar drop due in part to a growth in the number of natural gas customers over the past few years, hence the lower overall proposed revenue increase request):

<u>Illustration No. 2 – Idaho Electric Return on Equity[1]</u>



Company witness Ms. Schultz provides more details on actual results of operations, restated results, and other revenue requirement adjustments.

Q. In light of persistent challenges, has Avista had reason to reduce its earnings guidance?

A. Yes, it has. On November 1, 2022, the Company reduced both 2022 and 2023 earnings guidance, as a result of "headwinds" from ongoing inflation, rising interest rates, higher depreciation expense and higher expected pension expense.

Q. Have the financial markets, including the rating agencies, taken notice?

A. Yes, Standard and Poor's, in November of 2022, <u>reduced the Company's outlook to negative</u> (from stable), with further concerns expressed about whether financial

[1] The restate results for June 2022 considers the full effect of the Year 2 revenue requirement increase from Avista's last general rate case (AVU-E-21-01) which took effect on September 1, 2022.

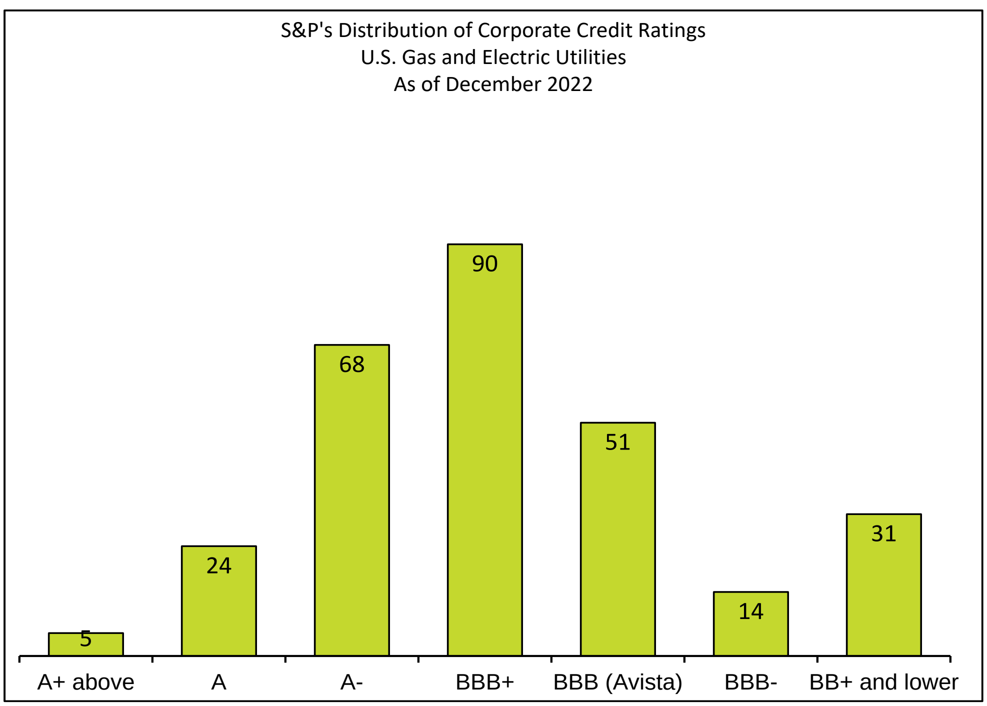
measures will further weaken to below the downgrade threshold.[2] Its rationale was expressed as follows:

> The negative outlook revision reflects our expectation for further weakening of Avista's financial performance to a level that is consistently below our downgrade threshold. Avista has historically operated with only a minimal financial cushion from its downgrade threshold. For 2018-2021, FFO to debt was 12.5% - 14.5%, indicative of a minimal financial cushion. However, incorporating inflation, rising interest rates, and regulatory lag, we expect its financial measures will consistently weaken to below our downgrade threshold of FFO to debt of 14%. Specifically, we expect FFO to debt to weaken to 13% - 14% through at least 2023.

Q. What is Avista's current S&P rating, and how does it compare with others in the industry?

A. As discussed by Mr. Thies, Avista currently maintains a BBB issuer credit rating from S&P, which is in the lower quadrant of utility ratings as shown in the chart below:

<u>Illustration No. 3 – S&P Corporate Credit Ratings - Utilities</u>



[2] "Avista Corp Outlook Revised to Negative on Weaker Financial Measures; Ratings Affirmed." https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/2916024 (November 11, 2022).

Accordingly, while Avista's rating is in the lower tier of comparable utility ratings, should it be downgraded further to BBB-, this would carry with it increased borrowing costs and other credit implications. Once downgraded, it typically takes a considerable time to reacquire the previous rating.

Q. Has Avista sought necessary relief from its other jurisdictions?

A. In Washington, the Company's largest jurisdiction, the Company has reached a multiparty settlement with nearly all parties (with the exception of the Office of Public Counsel); which was approved by the Commission on December 12, 2022, providing the Company with approximately 72% of its requested relief. That said, from the time the Company prepared and filed its Washington general rate case, and ultimately when the case was resolved, the ground upon which the case was based moved on us – namely the increases in interest rates, impacts due to increased inflation, and other cost pressures. As we noted during the process of the Washington case, the Company stated "[e]ven the Settlement level of agreed-upon revenue requirement may prove to be woefully inadequate, given higher inflation and interest rate increases that have occurred since the filing of this case".[3]

Q. Will the Company also be filing for rate relief in Oregon?

A. Yes. First, new rates in Oregon from the Company's last general rate case were effective in August 2022. As for the next rate case, Avista is expecting that filing to be made in the first half of 2023. With that filing, the Company will have done what it can to bring all cost recovery current in all jurisdictions it covers.

