

BEFORE THE
PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UG-366

DIRECT TESTIMONY OF DENNIS P. VERMILLION
REPRESENTING AVISTA CORPORATION

Policy and Operations

1 **I. INTRODUCTION**

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

3 A. My name is Dennis P. Vermillion and I am employed as the President of Avista
4 Corporation, and also sit on the board of directors. I am the chairman of the board of directors
5 for Avista's subsidiary Alaska Electric Light and Power Company. My business address is
6 1411 East Mission Avenue, Spokane, Washington.

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

9 A. Yes. I received a Bachelor of Science degree in electrical engineering from
10 Washington State University in 1985. I started working for Avista in 1985 and have held
11 numerous positions in energy trading, marketing, risk management, power transmission
12 contracting, and resource planning and coordination. I was appointed as President and Chief
13 Operating Officer of Avista Energy, Avista's marketing subsidiary, in 2001. I was appointed
14 Vice President of Energy Resources for Avista in 2007 at the close of the sale of Avista Energy.
15 I currently serve as a board member for Western Energy Institute (WEI) and American Gas
16 Association (AGA) and the Avista Foundation. I formerly served on the board of Spokane
17 County United Way and am a past chairman of the Spokane County United Way campaign.

18 **Q. What is the scope of your testimony?**

19 A. I will provide an overview of Avista Corporation. I will also summarize the
20 Company's rate request in this filing, the primary factors driving the Company's need for
21 general rate relief, and provide some background on why utility costs are continuing to increase.
22 A large part of our need for a rate increase is driven by the costs associated with continuing to

1 expand and replace the facilities we use every day to serve our customers. When we replace
2 old equipment with new, it results in higher overall costs to serve customers.

3 My testimony will also briefly explain the Company's customer support programs in
4 place to assist our customers, as well as our communications initiatives to help customers better
5 understand the changes in costs that are causing our rates to increase.

6 Finally, I will introduce each of the other witnesses providing testimony on the
7 Company's behalf.

8 **Q. Are you sponsoring exhibits in this proceeding?**

9 A. Yes. I am sponsoring three exhibits. Exhibit No. 101, page 1, includes a map
10 of the Company's service territories, and page 2 includes a map of the natural gas trading hubs,
11 interstate pipelines, and natural gas storage facilities. Exhibit No. 102 includes a diagram of
12 Avista's corporate structure, and Exhibit No. 103 shows natural gas pipeline pressures for a
13 portion of the Company's Medford-area distribution system before and after the completion of
14 the East Medford High Pressure Reinforcement. These exhibits were prepared under my
15 direction.

16 A table of contents for my testimony is as follows:

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1 **II. OVERVIEW OF AVISTA**

2 **Q. Please briefly describe Avista Utilities.**

3 A. Avista Utilities provides natural gas distribution service in southwestern and
4 northeastern Oregon. The Company also provides electric and natural gas service within a
5 30,000 square mile area of eastern Washington and northern Idaho.¹ Of the Company's
6 approximately 388,000 electric and 355,000 natural gas customers (as of December 31, 2018),
7 approximately 103,100 were Oregon customers.

8 As of December 31, 2018, Avista Utilities had total assets (electric and natural gas) of
9 \$5.5 billion (on a system basis), with electric retail revenues of \$801 million (system) and
10 natural gas retail revenues of \$288 million (system). As of December 31, 2018, Avista Utilities
11 had 1,766 regular and seasonal employees.

12 Avista serves four counties in southwest Oregon and one county in northeast Oregon,
13 which include the cities of Medford, Klamath Falls, Roseburg, Ashland, Grants Pass and
14 LaGrande, as shown on page 1 of Exhibit No. 101. The Company's Oregon service area
15 includes approximately 82 miles of natural gas distribution mains and 2,000 miles of
16 distribution lines. Natural gas is received at more than 20 points along interstate pipelines and
17 distributed to our residential, commercial and industrial customers.

