Exh. KKS-3T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-170485

DOCKET NO. UG-170486

REBUTTAL TESTIMONY OF

KAREN K. SCHUH

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

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

A. My name is Karen K. Schuh. I am employed by Avista Corporation as a Senior Regulatory Analyst. My business address is 1411 East Mission, Spokane, Washington.

Q. Have you previously provided direct testimony in this case?

A. Yes. My testimony and exhibits in this proceeding covered how the Company's capital investments in utility plant from December 31, 2016 through April 30, 2021 were incorporated into the proposed revenue requirements in this case. As discussed by Company witnesses Mr. Morris and Ms. Andrews, the Company proposed a Three-Year Rate Plan for the period beginning May 1, 2018 through April 30, 2021. As a part of the Three-Year Rate Plan, I prepared the capital adjustments that were incorporated in each of the four studies sponsored by Ms. Andrews within her direct filed case: (1) Traditional Pro Forma Study, (2) EOP Rate Base Study, (3) K-Factor Study, and (4) Rate Year Study.

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

A. In response to the testimony of Staff and other parties,[1] I will address pro forma capital adjustments and their inclusion in the Three-Year Rate Plan ("Rate Plan"). In addition, I explain the fact that the rate making studies prepared by Staff and other parties do not reflect a level of plant-in-service that will benefit customers during the Rate Plan. I follow this with a discussion of the Company's revised proposal on rebuttal for the level of rate base that should be included in customers' rates. Finally I will discuss the Parties' comments on the Company's

[1] I will refer to the other parties in the case as follows: Staff (Staff of the Washington Utilities and Transportation Commission), ICNU (Industrial Customers of Northwest Utilities), NWIGU (Northwest Industrial Gas Users) and Public Counsel (Public Counsel Unit of the Attorney General's Office).

upcoming depreciation study, and the capital reporting the Company is proposing for Years 1, 2, and 3 of the Rate Plan.

Q. Are you sponsoring any exhibits?

A. Yes. Exh. KKS-4 details capital additions the Company is proposing on rebuttal; Exh. KKS-5 demonstrates the differences with respect to capital investment balances between Avista's original filing, Staff's position, and Avista's position on rebuttal; and Exh. KKS-6 details the revenue requirement associated with Avista's adjustments 2.19 and 3.10 (electric) and 2.16 and 3.10 (natural gas). A table of contents for my testimony is as follows:

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II. OTHER PARTIES' POSITIONS

Q. What did Staff propose regarding the inclusion of capital additions in their proposed revenue requirement?

A. For Staff, their first adjustment took Avista's 2016 plant from a 2016 "average-of-monthly-averages" basis to a 2016 "end of period" basis. The Company is in agreement with this adjustment, with the exception of Staff's failure to recognize the associated depreciation expense, as discussed by Ms. Andrews in her rebuttal testimony.

Q. You say Staff excluded depreciation expense associated with their 2016 adjustment moving plant to an end-of-period basis (EOP). Is this appropriate?

A. No. As a part of Staff's case, they are including plant balances on an EOP basis for the period ending December 31, 2016. The annualization of the depreciation expense on those 2016 additions should <u>also</u> be included in the Company's 2016 EOP balances. The Company is already incurring the depreciation expense starting on January 1, 2017 for those projects placed in service during 2016, and therefore should have the depreciation expense necessary to <u>match</u> the level of rate base included in the revenue requirement. The revenue requirement impact of the associated depreciation expense is approximately $4.0 million electric and $767,000 natural gas. Ms. Andrews has reflected this in her rebuttal revenue requirement and discusses this further in her rebuttal testimony.[2]

Q. Did Staff include an adjustment using a "threshold" for "major pro forma projects" (0.5% of net plant before Accumulated Deferred Federal Income Taxes "ADFIT") through August 2017?

A. Yes. Staff's threshold level of capital covers only electric plant additions over $8.6 million and natural gas plant additions over $1.7 million.[3] The Company disagrees with this approach.

Q. What is the effect of Staff's use of a 0.5% threshold for pro forma capital additions?

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[2] See Exh. EMA-10T.
[3] Exh. KBS-1T, pp. 15:14-23:9.

A. The effect is that Staff's pro forma capital adjustment only includes 7 out of 121 discrete capital projects in 2017.[4] I will discuss the Staff's "threshold" later in my testimony.

Q. Briefly, how did the other parties treat capital additions?

A. ICNU/NWIGU joint witness Mr. Mullins did not include an adjustment for 2016 end of period plant as proposed by Staff, and only included 2 pro forma projects.[5] Public Counsel included the 11 pro forma study adjustments as proposed by the Company, but did not include the end of period plant adjustment for 2016 as proposed by Staff.[6] No party reached out <u>further</u> into 2017 to include capital additions that otherwise are, or will be, used and useful and serving customers before the May 1, 2018 effective date for Year 1 of the Rate Plan.

Q. What are the impacts of each Parties' adjustments on net plant for Year 1?

A. Staff's inclusion of an adjustment for December 2016 end-of-period plant and limited pro forma adjustments beyond the historical test period[7] increases net plant (after ADFIT) from December 2016 by $78.4 million and $22 million for electric and natural gas, respectively, for Year 1 of the Rate Plan.[8] ICNU/NWIGU's adjustment is an increase in net plant for Washington electric and natural gas of $5.6 million and $11.7 million, respectively, for Year 1. Public Counsel did not propose a change to the pro forma adjustment to net plant, and only

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[4] Staff's pro forma capital adjustments include 3 projects for the electric case and 5 projects for the natural gas case. However, one project is common between both services, with a portion of the investment allocated to electric service and a portion allocated to natural gas service. The total project count of 121 projects counts projects that are common to both electric and natural gas service as only one project.

[5] Exh. BGM-1T, pp. 23:1-28:5.

[6] Exh. MEG-11 (Electric) and Exh. MEG-12 (Natural Gas).

[7] Staff's adjustments for pro forma electric and natural gas capital additions are in error by not including the full transfer-to-plant amounts through August. Correcting Staff's adjustments result in an incremental increase of approximately $1.08 million and $500,916 in gross plant, for electric and natural gas, respectively, to Staff's <u>gross plant</u> additions. Please see Exh. KBS-1T, pp. 20-21, Exh. KBS-3, and Exh. KBS-4. The associated incremental increase to Staff's revenue requirement associated with these corrections would be $277,000 and $140,000 for electric and natural gas, respectively.