Q. Since the award of rate relief by this Commission in September of 2021, what new pressures have come to bear?

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[3] Dockets UE-220053 et. al., Exh. PDE-2T, p. 2.

A. First and foremost, inflation has greatly increased, which cuts across the board, affecting all goods and services, and even the labor the Company employs. The increases in the Producer Price Index (PPI) are most telling because they increase the goods and services that Avista purchases. As Company witness Dr. Forsyth testifies, the Stage 2 producer inflation has been higher than consumer inflation, with year-over-year inflation associated with goods impacts, service impacts, and construction impacts averaging approximately 12.5%, 10.4% and 11.3% respectively.[4] What was already a challenge to control costs before, has now become even more challenging. Moreover, this high level of inflation is likely to persist through the Two-Year Rate Plan, as testified to by Dr. Forsyth.

Q. To be more specific, can you cite to a few examples that show the impact that inflation has already had in the procurement of supplies?

A. Yes. When we simply look at just some of the key inputs utilized by Avista to provide service to our customers, in just 2022 alone, transformers have increased in cost by 30%, wood poles by 19%, electric conductor by 54%, electric and natural gas meters (when we can get them) by 32%, and natural gas pipe by 15%. These are the proverbial "nuts and bolts" we use to serve our customers and maintain our systems. These types of price increases, again just in 2022 alone, have put pressure on our returns and are a key driver of needed rate relief.

Q. Have supply chain disruptions also been a challenge?

A. Yes. Supply chain disruptions continue to affect our operations. We have had difficulties procuring, on a timely basis, everything from transformers, conductor, and meters. Presently <u>one out of every four shipments</u> of materials to Avista is <u>significantly delayed</u>.

[4] See Direct Testimony of Dr. Forsyth, Figure No. 3

Based on discussions with our supply chain team, those challenges are not projected to soon abate. While one out of four shipments being delayed might not sound meaningful, it has been disruptive. It has caused delays in project execution, and increased costs as we attempt to find other vendors that can support our needs on a timely basis.

Q. Do rising interest rates also present a challenge?

A. Yes. Interest rates have risen dramatically over the past several months and may continue to do-so-over time, as the Federal Reserve attempts to rein in inflation. In 2022, there were six increases in the Federal Funds Rate, bringing the current rate to a target range of 3.75% to 4.00%, from a target range of 0.25% to 0.50% prior to March 15, 2022.[5] That 375-basis point increase in the Federal Funds Rate spreads throughout all facets of the economy, affecting not only the cost of borrowing for Avista, but the cost of all goods purchased by the Company.

Q. Finally, what about labor costs and their effect on ongoing expenses?

A. Approximately half of our O&M costs are associated with labor, both union and non-union employees. Avista is operating in an increasingly competitive job market and has had to keep pace with salaries and wages to attract and retain a quality workforce – the very backbone of our operations. In April of 2022, the Company entered into a new-bargaining contract with its bargaining-unit employees, providing for increases of 3.5% in 2023, and an additional increase in 2024. These agreed-upon increases are generally in line with what the regional labor market demands to attract and retain employees. Likewise, non-bargaining unit employees also feel the pressures of the erosion of purchasing power as inflation takes hold. Their compensation must keep pace. To that end, we are seeing a 6% increase in 2023 for this

[5] https://www.forbes.com/advisor/investing/fed-funds-rate-history/

group and foresee a 3.5% increase in 2024 as well.

Q. Is the Company also faced with an increased level of retirements in its skilled workforce?

A. Yes, very much so. As the aging workforce continues to retire, this places additional pressures on the Company to attract and retain qualified candidates. While this impacts pension expense, it also focuses our attention on retaining existing employees with fair and reasonable compensation packages. Please be assured, however, that we do not manage these labor costs in a vacuum; instead, we rely on independent analysis of what the labor market demands.

Q. With all of that said, how would you characterize the environment in which the Company currently operates?

A. From a cost, commodity, supply chain, and labor perspective, it is among the most challenging environments that the Company has faced in many years. But we are also mindful of the pressures and challenges our customers are facing. They too are bearing the brunt of inflation in their day-to-day lives. To that end, we are looking for every opportunity to drive costs out of the organization, doing so without compromising service reliability. We are working hard to achieve that balance between cost and reliability. We answer to many constituents: our customers, our communities, our shareholders, and our employees. How we balance those interests answers the question of how successful we are.

Q. Is Avista continuing to pay particular attention to controlling its costs in order to mitigate the level of price increases to its customers?

A. Yes. We recognize that increases in costs will result in bills that will be more difficult for some of our customers to pay. I can assure you that we are not just sitting on the sidelines as our costs go up. We continue to aggressively manage costs to achieve the appropriate balance of providing safe and reliable service at cost-effective rates, along with a high level of customer satisfaction, while preserving the financial health of the utility. We are focused on long-term sustainable savings to continuously improve our service to customers and manage costs into the future.

Q. Is it fair to say that the environment of rising interest rates, inflation, supply chain disruptions has only worsened since rates were last established in Idaho in in the current rate plan?

A. Most definitely. Clearly all of the above creates additional rate pressure, notwithstanding our best efforts to manage costs. All of these pressures are compounded for a utility the size of Avista – one of the smallest investor-owned utilities in the Country.

Q. How is a focus on cost management instilled throughout the organization?

A. I believe that all of us at Avista are committed to providing safe, responsible, and affordable natural gas and electric service. One way to keep our employees focused on these goals is to have a portion of their compensation be at-risk, payable only with the achievement of certain customer-centered metrics. This "pay at-risk" component, in the form of our Short-Term Incentive Plan, keeps our employees focused on:

- O&M Cost per Customer (O&M CPC) - The O&M CPC is a measure that focuses on controlling costs and driving efficiencies in order to keep our costs reasonable for our customers. The metric is based on targeted O&M expense and number of customers. These components are combined to create the O&M CPC metric.