18 Avista purchases natural gas for its distribution customers in wholesale markets at
19 multiple supply basins in the western United States and western Canada. Purchased natural gas
20 can be transported through six connected pipelines on which Avista holds firm contractual
21 transportation rights. These contracts provide access to both US and Canadian-sourced supply,
22 as illustrated on page 2 of Exhibit No. 101. The US-sourced gas represents approximately 20%

¹ Avista also serves 32 retail electric customers in western Montana.

1 of the contractual rights, with transportation from the Rocky Mountains. The remaining 80%
2 comes from Alberta and British Columbia supply basins.

3 Avista was one of the three original developers of the natural gas storage facility at
4 Jackson Prairie. Avista, Puget Sound Energy and Williams Northwest Pipeline each hold a
5 one-third share of this underground natural gas storage facility. Development began in the
6 1960's and the project first went into service in 1972. A portion of this natural gas storage
7 facility is used to serve our Oregon customers.

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

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

14

15 **III. SUMMARY OF AVISTA'S GENERAL RATE REQUEST**

16 **Q. Why is Avista requesting a revenue increase?**

17 A. For the twelve-months ended December 31, 2018, Avista's earned rate of return
18 ("ROR") was 6.36% on a normalized basis, which is well below the previously approved
19 authorized ROR of 7.35% for the Company. We were last awarded general rate relief in 2017
20 and that covered the costs associated with new utility plant investment through November 1,
21 2017. Additional revenues from this case are necessary to cover the costs associated with
22 significant new plant investment, as well as increased operating costs for the twelve-month test
23 period ended December 31, 2020.

1 **Q. Would you please summarize Avista Utilities' request in this filing?**

2 A. Yes. A combination of increasing rate base and increases in general business
3 expenses results in an overall requested increase in billing rates of \$6.677 million or 7.8%.²
4 This request is based on a proposed rate of return of 7.55%, with a capital structure common
5 equity component of 50%, and a 9.9% return on equity. The Company is utilizing a forecasted
6 test year for the twelve-months ended December 31, 2020. The Company used the results of a
7 long-run incremental cost of service study as a starting point in developing the proposed spread
8 of the requested increase to the various customer rate schedules. Company witness Mr. Miller
9 discusses the proposed uniform percent of margin rate spread, and proposed rate design issues.

10 Based on an average usage level of 47 therms per month, the average residential bill
11 would increase \$3.91 per month, or 8.0%, from \$48.94 to \$52.85.

12 **Q. What are the primary factors causing the Company's request for a natural**
13 **gas rate increase?**

14 A. Over 92% (or approximately \$6.1 million) of the Company's need for additional
15 rate relief relates to the increase in rate base. As will be described in more detail by Company
16 witnesses Mr. Thies and Ms. Smith, these investments reflect, among other things, replacement
17 and maintenance of Avista's utility system to maintain reliability, safety, and service to
18 customers. Major projects included in this total include the continued Aldyl-A Pipe
19 Replacement program, Gas Meter Replacement, Endpoint Compute and Productivity System,
20 Customer Facing Technology Projects, compliance with municipal requirements (i.e.,
21 street/highway relocations), and the overall systematic replacement of aging infrastructure,

² The overall bill increase in total revenue, which includes natural gas costs and all other rate adjustments, is 7.8%. On a margin revenue basis, which excludes the cost of gas and other rate components, the overall increase is 10.3%.

1 among other projects and programs.

2 The remaining 8% (or approximately \$0.6 million) of the Company's requested revenue
3 requirement relates to an increase in O&M and A&G expenditures, net of the change in retail
4 revenues since our last rate case.

5 **Q. What is driving the investment in utility plant in Oregon?**

6 A. As discussed in more detail by Ms. Smith, the Company continues to maintain,
7 upgrade, and expand its distribution facilities to meet reliability requirements and capacity
8 needs. More specifically, the need for capital investment is driven by, among other factors,
9 capacity constraints, the systematic replacement of assets that have reached the end of their
10 useful lives, compliance with federal regulation (e.g., Pipeline and Hazardous Material Safety
11 Administration rules) or municipal requirements (e.g., street/highway relocations), connections
12 of new customers, the systematic replacement of aged and obsolete technology, and the
13 maintenance of supporting facilities and technology. The Company is also continuing with its
14 20-year program to systematically remove and replace select portions of the Aldyl-A pipe in
15 the Company's natural gas distribution system.