[8] This number represents Staff's Pro Forma Adjustments (Adjustment 2.19 and 3.10 for Electric service and Adjustments 2.16 and 3.10 for Natural Gas service). Staff includes increases to net plant for Years 2 and 3 through the application of a plant escalator.

increases plant beyond the historical test period by $34.9 million and $17.8 million for electric and natural gas, respectively in Year 1.

Q. How do these adjustments compare with the plant-in-service during Rate Year 1, as shown by the Company?

A. Table No. 1 below provides a comparison of electric and natural gas net plant after ADFIT ("rate base") additions, as originally proposed by the Company and other parties, at the start of Rate Year 1 (May 1, 2018).[9]

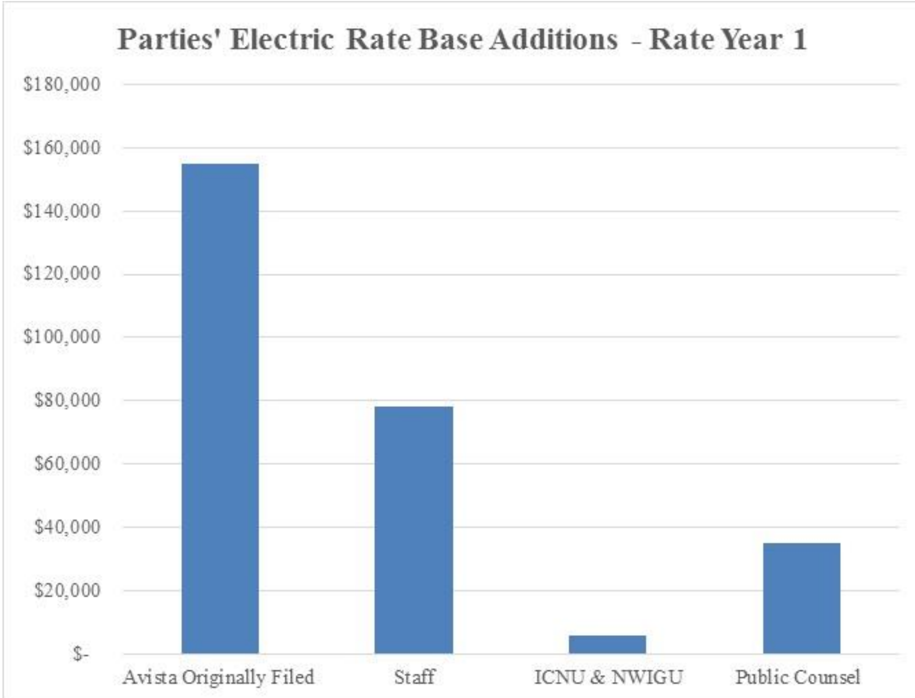
Table No. 1:

	Adjustments to Net Plant After ADFIT (000's) - Rate Year 1			
	Company Originally Filed	Staff	ICNU-NWIGU	Public Counsel
Electric	$ 154,785	$ 78,391	$ 5,565	$ 34,911
Natural Gas	$ 31,467	$ 22,032	$ 11,745	$ 17,841

Illustration No. 1 below shows this comparison for electric rate base adjustments for Rate Year 1 (2018):

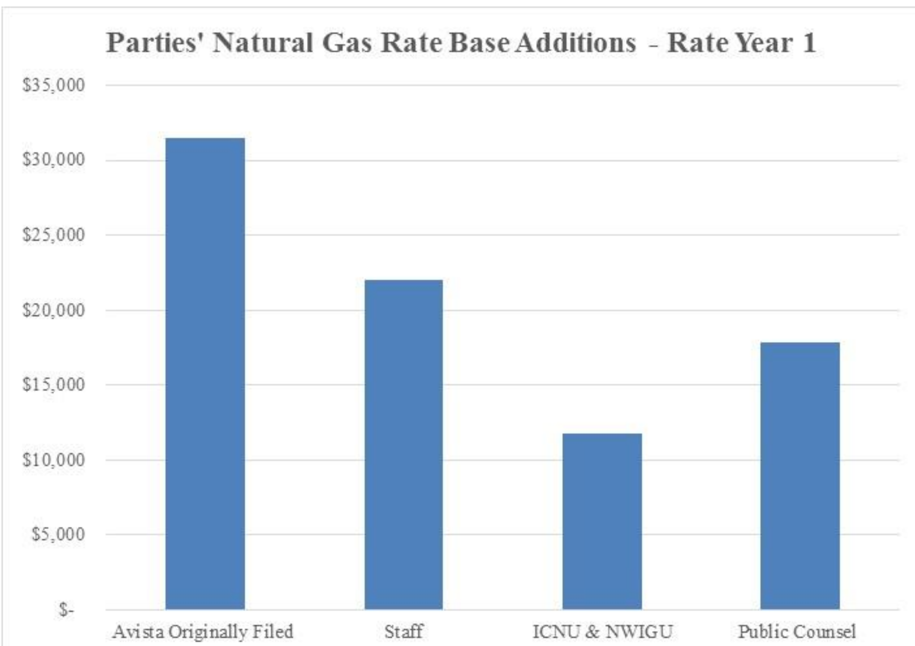
[9] The sources for these balances are as follows, for electric and natural gas, respectively: Avista—Exh. EMA-3 and Exh. EMA-7; Staff—Exh. JH-2 and Exh. JH-3; ICNU/NWIGU—Exh. BGM-3 and Exh. BGM-4; and Public Counsel—Exh. MEG-11 and Exh. MEG-12.

Illustration No. 1:



The following illustration shows a similar comparison for natural gas rate base adjustments for Rate Year 1 (2018):

Illustration No. 2:



These illustrations show that the parties' rate base adjustments fall well below the level of plant-in-service that will be in place and serving customers during Year 1 of the Rate Plan. They also illustrate why the Company does not agree with the use of an arbitrary "threshold" to limit the number of pro forma projects included in the revenue requirement, as well as limiting the dollar amount of those capital projects using a "cut-off point" of August 31, 2017, as proposed by Staff. Limiting the capital adjustments contained in the Pro Forma Study to only "major projects" already severely understates the actual plant investment that will be providing service to customers in the rate years. Further reducing the capital adjustment through the application of an August 31, 2017 "cut-off" only exacerbates this deficiency. An example of this August 31, 2017 "cut-off" is demonstrated in Table 1 in Exh. KBS-1T, where Staff witness Ms. Scanlan only included $0.9 million of "Substation Rebuilds," while the total level that the Company included in its original filing that would transfer to plant by the end of 2017 is approximately $10.4 million.