- Customer Satisfaction - This measure is derived from a Voice-of-the-Customer Survey, which is conducted each quarter by an independent agency. The rating measures the customer's overall satisfaction with the service they received during a recent contact with the Company's contact center and/or service center.

- Reliability - This measure tracks how quickly the Company restores outages, how frequently customers are affected by outages and what percent of customers experience more than three sustained outages per year. The Company combined three common industry indices in order to balance our focus.[6]

- Response Time – This measure tracks how quickly the Company responds to dispatched natural gas emergency calls. The primary objective is customer and public safety while consistently treating customers the same throughout our service territory.

We believe these metrics are intertwined, in that effective cost management aids in keeping our costs reasonable for our customers, which in concert with reliable service and appropriate response to disruptions in service, results in a positive experience for our customers as measured in the Company's Voice-of-the-Customer survey. In the end, we were very purposeful in choosing metrics we believe incentivize our employees to diligently execute cost management and efficiencies throughout the organization, while keeping our focus on safe and reliable electric and natural gas service.

Q. Earlier you mentioned continuous improvement. What initiatives have the Company employed in this area?

A. Avista is constantly looking for improvements in the way it provides services to its customers, as well as ways to reduce the costs of those services. Beginning several years ago, Avista actively engaged in Business Process Improvement (BPI). The goal of BPI is to give our employees the tools that allow for a mindset of continuous improvement through the elimination of waste. In BPI, waste is defined as defects, overproduction, waiting, nonstandard processes, transportation, inventory, and extra processing. There are many tools taught to those who have gone through BPI, and it is the intent of the program that graduates will continue the use of those tools and incorporate them into their work areas.

[6] This index combines Customer Average Interruption Duration Index (CAIDI), System Average Interruption Frequency Index (SAIFI) and Customer Experiencing Multiple Interruptions (CEMI3). CEMI3 measures the percentage of customers that experience more than three sustained outages in the year.

Q. Has the Company undertaken an even more recent initiative around transformational business change?

A. Yes, the Company embarked in 2020 on a new "Business Transformation" program. Business Transformation is an enterprise-wide, aspirational effort to create break-through, lasting value for our customers, employees, and shareholders by transforming the way we work and becoming a more adaptable organization. In short, we aim to "Aspire, Activate & Adapt for a thriving future." We aspire to create and deliver new value and sustained growth for <u>our customers</u> and shareholders, to activate <u>our people</u> to reimagine how we work, and adapt and <u>perform</u> with agility in a rapidly evolving world.

Q. Ultimately, have the benefits of Business Transformation affected electric and natural gas operations and customers in Idaho, and would you expect that to continue to the future?

A. The aspirations we have set forth under this long-term transformational program will help us make further progress in managing rising costs and help us meet our goal to provide affordable energy service to our customers. We must continue to evolve to become an even more adaptable organization that operates with focus, agility, accountability, and transparency. In the first 18 months of Business Transformation, the team designed and facilitated a Company-wide discovery of challenges and opportunities for transformation. Primary outcomes of this included uncovering multiple opportunities for long-term operational and cost efficiencies that may be able to drive better performance and a leaner culture. We have also completed a change readiness assessment of the organization that led to standing up an ongoing office of transformation and organizational change. The primary objective of the transformation office is to help us make further progress in managing rising costs and help us meet our goal to provide affordable energy service to our customers.

Q. What other measures have the Company undertaken in recent years to drive cost efficiencies?

A. First, the Company continues to operate under a hiring policy which requires final approvals by the President and CEO, the Chief Financial Officer, and the Vice President for Human Resources for all replacement or new hire positions. In an effort to keep medical office visits down, we offer access to phone or web-based 24/7 telemedicine and we have an on-site medical clinic. In 2017, Avista began offering a self-insured High Deductible Health Plan ("HDHP") in addition to the current self-insured plan. The HDHP requires plan participants to pay all costs of medical care up to defined deductible limits. Over time, we expect this plan to result in lower overall medical costs to the Company.

In addition, our process to identify and prioritize capital investment is designed to meet the overall need for investment, in the appropriate time frame, in a manner that best meets the future needs and expectations of our customers, in both the short-term and long-term. The Company's practice has been to constrain the level of capital investment each year, such that not all of the prioritized projects and programs will be funded in a given year at the level requested. Avista currently has chosen to stabilize the level of annual capital spending at what can be described as a constrained level of approximately $475 million (system), in an effort to accomplish the objectives described above. This is well below levels of requested funding generated within our organization. This is discussed in more detail by Mr. Thies.

Q. At the end of the day, how will these efforts position the Company going forward?

A. We pride ourselves on being an efficient, well-run utility that keeps the customer front and center. Whatever else happens, that remains our "core mission."

IV. SUMMARY OF GENERAL RATE CASE

Q. Would you please summarize the Company's Two-Year Rate Plan proposal included in this electric and natural gas general rate case filing?

A. Yes. In this filing, the Company is proposing a Two-Year Rate Plan, which would begin with new rates effective September 1, 2023 and September 1, 2024. The Company is proposing a Two-Year Rate Plan to, once again, avoid annual rate cases in its Idaho jurisdiction, providing benefits to all stakeholders. A Two-Year Rate Plan, with base rate increases in 2023 and 2024, would provide benefits to its customers by providing some level of rate certainty over this two-year period; relief to all stakeholders – customers, the Commission and its Staff, intervenors, and the Company - from the administrative burdens and costs of litigation of annual general rate cases; and to Avista by providing a two-year window to manage its business in order to achieve a fair rate of return within known price changes.[7] The Company filed for, and the Commission approved through settlement, a Two-Year Rate Plan in its 2021 general rate case. At that time, Avista found that the results would be reasonable, especially because the parties agreed, in settlement, to a reasonable first year revenue requirement. Unfortunately as we have all experienced, uncontrollable factors in the economy discussed earlier affected Avista's results during the present Two-Year Rate Plan, leading to insufficient cost recovery.