16 Company witness Mr. Thies (Exh. 201) sponsors Avista's "Infrastructure Investment
17 Plan", a plan that provides an overview of our capital investment prioritization process and the
18 six key "investment drivers", which are:

- 19 1. Respond to customer requests for new service or service enhancements;
- 20 2. Meet our customers' expectations for quality and reliability of service;
- 21 3. Meet regulatory and other mandatory obligations;
- 22 4. Address system performance and capacity issues;
- 23 5. Replace infrastructure at the end of its useful life based on asset condition; and

1 6. Replace equipment that is damaged or fails, and support field operations.

2 An explanation of each of these drivers, as well as examples of specific capital projects
3 under these drivers, is provided in the Infrastructure Investment Plan included as Exhibit No.
4 203 in this filing. Mr. Thies provides further details on our capital planning process, which is
5 used to identify and prioritize capital investment to meet the overall need for investment in the
6 appropriate time frame, in a manner that best meets the future needs and expectations of our
7 customers. Ms. Smith provides details of the capital projects included in the Company's filing.

8 **Q. Are any costs associated with the proposed merger with Hydro One**
9 **included in the Company's general rate request?**

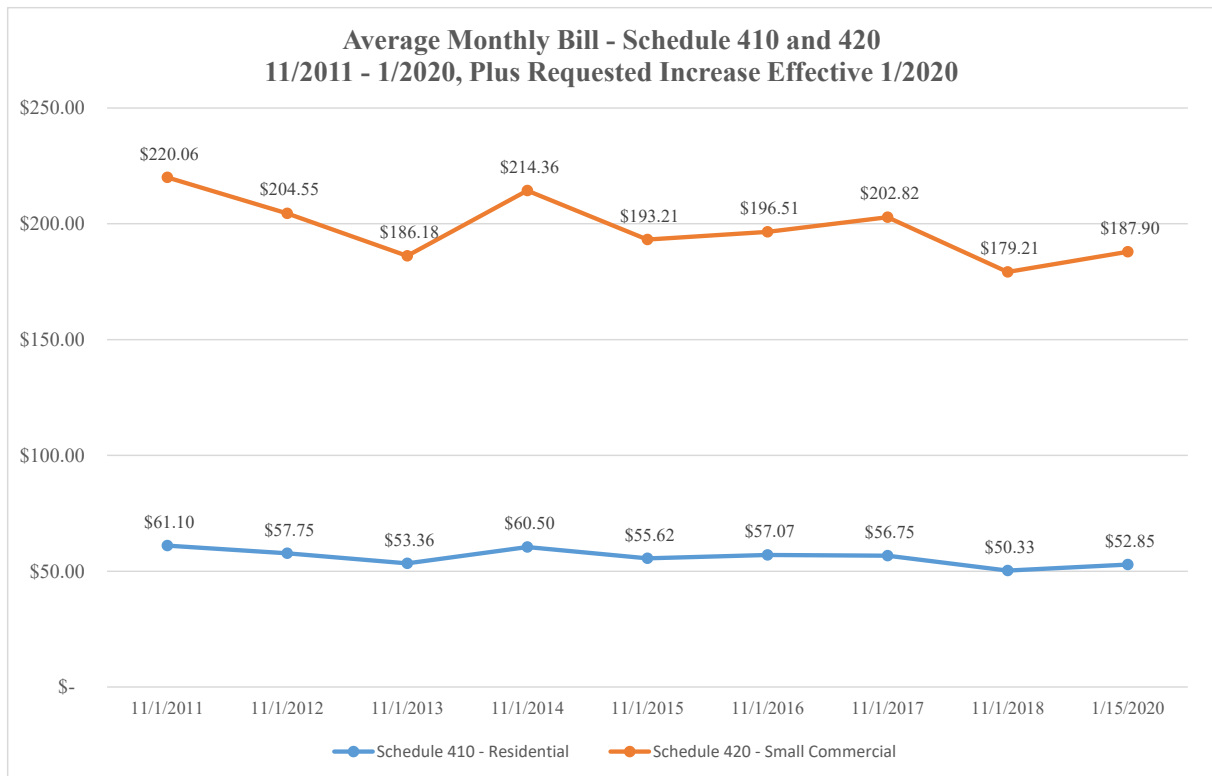
10 A. No, there are not. Any costs associated with the proposed merger were charged
11 to non-utility accounts. As a second check, Avista's Regulatory Affairs personnel did a
12 thorough review of its general ledger to verify that no costs were included in this case that were
13 associated with the proposed transaction, as testified to by Ms. Smith.