Q. What are the positions of the Parties regarding capital additions for Years 2 and 3 of the Rate Plan?

A. Only Staff acknowledges the need to reflect incremental capital additions in Years 2 and 3 of the Rate Plan, and that is reflected in Staff's escalators for those years.[10] ICNU/NWIGU and Public Counsel only include capital additions in Year 1, and oppose the Three-Year Rate Plan.[11]

Q. Will you be discussing the Company's revised position on capital additions in its rebuttal case?

[10] Exh. CHS-1T, pp. 18:21-19:19.
[11] Exh. BGM-1T, p. 21, ll. 6-13 (ICNU/NWIGU) and Exh. MEG-1T, p. 20:5-11 and pp. 20:14-21:2 (Public Counsel).

A. Yes, I will do so below, describing how Avista has further reduced the level of plant included in its proposed revenue requirements.

III. AVISTA'S PROPOSED LEVEL OF CAPITAL ADDITIONS

Q. Ms. Scanlan states that Avista used "an indiscriminate pro forma study with unlimited pro forma adjustments through December 2017."[12] Is such a representation fair?

A. No. In its original filing in May 2017, the Company included pro forma capital adjustments (Adjustments No. 3.10 and 3.15). In support of those adjustments, Avista provided a description of the need and timing for each capital project that was included for purposes of deriving a revenue requirement. More specifically, Company witnesses Mr. Kinney, Mr. Kensok and Ms. Rosentrater provided hundreds of pages of testimony[13] and exhibits[14] that provided descriptions of each and every project, the timing and need for the projects, and the consequences of not completing the projects in the timeframe considered. This approach was not indiscriminate; rather it was very purposeful.

Q. Did Avista also respond to discovery requests pertaining to some of these projects?

A. Yes. Avista responded to over 50 data requests related to capital additions from Staff alone. Further, Staff witness Ms. Scanlan, replying to an Avista data request, stated that:[15]

> As part of Staff's review, analysis and audit, Joanna Huang, Kathi Scanlan, and Christopher Hancock, met with Avista's pro forma project business case owners and project leads, Avista witness Karen Schuh, and plant accounting representatives on September 27, 2017, at Avista's Headquarters. We discussed the method and effectiveness of Avista's internal control system for capital projects,

[12] Exh. KBS-1T, p. 25, ll. 17-18.
[13] See Exh. SJK-1T, JMK-1T, and HLR-1T.
[14] See Exh. SJK-4, JMK-2 and HLR-6.
[15] Staff Response to Avista Data Request No. 1.

including capitalization policy for electric and natural gas operations and capital project request and approval procedures, using the company's "Capital Project Request" Form, Location List, and FERC accounts and task list categorization.

Q. Of the 121 projects contained in Avista's original filing, how many projects were the subject of additional discovery by Staff?

A. Unfortunately, because Staff relied on a threshold of 0.5% of overall net plant for capital projects in the pro forma period, Staff only performed written and/or on-site discovery regarding 10 projects of the 121 projects.[16]

Q. Is it your understanding that the use of the 0.5% threshold was meant, at least in the past, to limit the amount of audit work expected of Staff or intervenors?

A. If that is true, then it leads to perverse results. The use of a $8.6 million (electric) and $1.7 (natural gas) threshold limits Staff's focus to only 3 electric projects and 5 natural gas projects, out of 102 electric projects and 42 natural gas projects.[17] Clearly, in the five months since the Company made its filing and provided all of the source documents, Staff and other parties had the time and resources to audit more than 10 projects.

Q. Is the way Staff calculated the threshold to define major plant additions appropriate?

A. No. Staff used "one-half of one percent" of all net plant as a threshold.[18] This "threshold" is <u>inappropriate for ratemaking</u> for at least three reasons. First, Staff is relying upon WAC 480-140-040 as the basis for determining whether a project should be considered "major".

[16] These 10 projects correspond to Avista's major pro forma plant projects included in its original case—5 electric, 7 natural gas. One project is common between electric and natural gas service and one natural gas project was inadvertently included, leaving 10 discrete projects. Ultimately, Staff's selected threshold excluded 3 of these projects, leaving only 7 projects (2 electric, 4 natural gas, and 1 common to both electric and natural gas) included in Staff's case.

[17] For purposes of counting the number of projects associated with electric service alone and natural gas service alone, projects that are common to both services are counted once for each service type.

[18] Exh. JH-1T, p. 15, l. 19.

It is important to remember that the referenced WAC is related to budget reporting only, and was not meant to be used for ratemaking purposes. Avista understands that the Commission used this standard in its 2015 general rate case.[19] In Order 05 at ¶40 in that case, the Commission observed that "In the instant case, we find it reasonable to use the one-half of one percent threshold" (emphasis added); it did not state that the use of WAC 480-140-040 should be used for all future cases. More importantly, the Commission further observed in the subsequent 2016 Avista rate case in Order 06[20] that it has:

> … not established bright-line standards governing the timing or the number of adjustments that can be accepted in a given case, and **has not established a minimum size for pro forma adjustments** to be recognized. *(Emphasis added)*

Returning to the 2015 case, and perhaps most importantly, the Commission ultimately agreed with Staff that the traditional pro forma adjustments based on the use of this threshold would not give Avista a reasonable opportunity to earn its allowed return, and therefore granted an attrition adjustment to supplement the Pro Forma Study to derive rates for the Rate Year.

In this case, however, **Staff is proposing no further adjustment** that would provide Avista with a reasonable opportunity to earn its approved rate of return in Year 1 of the Rate Plan, unlike the 2015 case. Accordingly, Staff's approaches in the 2015 and 2016 cases are very different from this case. In 2015 and 2016, Staff acknowledged that the use of only a pro forma study would be insufficient, and therefore derived an attrition adjustment that added to the Pro Forma Study. Indeed, in the 2015 case, Staff witness McGuire acknowledged:

> Given that the rates calculated using a modified historical test year generate revenues that fall short of those necessary to provide Avista with a reasonable opportunity to earn a fair rate of return, Staff recommends the Commission provide Avista with an attrition allowance of $14.7 million for electric operations and $5.4 million for natural gas operations. This dollar amount corresponds to the difference

[19] Docket Nos. UE-150204 and UG-150205.
[20] Docket UE-160228 and UG-160229, Order 06, ¶82.

between Staff's pro forma revenue requirement and the revenue requirement calculated using Staff's attrition analysis.[21]

Likewise in the following year in the 2016 case, Staff Witness Hancock testified:

> Staff recommends the Commission include an attrition adjustment to the modified historical test year analysis based on the attrition studies I present. Staff witness Ms. Joanna Huang presents Staff's calculation of the revenue requirements for Avista's electric and natural gas services, which incorporates my attrition adjustment. Staff's analysis indicates that, absent an attrition adjustment, Avista will likely experience attrition and that the forces driving attrition are more likely than not outside of the Company's control.[22]

In this case, however, Staff does <u>not</u> offer an additional attrition adjustment for Year 1 – relying only on very limited pro forma adjustments that rely on an arbitrary threshold that excludes 114 out of 121 capital projects.[23]

Finally, even if the Commission accepted Staff's threshold, Staff's calculation should have at least reflected net plant <u>after</u> ADFIT. Staff's adjustment was calculated using the Company's December 31, 2016 electric and natural gas Commission Basis Reports by using the net plant balance <u>before</u> ADFIT. As noted by Ms. Scanlan, in the Company's 2015 case, the Commission even noted that the application of the 0.5% threshold should be on a net <u>rate base</u> basis:[24]

> Staff's proposed threshold for major plant additions relies on an established rule, albeit one established in a somewhat different setting. It has, however, the advantage of being proportional to the size of the Company's rate base and therefore relevant to the issue of the financial impact on the Company in the setting of rates. We find it reasonable to set the threshold in proportion to a company's <u>rate base</u>. In the instant case, we find it reasonable to use the one-half of one percent threshold. *(Emphasis added)*

Rate base, with respect to plant, is, by definition, net plant after ADFIT. The use of net plant before ADFIT serves only to artificially inflate the calculated "threshold" (thereby further reducing the

[21] See Docket Nos. UE-150204 and UG-150205, Exh. No. CRM-1T, p. 28, ll. 8-14.
[22] See Docket Nos. UE-160228 and UG-160229, Exh. No. CSH-1T, p. 3, ll. 10-16.
[23] Staff's only attempt to remove some of the regulatory lag was by restating 2016 plant from an average-of-monthly-averages (AMA) basis to an end-of-period (EOP) basis; this only captures $69.7 million of the $163.7 million of additional electric plant that will be in service in the 2018 rate year.
[24] Docket UE-150204 and UG-150205, Order 05, ¶40.

projects that exceed the threshold). Therefore, the threshold used to calculate the pro forma capital additions should be consistent with the method indicated by the Commission. The Company correctly used the net plant after ADFIT balance to calculate this threshold in its filed case.

Q. What is the result of employing Staff's 0.5% threshold in this case for purposes of developing a revenue requirement?

A. For electric operations, the use of an $8.6 million threshold only captures 3 projects (or $11.2 million). For natural gas operations, the use of a $1.7 million threshold only captures 5 projects (or $9.9 million). The use of such a threshold says nothing about the actual level of plant that will be in service and used and useful when rates go into effect in May 2018. Further, it leaves, on the "cutting room floor," 99 electric projects (or $198.2 million of gross plant), and 37 natural gas projects (or $34.4 million of gross plant).[25]

Q. Irrespective of the threshold used by Staff, did the Company provide sufficient information in its original filing to allow Staff and others to gain an understanding of each of the 121 discrete projects (both need and timing) which would have easily allowed Staff and any other party to identify any project about which they might have concerns, and conduct additional discovery accordingly?

A. Yes. As I discussed earlier in my testimony, the Company provided hundreds of pages of testimony and exhibits, sponsored by three Company witnesses, which provided more than sufficient information on each project from which Staff and the parties could have identified projects that required additional analysis. The Company believes that it was unfortunate that Staff arbitrarily cut off their review based on this arbitrary 0.5% threshold.

[25] As noted previously, for purposes of counting projects specifically for electric service and natural gas service, electric and natural gas projects are counted separately (e.g., a project common to both is counted once for each service type).

Q. Did Staff in the prior two Avista general rate cases rely solely on the use of a capital threshold for purposes of deriving a revenue requirement in the rate year?

A. No. As discussed above, in those cases, Staff supported an attrition adjustment for Avista because the traditional modified historical test year with limited pro forma adjustments (using a 0.5% threshold) would not provide the Company with a reasonable opportunity to recover its costs and earn its allowed rate of return. In the end, Staff's attrition adjustment escalated revenues, expenses, and rate base to a level more appropriate for the rate effective period. By now exclusively relying on a threshold level of capital as the final answer for ratemaking purposes, and discarding the vast majority of projects that will be in service before new rates go into effect, Staff's revenue requirement will not afford the Company with a reasonable opportunity to earn a fair rate of return in the rate effective period.

IV. AVISTA'S POSITION ON REBUTTAL

Q. You indicated earlier that Staff's approach would serve to exclude a substantial amount of plant that will be in service in 2017. How have you determined this?

A. I have prepared Exh. KKS-5 where I have tabulated, by project number (ER), each item of plant included in Avista's original filing, and compared that with those items of plant included in Staff's case. I have also included in that Exhibit a more limited subset of plant items that Avista now proposes to include in this rebuttal case. Table Nos. 2 and 3 below are abbreviated tables that summarizes the results of what is shown in that exhibit, for electric and natural gas, respectively:

<u>Table No. 2: Summary of Capital Included by Avista and Staff for Year 1 – Electric</u>

		Total Investment Amount (Gross Plant)	Number of ER Projects
Avista Filed	$	209,451	102
Staff	$	11,242	3
Avista Rebuttal	$	79,076	31

<u>Table No. 3: Summary of Capital Included by Avista and Staff for Year 1 – Natural Gas</u>

		Total Investment Amount (Gross Plant)	Number of ER Projects
Avista Filed	$	44,321	42
Staff	$	9,907	5
Avista Rebuttal	$	20,967	17

Q. In light of this, has the Company's proposal for capital additions changed since its direct filed case?

A. Yes. On rebuttal, in an effort to strike a balance between Avista's original request, and the level of capital supported by the parties, the Company has <u>reduced</u> the level of rate base that should be reflected in Year 1 of the Rate Plan effective May 1, 2018. The Company, on rebuttal, has included only pro forma capital that has been calculated using a similar methodology as Staff used in the recent Puget Sound Energy ("PSE") General Rate Case, Docket Nos. UE–170033 and UG–170034. This methodology, which Avista will refer to as a "functionalized threshold," is best explained by Staff witness Mr. Wright, as recently as June 30, 2017, in that very PSE case:

> Staff found smaller adjustments that would otherwise be reasonable, such as Distribution plant adjustments, would not be captured if the threshold were only applied to gross rate base. Therefore, Staff refined the standard in this case, applying the one-half of one percent threshold to **<u>net utility plant in service by</u>**

> **<u>category</u>** instead of rate base. **<u>Staff believes the refinement will allow a better review of plant adjustments in this, and future, rate cases.</u>** *(Emphasis added)*[26]

Q. Did Ms. Scanlan in <u>this</u> case make any effort to use a "functionalized" approach, in order to be consistent with Staff's position in the Puget case?