Q. Please elaborate on the benefits of a reasonable first year revenue requirement.

[7] The Two-Year Rate Plan would not preclude tariff filings authorized by or contemplated by the terms of the Power Cost Adjustment (PCA), Purchased Gas Adjustment (PGA), Public Purpose Rider Adjustment (DSM) or similar adjustments. The Company is proposing that the Two-Year Rate Plan also not preclude the Company from filing for rate relief or accounting treatment for major changes in costs not reflected in this filing, including but not limited to the potential for increasing corporate tax rates or new safety or reliability requirements imposed by regulatory agencies.

A. In any multiyear rate plan, the first-year revenue requirement approved by a commission will persist for each year of the rate plan and is the basis for an additional revenue adjustment in Rate Year 2. If the revenue requirement is sufficient for the first year of the plan, and the next year is built off of that revenue requirement, the utility would have a better opportunity to earn its allowed rate of return. But if the first-year revenue requirement is insufficient, that insufficiency will persist, and the utility may not be able to earn its authorized returns during the plan.

Q. Would you please provide an overview of the Company's general rate request?

A. Yes. As discussed by Company witnesses Ms. Schultz and Mr. Miller, the Company is requesting a Two-Year Rate Plan with a Rate Year 1 electric base rate relief of $37.5 million (14.7 percent billed) and natural gas base rate relief of $2.8 million (2.7 percent billed), effective September 1, 2023. Table No. 1 below provides the electric bill percentage change. The Company is also requesting a Rate Year 2 electric base rate relief of $13.2 million (4.5 percent billed) and natural gas base rate relief of $0.1 million (0.1 percent billed), effective September 1, 2024.

Table No. 1 below provides the billed impact of the Company's electric rate request, by rate schedule, for each of the two years. Table No. 2 provides the billed impact of the Company's natural gas rate request, again, for each of the two years, by rate schedule.

Table No. 1 – 2023 and 2024 Electric Billed Percentage Change

Rate Schedule	Description	2023 Billing Change	2024 Billing Change
Residential Service	Schedule 1	15.3%	4.7%
General Service	Schedules 11 & 12	14.2%	4.4%
Large General Service	Schedules 21 & 22	14.1%	4.3%
Extra Large General Service	Schedule 25	14.2%	4.4%
Extra Large General Service 25P	Schedule 25P	14.0%	4.3%
Pumping Service	Schedules 31 & 32	14.2%	4.4%
Street & Area Lights	Schedules 41 - 49	13.8%	4.2%
Total		**14.7%**	**4.5%**

Table No. 2 – 2023 and 2024 Natural Gas Billed Percentage Change

Rate Schedule	Description	2023 Billing Change	2024 Billing Change
General Service	Schedule 101	3.5%	0.1%
Large General Service	Schedules 111 & 112	0.0%	0.0%
Interruptible Service	Schedules 131 & 132	0.0%	0.0%
Transportation Service	Schedule 146*	0.0%	0.0%
Total		**2.7%**	**0.1%**

Q. What is the Company's proposed cost of capital?

A. The Company's electric and natural gas requests are based on a proposed rate of return of 7.59 percent, with a capital structure comprised of 50 percent equity and 50 percent debt, a 4.92 percent cost of debt, and a 10.25 percent return on equity (ROE). Company witnesses Mr. Thies and Mr. McKenzie discuss the support for the proposed cost of capital components.

Q. What is the monthly bill change for a residential electric customer with average consumption, in Year 1?

A. The proposed monthly bill change for a residential customer using an average of 927 kWhs per month is $13.18 per month, or a 15.4 percent change in their electric bill. The present monthly bill for 927 kWhs is $85.40, and that would increase to $98.58. This includes an $8 per month proposed increase in the basic charge, as discussed by Mr. Miller.

Q. What is the monthly bill change for a residential <u>electric</u> customer with average consumption, in <u>Year 2</u>?

A. The proposed monthly bill change for a residential customer using an average of 927 kWhs per month is $4.66 per month, or a 4.7 percent change in their electric bill. The present monthly bill for 927 kWhs is $98.58, and that would increase to $103.24. The monthly bill increase incorporates a $5 per month proposed increase in the basic charge, and a slight decrease in volumetric rates, as discussed by Mr. Miller.

Q. What is the monthly bill change for a residential <u>natural gas</u> customer with average consumption, in <u>Year 1</u>?

A. The proposed monthly bill change for a residential customer using an average of 64 therms of natural gas per month would be an increase of $2.60 per month, or 3.5 percent. The present monthly bill for 64 therms per month is $73.42, and the proposed bill would be $76.02. The monthly bill increase incorporates an $8 per month proposed increase in the basic charge (and decrease in the volumetric rate), as discussed by Mr. Miller.

Q. What is the monthly bill change for a residential <u>natural gas</u> customer with average consumption, in <u>Year 2</u>?

A. The proposed monthly bill change for a residential customer using an average of 64 therms of natural gas per month would be $0.14 per month, or 0.2 percent. The present bill for 64 therms per month is $76.02, and the proposed bill would be $76.16. The monthly bill increase incorporates a $5 per month proposed increase in the basic charge, offset by a decrease in volumetric rates, as discussed by Mr. Miller.