14 **Q. Is Avista mindful of the impacts to customers' bills as it continues to make**
15 **necessary investments to its natural gas system?**

16 A. Yes. We know natural gas infrastructure investments have a direct effect on
17 customer bills. As we continue to prioritize the investments necessary to provide safe, reliable
18 service, we are also paying attention to the impacts these investments have on customers' bills.

19 Illustration No. 1 below provides a comparison of an average monthly bill for Schedules
20 410 and 420 at November 1 of each year, starting in 2011, as well as the estimated bill at January
21 15, 2020 (the estimated date new rates would go into effect as a result of this general rate case).

Illustration No. 1: Average Monthly Bill Schedule 410 Residential and 420 Small Commercial



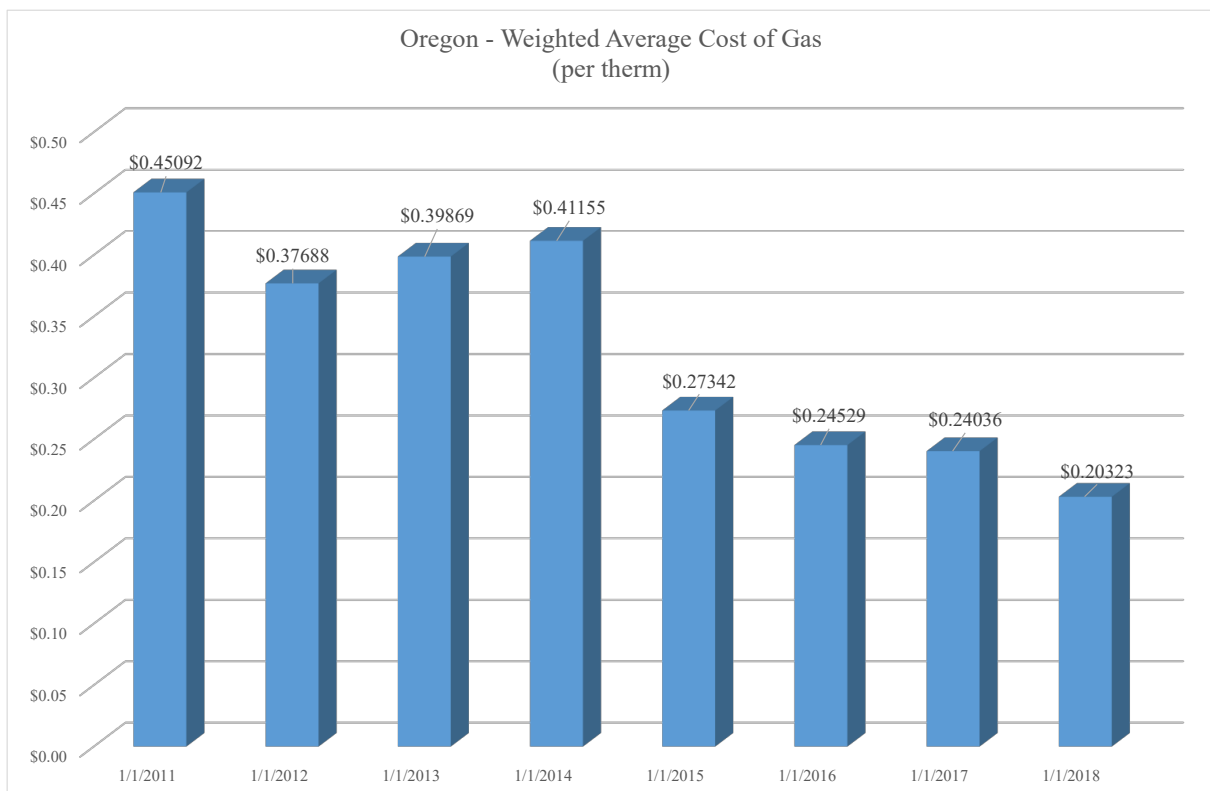
The illustration shows that bills for residential customers, using an average of 46 therms under Schedule 410, have remained relatively flat over this time period. The same is true for small commercial customers on Schedule 420.