A. No, she did not. Mr. Wright's testimony in the Puget docket (UE-170033 / UG-170034) on behalf of Staff, and using a "functionalized" approach, was filed on June 30, 2017, more than three and one-half months <u>before</u> Ms. Scanlan's testimony on the same issue was filed in this case, allowing more than enough time to consider this method in Avista's case, but it was not.

Q. In order to reach for common ground, how were the capital additions developed for the Company's rebuttal position for Year 1?

A. Avista started with rate base for the historical test year ending December 31, 2016 on an AMA basis. Next, the Company moved the plant balances, together with the associated AD and ADFIT, to an end-of-period basis as of the year ended December 31, 2016. These adjustments also correctly included associated depreciation expense on an annualized basis. The effect of this adjustment increased electric rate base by $69.7 million and natural gas rate base by $14.2 million, and with the exception of the Company including depreciation expense, is consistent with the first step of Staff's adjustment.

Next, the Company removed the Traditional Pro Forma Study capital adjustments (Adjustment 3.10) and the End of Period Rate Base Study capital adjustments (Adjustment 3.15), contained within its original filing. The effect of this <u>decreases</u> electric rate base by $85.1 million and natural gas rate base by $17.3 million.

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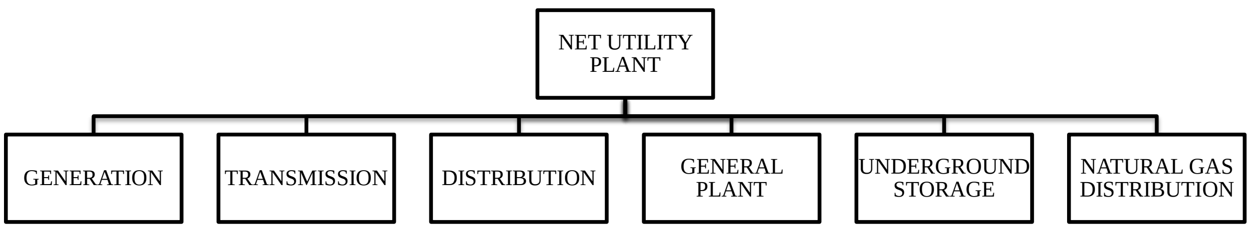
[26] Docket Nos. UE-170033 and UG-170034, Exh. ECW-1T, pp. 6:22-7:6

Finally, the Company determined a threshold for the pro forma electric and natural gas projects of 0.5% of the Company's net plant by functional group (i.e., a functionalized threshold), as in the Puget Docket (UE-170033 and UG-170034). Instead of using 0.5% on all aggregate plant, the Company used 0.5% of functional plant by FERC accounting groups listed in the FERC form 1, as did Staff in the Puget case.[27] Those accounts are: Generation,[28] Transmission, Distribution, General Plant, Underground Storage and Gas Distribution. Illustration No. 3 below provides a simple schematic of this functionalization:

Illustration No. 3: Electric and Natural Gas Functional Groups



Using 0.5% of the Company's net plant by functional group, the Company identified pro forma projects that are above the 0.5% threshold as applied to net plant before ADFIT by functional group. This threshold yielded 31 electric projects and 17 natural gas projects, with a total of 36 discrete projects to be included within Avista's pro forma capital adjustment, instead of Staff's 7 discrete projects for Electric and Natural Gas.[29] These Pro Forma functional group projects represent actual capital additions as of October 31, 2017, together with the associated AD

[27] As discussed earlier, Avista believes that it is more appropriate to reflect Net Plant after ADFIT. For rebuttal purposes only, Avista also used Staff's net plant before ADFIT methodology in an effort to reach common ground in this case.
[28] For generation projects, Avista functionalized this category into thermal, hydro, and other generation.
[29] 12 projects are common to both Electric and Natural Gas service in Washington. As a result, the total of 36 discrete projects is composed of 19 Electric projects, 5 Natural Gas projects, and 12 projects common to both.

and ADFIT. The associated ADFIT includes the repairs deduction and bonus tax depreciation expected through October 31, 2017. These adjustments also include associated depreciation expense for each capital addition. Capital additions were included on an actual basis, to reflect plant that is used and useful as of October 31, 2017. These adjustments are included by Ms. Andrews as Pro Forma Adjustment 3.10 in her electric and natural gas revenue requirement studies. These adjustments increase electric rate base by $62.5 million and natural gas rate base by $16.5 million.

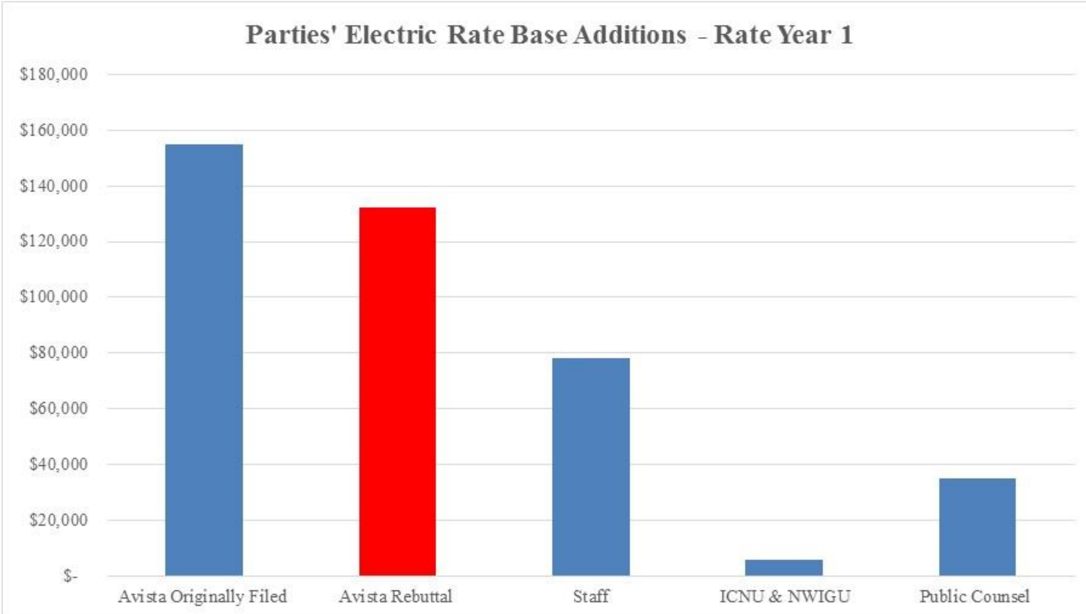
The overall net plant after ADFIT (rate base) change from Avista's filed case to the rebuttal case is a decrease in rate base of $22.6 million and $0.8 million for electric and natural gas, respectively, from the Company's filed case. The specific projects included in Avista's rebuttal proposal are identified in Exh. KKS-4 on a Washington electric and natural gas basis, as well as in my workpapers. The Company's proposed level of net plant additions, using the functionalized threshold for rebuttal purposes, is shown in Table Nos. 4 and 5 below under "Avista Rebuttal." The following table shows this comparison for electric net plant adjustments for Rate Year 1 (2018), as compared with Avista's original filing and with Staff and intervenor positions:

Table No. 4: Parties' Electric Rate Base Additions:

	Avista Originally Filed	Avista Rebuttal	Staff	ICNU & NWIGU	Public Counsel
Rate Year 1 Rate Base	$ 154,785	$ 132,235	$ 78,391	$ 5,565	$ 34,911

This same information is also reflected in Illustration No. 4, below:

Illustration No. 4:



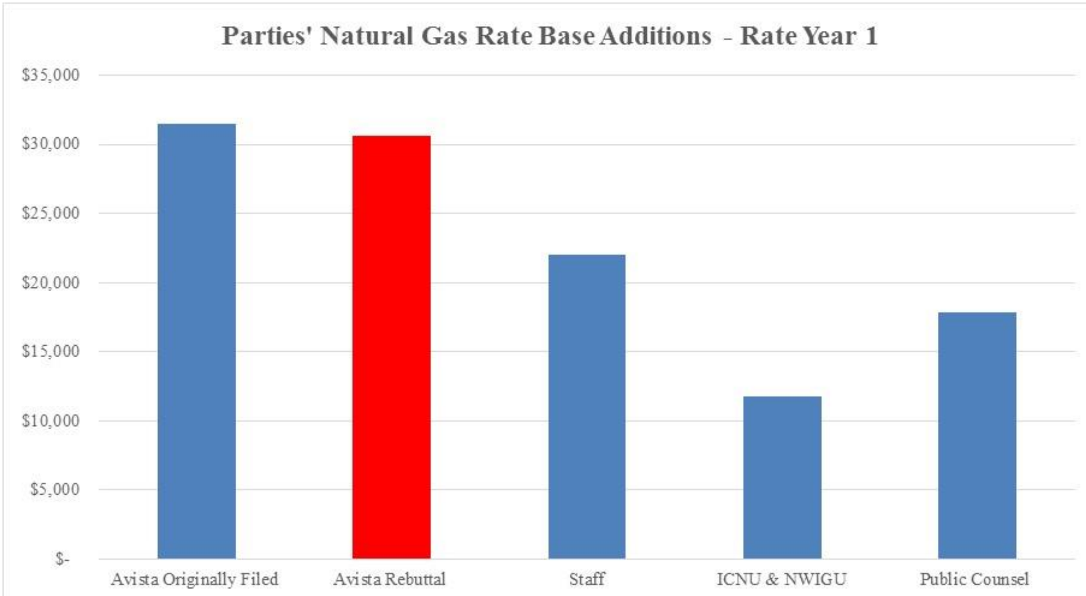
The following table shows this comparison for natural gas net plant adjustments for Rate Year 1 (2018) including Avista's rebuttal position, as compared with its original filing and with Staff and intervenor positions:

Table No. 5: Parties Natural Gas Rate Base Additions:

	Avista Originally Filed	Avista Rebuttal	Staff	ICNU & NWIGU	Public Counsel
Rate Year 1 Rate Base	$ 31,467	$ 30,648	$ 22,032	$ 11,745	$ 17,841

This same information is reflected in Illustration No. 5, below:

<u>Illustration No. 5:</u>



As both of the above illustrations reflect, Avista is attempting to move closer to the other parties' positions, by making use of a threshold, in a similar way as Staff did in the pending Puget case. As previously discussed, while the Company does not believe in the use of thresholds, for purposes of seeking common ground, we applied the functionalized threshold, used by Staff in the recent Puget rate case, for purposes of the pro forma capital adjustment.

Q. How many projects and how much in rate base additions did the "functional" group method exclude from the Company's original filing?

A. The functional group method still <u>excludes 85 discrete projects</u> expected to be in service during 2017 and is approximately $23 million less in overall rate base additions than what the Company included in its original filing. Accordingly, on rebuttal, the Company is now <u>excluding</u> a number of projects that it expects to go into service in 2017, not to mention projects that are not included from the January 1 to May 1, 2018 time period but will be in service at that time. Table No. 6 below reflects these differences.

<u>Table No. 6: 2017 Projects Included in Original and Rebuttal Filings</u>

2017 Projects				
	Number of Projects	**Rate Base Additions in ($000's)**		
		WA Electric	**WA Natural Gas**	**Total WA**
Originally Filed - 12.31.17	121	$ 85,094	$ 17,307	$ 102,401
Rebuttal Position 10.31.17	36	62,544	16,488	79,032
Not included	**85**	**$ 22,550**	**$ 819**	**$ 23,369**
Staff Position	7	$ 8,700	$ 7,872	$ 16,572

Q. Has the Company provided information on these projects in this case?

A. Yes. The Company has provided extensive evidence in its direct filing and through the pendency of this case as it relates to capital. In Exh. KKS-4, I have referenced where the supporting documents for each business case can be found. In addition, for the limited subset of projects included in Avista's "functionalized" threshold, Mr. Kinney discusses the generation capital projects in Exh. SJK-5T, Ms. Rosentrater discusses the transmission, electric and natural gas distribution plant, and general plant items in Exh. HLR-7T, and Mr. Kensok discusses the IS/IT capital projects at Exh. JMK-3T. These witnesses also summarize the remaining plant items that have been <u>excluded altogether</u> from the Company's rebuttal case.