V. GENERAL RATE CASE DRIVERS

Q. What are the primary factors driving the Company's requested electric and natural gas revenue increases?

A. As discussed by Ms. Schultz, the primary factor driving the Company's electric and natural gas revenue requirements in Rate Year 1 and Rate Year 2 is an increase in net plant investment (including return on investment, depreciation, and taxes, and offset by the tax benefit of interest) from that currently authorized. For Rate Year 1 and Rate Year 2, electric net power supply expenses also contribute significantly to the incremental electric revenue requirement in each year. Other changes impacting the Company's revenue requirement requests relate to increases in distribution, operation and maintenance (O&M), and administrative and general (A&G) expenses for both electric and natural gas operations, compared to current authorized levels.

Q. What are the major components of the increased plant investment included in the Company's Rate Year 1 and Rate Year 2 electric and natural gas results?

A. Looking at the changes to "gross" plant in service for Rate Year 1, Idaho "gross" plant increases by approximately $240.6 million for electric, and approximately $45.6 million for natural gas, as compared to what is currently embedded in base retail rates.[8] For Rate Year 2, "gross" plant increases by approximately $83.5 million for electric, and approximately $11.9 million for natural gas, as compared to Rate Year 1. A breakdown of the incremental electric and natural gas gross plant additions for each year is shown in Table No. 3 as follows:

[8] Current embedded base retail rates include most net plant additions through December 31, 2021 for electric and natural gas base rates.

Table No. 3 – Gross Plant Additions

Gross Plant Additions (000s)						
	Electric				Total Over 2-YR Plan	
Investment	RY1[1]		RY2[2]			
Generation/Transmission	$	69,440	$	26,272	$	95,712
Distribution	$	131,261	$	46,325	$	177,586
General & Intangible	$	39,918	$	10,859	$	50,777
Total Electric Gross Additions	$	240,619	$	83,456	$	324,075
Net Plant Additions	$	148,250	$	36,752	$	185,002
	Natural Gas				Total Over 2-YR Plan	
Investment	RY1[1]		RY2[2]			
Distribution	$	41,077	$	11,503	$	52,580
General & underground Storage	$	4,522	$	353	$	4,875
Total Natural Gas Gross Additions	$	45,599	$	11,856	$	57,455
Net Plant Additions	$	32,708	$	4,947	$	37,655

[1]**RY1 - Effective September 1, 2023 - August 31, 2024**
[2]**RY2 - Effective September 1, 2024 - August 31, 2025**

The specific 2022 through August 2025 pro forma capital expenditures undertaken by the Company to expand and replace its generation, transmission, distribution and general facilities are discussed further by Company witnesses Mr. Kinney regarding production investment (including the Company's investment in Colstrip Units 3 and 4), Mr. DiLuciano regarding transmission, distribution and general investment, Mr. Kensok regarding the costs associated with Avista's IS/IT projects, Mr. Howell regarding Wildfire Plan investments, and Ms. Hydzik regarding customer technology projects.

Company witness Ms. Benjamin sponsors the restating and pro forma capital adjustments which incorporate the effects of these capital investments in the determination of the Company's proposed revenue requirements.[9]

[9] With the exception of the Pro Forma Colstrip Unit 3 and 4 investment and regulatory amortization included in Pro Forma Adjustments 3.17, which is discussed and sponsored by Ms. Andrews. The Colstrip Unit 3 and 4 generation capital additions in 2022 are discussed and sponsored by Mr. Thackston.

Q. What is driving the need for continued capital investment?

A. As discussed my Mr. Thies, there are six drivers of the Company's capital investments:

1. Respond to customer requests for new service or service enhancements;
2. Meet regulatory and other mandatory obligations;
3. Replace equipment that is damaged or fails, and support field operations;
4. Replace infrastructure at the end of its useful life based on asset condition;
5. Meet our customers' expectations for quality and reliability of service; and
6. Address system performance and capacity issues.

An explanation of each of these drivers, as well as examples of specific capital projects under these drivers, is provided by Mr. Thies, who also provides further details on our capital planning process, which is used to identify and prioritize capital investment, in the appropriate time frame, in a manner that best meets the future needs and expectations of our customers.

Q. Has Avista proposed to update changes in power supply costs, and transmission revenues and expenses?

A. Yes. As discussed in Company witness Mr. Kalich's testimony, the level of Idaho's share of power supply expense effective with Rate Year 1 has increased by approximately $10.3 million ($29.8 million on a system basis) from the level currently included in base rates. For Rate Year 2, Idaho's share of net power supply expense has increased by approximately $4.6 million ($13.2 million on a system basis) above Rate Year 1 levels.

In addition, as discussed by Company witness Mr. Dillon, effective with Rate Year 1, the level of Idaho's share of pro forma transmission <u>revenues increased</u> $2.9 million ($8.4 million on a system basis) from the level currently included in base rates. Idaho pro forma transmission revenue, however, decreases by $335,000 ($880,000 on a system basis) in Rate Year 2, versus that included in Rate Year 1.

Therefore, the net change in power supply expense and transmission revenues result in an overall net increase in electric costs of approximately $7.4 million in Rate Year 1 and $4.3 million in Rate Year 2.

Q. Please identify the main components of the distribution, O&M and A&G expense changes included in the Company's filing.

A. Although the Company has a series of increases in expenses, for electric operations these increases are largely due, in part, to changes in costs associated with the Company's Wildfire Plan expenses and increases in insurance related to higher premiums, as a result of wildfires across the Country. In addition, for both electric and natural gas operations, other increases are a result of increases in labor and benefits, as well as other operating expenses as a result of higher inflationary pressures experienced across the Company's operations. To recognize these cost changes, the Company has included a number of pro forma adjustments for Rate Year 1 and Rate Year 2 to capture the net increases the Company will experience from the June 30, 2022 test year. Further, Ms. Andrews provides testimony related to the present Wildfire Expense Balancing Account, and the Company's proposal to establish an Insurance Expense Balancing Account and baseline to reflect the significant increase in insurance expenses.