The reduction in wholesale natural gas commodity costs have helped to insulate customers from necessary increases required to maintain a safe and reliable natural gas distribution system. If the Company's proposed base rate increase is approved as filed, the bill for a Schedule 410 customer, with average usage, would be 13.5 percent lower than the comparable customer bill in 2011. The bill for a Schedule 420 customer with average usage would be 14.6 percent lower than in 2011.

1 **Q. Please briefly summarize the change in natural gas commodity costs in**
2 **recent years.**

3 A. The strong supply of natural gas resulting from technological advancement in
4 drilling has put downward pressure on the wholesale price of natural gas in the recent years.
5 The bar chart in Illustration No. 2 below shows the weighted average cost of natural gas
6 embedded in our Oregon customers’ retail rates from 2013 through 2018. The full benefits of
7 the decrease in wholesale natural gas costs during this period were passed through to natural
8 gas customers in our annual Purchased Gas Adjustment (PGA) filings, with new rates effective
9 November 1st of each year.³

10 **Illustration No. 2: Oregon Weighted Average Cost of Gas**



³ On December 22, 2017, Avista filed an “out of cycle” PGA in order to pass through to customers the benefits of lower wholesale natural gas prices. The Commission approved the Company’s filing effective February 1, 2018.

1 **IV. COST MANAGEMENT AND EFFICIENCIES**

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

4 A. Yes. We recognize that increases in costs will result in bills that will be more
5 difficult for some of our customers to pay. I can assure you that we are not just sitting on the
6 sidelines as our costs go up.

7 We continue to manage costs to achieve the appropriate balance in providing safe and
8 reliable service at cost-effective rates, and a high level of customer satisfaction, while
9 preserving the financial health of the utility. We are focused on long-term sustainable savings
10 to continuously improve our service to customers and manage costs into the future. Some of
11 the cost-savings measures from the last few years that we are continuing are briefly explained
12 below, as well as a number of more recent initiatives.

13 First, the Company continues to operate under a hiring restriction which requires
14 approval by the Chairman and CEO, the President, the Chief Financial Officer, and the Senior
15 Vice President for Human Resources for all replacement or new hire positions.

16 In an effort to keep medical office visits down, we offer access to phone or web-based
17 24/7 telemedicine and we have an on-site medical clinic. Beginning in 2017, Avista offered a
18 self-insured High Deductible Health Plan (“HDHP”) in addition to the current self-insured plan.
19 The HDHP requires plan participants to pay all costs of medical care up to defined deductible
20 limits. Over time we expect this plan to result in lower overall medical costs to the Company.

21 Avista continues to work to automate our systems through technology where reasonable
22 and prudent to do so, and we work to negotiate discounted multi-year contracts with vendors
23 that result in discounted maintenance and expenses. As an example, in 2016 we introduced a

1 cloud-based business performance monitoring tool that automates a portion of the labor
2 performed by our IS teams. This subscription-based license model resulted in a significant
3 reduction of internal labor costs over a three year period, allowing us to redeploy our IS
4 operations team labor resources and providing immediate cost savings.