Q. Even though actual transfers to plant for each project may vary by month through October, has the need for, nature of, and scope of the project changed from what was originally described in the Company's filing in May 2017?

A. No, they have not. The need for, and prudency of, each project has not changed since they were included in the Company's initial filing in May of 2017, and could easily have formed the basis for an expanded Staff audit.

Q. Has the Company also provided corresponding information on the rate base and revenue requirement effect of the Company's proposed level of capital included on rebuttal?

A. Yes. Table No. 7 below, which is a summary of information from Exh. KKS-6, provides the electric and natural gas level of rate base, and corresponding revenue requirement, for capital additions from January 1, 2017 to October 31, 2017 (i.e., this does not include the 2016 AMA to EOP capital adjustment). I have also provided the values for August and September should the Commission utilize a different ending point for capital additions.

<u>Table No. 7: 2017 Rate Base and Revenue Requirement using Avista Functionalized Threshold</u>

		2017 Pro Forma Additions (Through October)	2017 Pro Forma Additions (Through September)	2017 Pro Forma Additions (Through August)
Electric				
	Net Rate Base	$ 62,544	$ 53,029	$ 45,841
	Revenue Requirement	$ 11,610	$ 10,055	$ 8,671
Natural Gas				
	Net Rate Base	$ 16,488	$ 14,189	$ 12,453
	Revenue Requirement	$ 3,170	$ 2,787	$ 2,441

Q. How does the reduced level of capital Avista is supporting on rebuttal for Year 1 of the Rate Plan impact Years 2 and 3?

A. On rebuttal, as in our filed case, the Company is including a revenue growth factor adjustment for Years 2 and 3 of the Rate Plan that <u>builds on</u> the level of net plant in Year 1.[30] Therefore, by reducing the level of capital additions in Year 1, it will also have the effect of

[30] The revenue growth factor includes a Net Plant after ADFIT component of 3.04% (electric) and 5.02% (natural gas). Staff has accepted this component as proposed by Avista.

reducing the level of plant being escalated in the remaining two years. Ms. Andrews discusses this in further detail in her testimony. This only serves to underscore the fact that the Commission needs to get the amount of capital in service for Year 1 right; if it understates this capital, the problem will only compound itself for Years 2 and 3, because each of these years build on Year 1.

Q. What is the effect of this?

A. As discussed by Ms. Andrews in Exh. EMA-10T, Staff's proposed starting point for Rate Year 1, and the associated impact in Years 2 and 3 of the rate plan would result in a scenario in which the rate base proposed by Staff would not reach the Company's expected rate base balance at December 31, 2017 until Rate Year 3.[31] In short, we need to get the level of Year 1 rate base right.

Q. For the projects Avista is including using its "functionalized threshold", are there any O&M offsets that should be accounted for?

A. Yes. Table No. 8 below shows the electric and natural gas O&M offsets that have been included in Adjustment No. 3.11, "O&M Offsets Adjustment."

Table No. 8: Electric and Natural Gas O&M Offsets

ER	Business Case Name	Electric	Natural Gas
2423	System Transmission Rebuild Condition	$ 21,691	$ -
2457	Benton-Othello 115kv Reconductor	6,573	-
2060	Wood Pole Management	44,959	-
2584	Street Light Conversion to LED Fixtures	800,038	-
5005	Information Technology Refresh	18,017	5,190
7139	Downtown Network New Warehouse/Operations Building	210,000	-
Total		**$ 1,101,278**	**$ 5,190**

[31] See Exh. EMA-10T, pp. 27:11-30:16.

As Mr. Kinney, Ms. Rosentrater, and Mr. Kensok note in their rebuttal testimonies, many of the projects do not have O&M offsets. It is important to remember that many projects undertaken by the Company do not have, and have not been justified by, O&M offsets. Many projects are justified based on other investment drivers as discussed by Mr. Morris.[32] That should not be a reason why these projects should be excluded from the Company's case. However, the Company for rebuttal purposes, and in an effort to provide meaningful actual savings for customers, <u>included the O&M offsets for ER 2584 – Street Light Conversion to LED Fixtures. While the O&M offsets have been included on rebuttal (reducing the Company's revenue requirement), the capital costs for this street light conversion project did not make the Company's functionalized threshold, and therefore have been excluded from the revenue requirement.</u> This adjustment provides a 10% reduction in the electric revenue requirement amount included related to the 2017 capital additions.[33]

Q. Even if the Commission decides to use the functional group method, does the Company believe that the use of <u>any</u> limiting threshold is appropriate and reflective of the plant-in-service in the rate years?

A. No. As discussed earlier in my testimony, the Company is attempting to simply use a method employed by Staff in the Puget case. The Company still believes the use of any 0.5% threshold is arbitrary for ratemaking, whether or not it is applied to functional net plant. The Company will still incur a level of rate base far greater than what is being included on a limited basis and is only proposing this method to reach a resolution in this instant case.

[32] Exh. SLM-1T, p. 32, ll. 7-21.

[33] Electric Pro Forma threshold adjustment (3.10) revenue requirement total ($11.6 million) versus electric O&M Offsets Adjustment (3.11) revenue requirement reduction of $1.1 million.

Q. Staff witness Mr. Hancock proposed using Construction Work in Progress (CWIP) as an alternative to Avista's 2017 EOP adjustment.[34] Is including CWIP in rate base beneficial?

A. No it is not. First, the Company does not track CWIP on a Washington electric and natural gas allocated basis. Tracking this on a Washington basis would be an enormous administrative burden increasing operations expense. This is because the Company accrues Allowance for Funds Used During Construction (AFUDC) while projects are in CWIP. The Company would need to stop allocating AFUDC to Washington electric and natural gas projects (to avoid double counting), while still allocating AFUDC to the Company's other jurisdictions. The Company's current accounting system does not have this capability. In addition, CWIP on a system basis as of December 31, 2016 is $144.7 million. Simply using a general allocation[35] results in a Washington electric and natural gas amount of $70.5 million and $19.7 million, respectively. These balances are lower than the amount even Staff has proposed in this case and do not reflect the level of plant in service that will benefit customers during Rate Year 1.

Q. Turning now to ICNU/NWIGU, they calculated the threshold to define major pro forma plant additions using a "general threshold around $8,000,000 to $12,000,000 to determine whether a discrete project constituted a major plant addition,"[36] do you think this is appropriate?