VI. COMMUNICATIONS WITH CUSTOMERS

Q. How is Avista communicating with its customers to explain what is driving increased costs for the Company?

A. The Company proactively communicates with its customers about a range of subjects through a variety of channels: Avista's website www.myavista.com, electronic and print newsletters, Avista Connect www.myavista.com/Connect, social media, customer forums, one-on-one customer interactions through field personnel and account representatives, bill inserts, direct email, media contacts, group presentations, and through our employees' involvement in community, business and civic organizations. We believe our communications help our customers and the communities we serve to better understand the utility business as well as issues faced by the Company that contribute to their energy rates, such as increased and ongoing infrastructure investment and improvement, commodity cost volatility, and security, among other things.

Our employees provide excellent customer service, and this focus on communicating with our customers includes providing our employees messaging and new tools and training to make it easier to communicate effectively with friends, family, and customers. We are finding that once a customer talks with our employees and voice their concerns and receive answers to their questions, their satisfaction level increases. We are also continuing our focus on informing customers of the many programs we offer to aid in managing their energy bills and ensuring that our employees are equipped to engage in these conversations.

Q. Would you briefly describe efforts the Company continues to undertake to drive a better customer experience when working with Avista?

A. Yes. I am very proud of the Company's primary focus on putting our customers at the center of our business in order to drive a better customer experience (CX). CX is how customers perceive their interactions with an organization. A customer's perception starts the moment they become aware of our Company and is made up of the sum of all of the interactions they have with us. There are three dimensions to CX that are components of an experience that increases customer experience and creates customer loyalty, these are:

Effective: effective interactions meet the needs of the customer. The product or service must deliver value to our customers or the experience will fail fundamentally. Effectiveness is critical even though it is less likely to drive customer loyalty than emotion.

Ease: easy interactions let customers achieve their goals with minimal effort. When alternative paths to value are harder, ease of doing business creates increased customer experience.

Emotion: the best interactions evoke positive customer emotions and avoid provoking negative emotions. Positive customer emotions can lead to customer retention, enrichment, advocacy, and loyalty.

CX creates customer loyalty and loyal customers mean more than retention. Loyal customers become advocates, they are more likely to seek our advice as trusted energy advisors and follow our safety messages. Loyal customers are more likely to be aware of and participate in the variety of products and services we offer such as Comfort Level Billing, energy efficiency programs, or renewable energy programs, to name a few. We also believe that loyal customers are beneficial for the utility and all other customers in the long-term, as competitive forces take hold in our industry.

Illustration No. 1 provided earlier in my testimony provides a summary of how Avista is showing *care* for our customers, the *ease* with which customers can interact with us, how we continue to build *trust*, and the *ownership* each and every employee should have for our customers. Through employee training, this has become essentially our "mantra".

VII. CUSTOMER SATISFACTION

Q. What kind of feedback are you receiving from customers related to customer satisfaction?

A. Our customer service surveys indicate that customer satisfaction remains high. Our overall customer satisfaction from our Voice-of-the-Customer (VOC) surveys for the month of November 2022 was 98% in our Washington, Idaho, and Oregon operating divisions. The purpose of the VOC Survey is to measure and track customer satisfaction for Avista Utilities' "contact" customers – i.e., customers who have contact with Avista through the Contact Center and/or work performed through an Avista construction office. This rating reflects a positive experience for customers who have contacted Avista related to the customer service or field service they received. These results can be achieved only with very committed and competent employees.

VIII. CUSTOMER SUPPORT PROGRAMS

Q. Please briefly summarize the customer support programs that Avista provides for its customers in Idaho.

A. Avista Utilities offers a number of programs for its Idaho customers, such as energy efficiency programs, Project Share for emergency assistance to customers, the Customer Assistance Referral and Evaluation Service (CARES) program, level pay plans, and payment arrangements. Some of these programs have served to mitigate the impact that COVID-19, in particular, had – and is continuing to have – on our customers and the overall affordability of their energy bill. In the 2021-2022 program year (October 1, 2021-September 30, 2022), approximately 11,997 payments were made to Idaho customers, totaling over $4.2 million in various forms of energy assistance (Federal LIHEAP program, Project Share, and local community funds). Some of the key programs that we offer, or support, are as follows:

1. **Project Share.** Project Share is a community fuel fund that is supported by a partnership of utilities and community action agencies; it provides "emergency" energy assistance to qualified households that have exhausted all other energy assistance resources. Avista employees and customers voluntarily donate to Project Share, and in 2021 this group donated $83,265 to the program. Additionally, during the same year the Company contributed $ $71,940 to Project Share. In 2021, 601 Avista customers were assisted by Project Share. In 2022, we

will see similar results.

2. **Customer Assistance Referral Evaluation Services (CARES) Program.** Avista's CARES Department works with customers experiencing circumstances such as medical crisis, unemployment, family hardships, or other special conditions that may impact the customer's ability to pay their utility bill. CARES works with the customer to connect them with energy assistance, provide specialized payment arrangements, and often delays disconnect to accommodate this process.

3. **Comfort Level Billing (CLB).** The Company offers the option for residential customers to pay the same bill amount each month of the year by averaging their annual usage. Under this program customers can avoid unpredictable winter heating bills.

4. **Multiple Payment Methods.** The Company offers a number of no-cost payment methods for residential customers. In addition to making a payment at pay stations, drop boxes, or paying by cash at pay stations or the Company's office, Avista also offers customers online payment options through the Company's website via ACH or credit/debit card. Whether paying online or by telephone, these options post to the customer's account almost immediately and these transactions can be completed without the customer leaving their home.