5 The Company's "Work Digitization Effort" prioritized opportunities that have a cost
6 savings potential by digitizing the remaining back office, work processes, inventory or other
7 areas where we might be able to achieve efficiencies. This presented a chance to think about
8 how we might continue to streamline our processes using technology and ultimately create an
9 inventory of opportunities. Avista assembled a team of 40 individuals from across the
10 organization and requested that they poll their respective business units for possible ideas to
11 achieve efficiencies and find cost savings. The team collected the ideas and brought them in
12 for review and analysis to determine if they were being addressed in another forum, or if they
13 had merit for future sequencing, planning & implementation efforts. This activity allowed our
14 project planning team an opportunity to ensure that efforts known to create efficiencies were
15 being appropriately sequenced for action. Some of the initiatives did indeed have planned
16 phased approaches in order to provide streams of value in smaller, sequential projects, such as
17 the Retirement Unit Catalog effort, Online Gas Availability and Intranet web page rollouts (per
18 business unit). We are continuing to sequence these efforts for planning and implementation
19 as we have funding to do so, and as they make prudent sense to complete.

20 Another example where the Company has successfully managed its expenses, is related
21 to our Fleet asset management program which includes optimizing our maintenance schedule
22 to reduce repairs and ensure peak performance, idle reduction programs to reduce fuel
23 consumption, "right-sizing" engines to maximize fuel efficiency, and using recycled motor oil.

1 The Company's Investment Recovery Department receives used and unused materials
2 from the field and inspects these materials for reassignment, reuse, recycling or scrapping.
3 Avista inspected 1.7 million pounds of scrap in 2017 for a total savings of \$690,000 (system).

4 In 2016, Customer Service partnered with Supply Chain to review the existing contracts
5 with each of our three collection agencies. At the same time, Avista participated in a benchmark
6 study that revealed opportunities for lowering the fees we were paying to our collection
7 agencies and implement new processes of working together to increase the recovery percentage
8 on the dollars we assign to the collection agencies. Later that same year, Customer Service
9 adopted a scorecard process utilized by Supply Chain as a tool for performance management.
10 The collection agency scorecard provides a baseline against which future results are compared
11 (trend analysis). This weighted scoring matrix includes delivery, innovation and technology,
12 quality of service and communication, risk mitigation and customer service. The new scoring
13 matrix was presented to each agency along with a request to reduce fee rates in order to match
14 the industry norms and improve collection recovery rates.

15 Shortly after the initial presentation of the new scorecards, three new contracts were
16 fully executed, each including reduced fee rates. The efforts put forth in building strong
17 partnerships, mutual accountability and communication have proven to be highly successful. In
18 comparison to the baseline performance established in 2016, the collection agency recoveries
19 have increased by 50% while our fee rates paid have been reduced by 12%. The estimated
20 value for 2018 compared to the 2016 baseline performance is approximately \$511,000 (system).

21 **Q. Are these the only measures the Company has taken recently to mitigate**
22 **increased costs?**

23 A. No. As provided earlier, Avista is constantly looking for improvements in the

1 way it provides services to its customers, as well as ways to reduce the costs of those services.
2 Ideas are generated through Business Process Improvement (BPI). BPI integrates the expertise
3 of people, streamlines process, and appropriately applies technology to optimize business
4 processes and create sustainable results. Most of the savings/efficiencies referenced above are
5 a direct result of this process.

6
7 **IV. CUSTOMER COMMUNICATION, SATISFACTION, AND SUPPORT**
8 **PROGRAMS**

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

11 A. The Company communicates with its customers in a number of ways: customer
12 forums, one-on-one customer interactions through field personnel and account representatives,
13 through Avista's website and device applications, bill inserts, social media, and through our
14 employees' involvement in community, business and civic organizations, to name a few. We
15 believe our communications are helping our customers, and the communities we serve, better
16 understand the issues faced by the Company, such as increased infrastructure investment, which
17 has led to higher costs for our customers.

18 Our employees provide excellent customer service, and this focus on communicating
19 with our customers includes providing our employees messaging and training to make it easier
20 to communicate with friends, family and customers. We are finding that once a customer talks
21 with our employees, and voices their concerns and receives answers to their questions, their
22 satisfaction level increases.

23 We are also continuing our focus on informing customers of the many programs we
24 offer to provide assistance in managing their energy bills, and ensuring that our employees are

1 equipped to engage in these conversations.