5. **Energy Efficiency.** Avista began offering energy efficiency programs to its customers in 1978. These programs pursue all cost-effective energy efficiency and operate within the prevailing market and economic conditions. Recent programs with the highest impacts on energy savings include residential and non-residential prescriptive lighting, residential fuel efficiency, site-specific lighting, and small business projects. Avista energy efficiency programs provide conservation and education options to the residential, low income, commercial, and industrial customer segments. Program delivery includes prescriptive, site-specific, regional, upstream, behavioral, market transformation, and third-party direct install options. Prescriptive programs, or standard offerings, provide cash incentives for standardized products such as the installation of qualifying high-efficiency heating equipment. Prescriptive programs work in situations where uniform products or offerings are applicable for large groups of homogeneous customers and primarily occur in programs for residential and small commercial customers.

IX. SUMMARY OF WITNESSES

Q. Would you please provide a brief summary of the testimony of the other witnesses representing Avista in this proceeding?

A. Yes. The following additional witnesses are presenting direct testimony on behalf of Avista:

Mr. Mark Thies, Executive Vice President, Chief Financial Officer and Treasurer, will provide a financial overview of Avista Corporation as well as explain our credit ratings and the Company's proposed capital structure and overall rate of return in this case. In brief, he provides information that shows:

1. Avista's plans call for a continuation of utility capital investments in generation, transmission, electric and natural gas distribution systems, and technology to preserve and enhance service reliability for our customers, including the continued replacement of aging infrastructure. Capital expenditures of $475 million per year (system) are planned for the five-year period ending December 31, 2027. Avista needs adequate cash flow from operations to fund these requirements, together with access to capital from external sources under reasonable terms, on a sustainable basis.

2. We are proposing an overall rate of return of 7.59 percent, which includes a 50 percent common equity ratio, a 10.25 percent return on equity, and a cost of debt of 4.92 percent. We believe our proposed overall rate of return of 7.59 percent and the proposed capital structure provide a reasonable balance between safety and economy.

3. Avista's corporate credit rating from Standard & Poor's (S&P) is currently BBB and Baa2 from Moody's Investors Service, However, in November 2022, S&P revised their outlook on Avista to negative from stable and affirmed our 'BBB' issuer credit rating. S&P cited weaker financial measures due to higher expenses (inflation), customer refunds, rising interest rates and delayed recovery of purchased fuel costs as reasons for their revision. Avista must operate at a level that will support a solid investment grade corporate credit rating in order to access capital markets at reasonable rates. A supportive regulatory environment is an important consideration by the rating agencies when reviewing Avista. Maintaining solid credit metrics and credit ratings will also help support a stock price necessary to issue equity under reasonable terms to fund capital requirements.

Mr. Adrien McKenzie, as President of Financial Concepts and Applications (FINCAP), Inc., has been retained to present testimony with respect to the Company's cost of common equity. He concludes that:

- To reflect the risks and prospects associated with Avista's jurisdictional utility operations, his analyses focus on a proxy group of 22 utilities with comparable investment risks.

- Because investors' required return on equity is unobservable and no single method should be viewed in isolation, he applies the DCF, CAPM, ECAPM, and risk premium methods to estimate a fair ROE for Avista, as well as referencing the expected earnings approach.
- Based on the results of these analyses and giving less weight to extremes at the high and low ends of the range, he concludes that the cost of equity for the proxy group of utilities is in the **9.9 percent to 11.3 percent** range, or **9.97 percent to 11.37 percent** after incorporating an adjustment to account for the impact of common equity flotation costs.
- As also reflected in the testimony of Mark T. Thies, Avista is requesting a fair ROE of **10.25 percent**, which is below the **10.67 percent** midpoint of his recommended range. Considering capital market expectations, the exposures faced by Avista, and the economic requirements necessary to maintain financial integrity and support additional capital investment even under adverse circumstances, it is his opinion that 10.25 percent represents a reasonable ROE for Avista.

Ms. Kaylene Schultz, Manager of Regulatory Affairs, describes accounting and financial data in support of the Company's Two-Year Rate Plan for the period September 1, 2023, through August 31, 2025. She explains pro formed operating results, including expense and rate base adjustments made to actual operating results and rate base. In addition, she incorporates the Idaho-share of the proposed adjustments of other witnesses in this case.

Ms. Elizabeth Andrews, Senior Manager of Revenue Requirements, describes various adjustments included in the electric and natural gas revenue requirement studies prepared for the Company's proposed Two-Year Rate Plan. These adjustments include the following: 1) Pro Forma Wildfire Plan Expenses, 2) Pro Forma Insurance Expense, 3) Pro Forma EDIT (RSGM)[10], 4) Pro Forma Miscellaneous Operations and Maintenance (O&M) Expense, and 5) Pro Forma Colstrip Capital Additions & Amortization Expense.[11] In addition, she discusses the Company's requests to update its Wildfire Balancing Account baseline to match pro

[10] Reverse South Georgia Method

[11] The Company has reflected a change in accounting method for EDIT expense from the Average Rate Assumption Method (ARAM) to the Reverse South Georgia Method (RSGM). This accounting change results in a minimal reduction to Idaho electric and natural gas EDIT expenses.

formed wildfire plan expenses, as well as discusses the Company's proposal to establish an Insurance Expense Balancing Account and baseline to reflect the significant increase and volatility in insurance expenses. Finally, she discusses the accounting methodology change related to the Company's Excess Deferred Income Taxes (EDIT) expense that has occurred since the Company prior general rate case, as well as provided an update on the Company's electric and natural gas deferred federal tax credit balances.