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

4 A. Our customer service surveys indicate that customer satisfaction remains high.
5 Our overall customer satisfaction from our voice-of-the-customer (VOC) surveys for 2018 was
6 97% in our Oregon, Washington, and Idaho operating divisions, the highest ever ratings since
7 the Company began tracking VOC over twenty years ago. The purpose of the VOC Survey is
8 to measure and track customer satisfaction for Avista Utilities' "contact" customers – i.e.,
9 customers who have contact with Avista through the Contact Center and/or work performed
10 through an Avista construction office. This rating reflects a positive experience for customers
11 who have contacted Avista related to the customer service or field service they received. These
12 results can be achieved only with very committed and competent employees.

13 **Q. Please explain the customer support programs that Avista provides for its**
14 **customers in Oregon.**

15 A. Avista Utilities offers a number of programs for its Oregon customers, such as
16 the Low-Income Rate Assistance Program (LIRAP), energy efficiency programs, Project Share
17 for emergency assistance to customers, a Customer Assistance Referral and Evaluation Service
18 (CARES) program, level pay plans, and payment arrangements. Through these programs, the
19 Company works to ease the burden of energy costs for customers that have the greatest need.

20 To assist our customers in their ability to pay, the Company focuses on actions and
21 programs in four primary areas: 1) advocacy for, and support of, bill payment assistance
22 programs providing direct financial assistance; 2) low income and senior outreach programs;
23 3) energy efficiency and energy conservation education; and 4) support of community programs

1 that increase customers' ability to pay basic costs of living.

2 **Q. What is the Company's Low Income Rate Assistance Program or LIRAP?**

3 A. LIRAP, which was approved by the Commission in 2002, collects revenue under
4 Schedule 410, "General Residential Natural Gas Service—Oregon." These funds are distributed
5 by community action agencies in a manner similar to the Federal and State-sponsored Low
6 Income Home Energy Assistance Program (LIHEAP). The current rate for LIRAP is
7 approximately 0.4% of the current volumetric billing rate. The purpose of LIRAP is to reduce
8 the energy cost burden among those customers least able to pay energy bills, and supplements
9 the reach of available LIHEAP funds. LIRAP provided 456 grants totaling \$133,267 during
10 the past heating season in Avista's Oregon service territory.

11 **Q. Please describe the Project Share program.**

12 A. Project Share is a community-funded program Avista sponsors to provide one-
13 time emergency support to families in the Company's service area. Avista customers and
14 shareholders help support the fund with voluntary contributions that are distributed through
15 local community action agencies to customers in need. Grants are available to those in need
16 without regard to their heating source.

17 **Q. Does the Company offer a bill-averaging program?**

18 A. Yes. Comfort Level Billing helps smooth out the seasonal highs and lows of
19 customers' energy bills and provides the customer with the option to pay the same bill amount
20 each month of the year. This allows customers to more easily budget for energy bills and it
21 also avoids higher winter bills. This program has been well-received by participating
22 customers. In addition, the Company's Contact Center Representatives work with customers
23 to set up payment arrangements to pay energy bills.

1 the Company's proposed overall capital structure and will testify in support of the proposed
2 9.9% return on equity.

3 Ms. Jody Morehouse, Director of Gas Supply, will describe Avista's natural gas
4 resource planning process, and provide an overview of the Company's 2018 Natural Gas
5 Integrated Resource Plan.

6 Ms. Jennifer S. Smith, Manager, Regulatory Affairs, will discuss the Company's overall
7 revenue requirement proposal. She will also explain the twelve-months ended December 31,
8 2020 test year operating results, including expense and rate base adjustments made to actual
9 operating results and rate base.

10 Dr. Grant D. Forsyth, Chief Economist, describes the Company's methodology used to
11 generate the forecasts for customers, use-per-customer, and total load which are used in the
12 Company's twelve-months ended December 31, 2020 Test Year Revenue Load Adjustment.

13 Mr. Joseph D. Miller, Manager, Pricing and Tariffs, discusses the spread of the proposed
14 revenue increase among the Company's general service schedules and related rate design. Mr.
15 Miller also sponsors the long-run incremental cost study for Oregon natural gas service and the
16 twelve-months ended December 31, 2020 Test Year Revenue Load Adjustment.

17 **Q. Does that conclude your direct testimony?**

18 A. Yes.