Mr. Scott Kinney, Vice President of Power Supply, provides an overview of Avista's electric and natural gas resource planning and power and natural gas supply operations. This overview includes summaries of the Company's current and future resource plans, as well as an overview of the Company's Energy Resources Risk Policy. He addresses the generation-related capital projects included in the Company's Two-Year Rate Plan filed in this case, including capital additions associated with the Company's investment in Colstrip Unit Nos. 3 and 4 pro-formed in this case (i.e. the 2022 Dry Ash project). He concludes with a discussion of the Chelan PUD Power Purchase Agreement.

Mr. Clint Kalich, Senior Manager of Resource Planning & Power Supply Analyses, includes documentation of the rationale for key inputs and assumptions driving power supply cost values, including loads, natural gas and electricity prices, and a comparison to current levels of authorized power supply expense. He provides an overview on contract changes since our last filing, including our newly signed Columbia Basin Hydro contract, and discusses Washington State's new Climate Commitment Act (CCA) and how its limitations on thermal plant carbon emissions affect Idaho costs. Finally, he identifies and explains the proposed pro forma adjustments to test period power supply revenues and expenses, including the Retail Revenue Credit used in the Power Cost Adjustment (PCA).

Mr. Kenneth Dillon, Senior Manager, FERC Policy and Transmission Services, presents Avista's transmission revenues and expenses included in the Company's request for rate relief over the Two-Year Rate Plan, supporting updated transmission revenues effective September 1, 2023 (Rate Year 1) and September 1, 2024 (Rate Year 2).

Mr. Joshua DiLuciano, Vice President of Energy Delivery, will provide an overview of the Company's electric and natural gas energy delivery facilities and explain the factors driving our continuing investment in electric distribution infrastructure. He explains how our efforts to maintain the asset health and performance of our electric transmission system, including compliance with mandatory federal standards for transmission planning and operations, is driving a continuing demand for new investment. Further, he describes why our investments in natural gas distribution are necessary in the time frames completed and why each capital investment in our operations facilities and fleet operations is needed to support the efficient delivery of service to our customers, today and into the future. Furthermore, he addresses the electric and natural gas distribution, transmission, general plant and fleet-related capital additions included in the Company's Two-Year Rate Plan filed in this case, for the periods July 1, 2022 through August 2025.

Mr. David Howell, Director of Electric Operations and Asset Maintenance, discusses the status of the Company's Wildfire Resiliency Plan ("Wildfire Plan" or "Plan"), reiterates its goals and objectives, and summarizes the technical and operational aspects of the Plan. Avista's Wildfire Plan reflects the Company's 130-year operating history, combined with recent efforts to quantify and respond to the financial, safety-related, and service reliability risks associated with wildfires.

Mr. James Kensok, Vice President and Chief Information and Security Officer, provides an overview of, and discusses costs associated with, the Company's Information Service/Information Technology (IS/IT) programs, projects and security. These costs are comprised of the capital investments for a range of IS/IT projects that support systems used by the Company, as well as cyber and physical security projects and costs. He explains why our information technology and security investments are necessary in the time frames indicated and why investments in technology are necessary. In addition, he describes the capital additions, and incremental expenses, associated with the Company's IS/IT costs included over the Two-Year Rate Plan.

Ms. Nicole Hydzik, Director of Energy Efficiency, will provide an overview of the Company's "Customer at the Center" initiative as discussed earlier in my testimony, and addresses the rationale for the projects that we have included in this rate case over the Two-Year Rate Plan.

Ms. Tia Benjamin, Manager of Regulatory Affairs, describes the Company's restated twelve-months ended June 30, 2022, net plant from average-of-monthly-averages (AMA) to end-of-period (EOP) adjustment, as well as explains how pro forma capital additions for the period of July 1, 2022 through August 31, 2025, including the effect of newly proposed depreciation rates, are incorporated into the Company's Two-Year Rate Plan and proposed electric and natural gas revenue requirements sponsored by Ms. Schultz.

Mr. John Spanos, President of the firm Gannett Fleming Valuation and Rate Consultants, LLC, sponsors the depreciation study performed for Avista. He states that the depreciation rates as of December 31, 2021, appropriately reflect the rates at which the values of Avista's assets have been consumed over their useful lives to date. These rates are based on the most commonly used methods and procedures for determining depreciation rates. The life and net salvage parameters are based on widely used techniques and the depreciation rates are based on the average service life procedure and remaining life method. Therefore, the depreciation rates set forth in his Exhibit represent the calculated rates as of December 31,

2021. Ms. Benjamin reflects the results of his developed depreciation rates per the Depreciation Study within her capital adjustments, impacting the Idaho electric and natural gas revenue requirement over the Two-Year Rate Plan proposed in this proceeding.

Dr. Grant Forsyth, Chief Economist, describes the inflationary pressures facing the Company that I discussed earlier in my testimony. He also discusses the proposed methodology changes to the Company's weather normalization process.

Mr. Marcus Garbarino, Manager of Regulatory Affairs, covers the Company's electric revenue normalization adjustment to the test year results of operations, the proposed Load Change Adjustment Rate to be used in the Power Cost Adjustment and Fixed Cost Adjustment mechanisms, and the electric cost of service study performed for this proceeding.

Mr. Joel Anderson, Regulatory Analyst, covers the Company's natural gas cost-of-service study performed for this proceeding. Additionally, he is sponsoring the natural gas revenue normalization adjustments to the test year results of operations.

Mr. Joseph Miller, Senior Manager of Rates and Tariffs, discusses the spread of the proposed 2023 and 2024 electric and natural gas base revenue increases among the Company's electric and natural gas general service schedules. His testimony will also describe the changes to the rates within the Company's electric and natural gas service schedules, and proposed changes to the residential basic charges.

Q. Does this conclude your pre-filed direct testimony?

A. Yes.