[34] Exh. CSH-1T, pp. 43:19-44:2.
[35] For illustrative purposes, the Company used a common allocated all (CD AA) allocation factor to estimate the Washington electric and natural gas balances. The Company realizes this will not be the actual allocated basis due to some projects being directly assigned to Washington as well as direct assignment to other jurisdictions.
[36] Exh. BGM-1T, p. 25, ll. 12-13

A. No. As noted in a recent Avista Order[37], the Commission did not agree with selecting an arbitrary threshold and stated:

> ICNU's proposed $10 million dollar threshold is not supported by any discernible principle. ICNU does not define what it means by "natural [threshold]," and we do not find a compelling reason to adopt its threshold.[38]

It is appears this threshold was selected by ICNU/NWIGU as a method of eliminating more capital projects.

Q. ICNU-NWIGU also exclude recurring plant from their calculations. Do you agree with this methodology?

A. No. ICNU/NWIGU remove recurring plant from their calculations, because their witness Mr. Mullins believes "routine replacements cannot be effectively reviewed under the Commission's practice since the routine replacements consist of an aggregation of many small projects."[39] Some of the routine replacements ICNU/NWIGU are recommending for exclusion are projects or programs that, as discussed by Ms. Rosentrater in her direct testimony, represent:

> Investments to replace assets based on established asset management principles and systematic programs adopted by the Company, which are designed to optimize the overall lifecycle value of the investment for our customers.[40]
>
> The Company relies on these primary programs for making systematic investments in our distribution plant, which allows us to cost-effectively maintain a safe and highly reliable system that meets the expectations of our customers.[41]

Therefore, excluding these important "bread and butter" projects on the basis of being "recurring" makes no sense. It excludes projects about which there should be no controversy.

[37] Docket Nos. UE-150204 and UG-150205, Order 05, ¶43.
[38] Ibid.
[39] Exh. BGM-1T, p. 25, ll. 19-21.
[40] Exh. HLR-1T, p. 17, ll. 16-18.
[41] Exh. HLR-1T, pp. 17:21-18:2.

Q. Mr. Mullins argues in this case that the investment in <u>general plant</u> is "generally less time-sensitive" and that "it is probably unnecessary for a Company experiencing low load growth to invest in a new office building?"[42] Do you agree with his statement?

A. No. Mr. Mullins made the assumption that the only asset types included in the general plant category are those of an office building or those of a facilities-related nature. However, the FERC uniform system of accounts includes a number of <u>other</u> categories in the "General Plant" category, as well. Table No. 9 includes each FERC account within General Plant, along with the AMA balance included in each account, as of December 31, 2016, for both Washington Electric and Natural Gas services:

<u>Table No. 9:</u>

FERC Accounts - General Plant	Avista Washington Electric Plant Balance 12.31.16	Percent of Balance	Avista Washington Natural Gas Plant Balance as of 12.31.16	Percent of Balance
389 Land and land rights	5,855,163	3%	2,160,362	4%
390 Structures and improvements	62,729,604	27%	19,008,592	33%
391 Office furniture and equipment	36,837,169	16%	8,905,991	16%
392 Transportation equipment	29,328,633	13%	9,098,889	16%
393 Stores equipment	2,278,594	1%	653,060	1%
394 Tools, shop and garage equipment	8,689,747	4%	5,392,411	9%
395 Laboratory equipment	34,907	0%	261,993	0%
396 Power operated equipment	640,692	0%	3,691,203	6%
397 Communication equipment	21,417,784	9%	7,671,362	13%
398 Miscellaneous equipment	65,176,536	28%	60,195	0%
399 Other tangible property	277,762	0%	-	0%
Total	**233,266,591**	**100%**	**56,904,058**	**100%**

For example, the General Plant category includes assets such as Transportation Equipment, Tools, and Communication Equipment, which are all tied to the everyday operations of the Company. These are items that are no less "time-sensitive" than other asset categories. This table also shows the relative size of each account as a percentage of the total general plant balance.

[42] Exh. BGM-1T, p. 18, ll. 10-13.

Communication Equipment and Transportation Equipment represent significant portions of the overall general plant category balance. In addition, Structures and Improvements are indeed a large part of the balance (27% for electric) of this category. However, the Company has been investing in its current office facilities, as many of our facilities have been in service for over 50 years. Avista is investing in its existing main office building and campus to "make do" with the existing facilities, to avoid the need to build a new building and new campus in another location.

V. DEPRECIATION STUDY

Q. What concerns were raised by Public Counsel, and ICNU and NWIGU, with regard to Avista's in-progress depreciation study?

A. Public Counsel witness Mr. Garrett states that "It is possible that depreciation costs could be low enough that they would offset much of the Company's requested increases particularly in years two and three"[43] and that he "see[s] no reason to commit to a significant rate increase in a multi-year rate plan when a critical cost component is unknown at this time."[44] ICNU and NWIGU witness Mr. Mullins expresses a concern that "if depreciation rates decline, that will provide a windfall to Avista"[45] and that "if depreciation rates decline, any rates approved in this matter will over compensate the utility relative to the ultimate depreciation expense it incurs."[46] Mr. Mullins also commented that the adjustment related to major pro forma plant balances includes a provision for depreciation expense and that he does not believe the impact of an adjustment to depreciation rates would be able to be addressed in a stand-alone proceeding associated with the

[43] Exh. MEG-1T, p. 20, ll. 8-9.
[44] Exh. MEG-1T, p. 20, ll. 10-11.
[45] Exh. BGM-1T, p. 33, ll. 8-9.
[46] Exh. BGM-1T, p. 33, ll. 9-11.

depreciation study.[47] These witnesses believe that a revenue requirement cannot be established without consideration of the depreciation rate updates that will result from Avista's ongoing depreciation study, upon its completion.

Q. Do you agree with the Parties assumptions?

A. No. I do not.

Q. Would you explain how Avista envisions the filing of its depreciation study?

A. Mr. Garrett and Mr. Mullins are correct in stating that the Company is currently in the process of performing a depreciation study.[48] Upon completion of this study (expected in the first quarter of 2018), Avista foresees filing the results of its study with the Commission, as well as with the Idaho Public Utilities Commission and the Public Utility Commission of Oregon. These filings would take the form of accounting petitions requesting the approval to update depreciation rates to the rates suggested by the results of the study. Along with the approval to update the depreciation rates, Avista would request approval to surcharge or rebate customers, through a separate tariff, to reflect the actual depreciation expense associated with the updated depreciation rates. Alternatively, in the absence of approval to surcharge or rebate customers, the Commission could approve deferral of the difference (as a regulatory asset or liability, respectively, depending upon whether the difference is an increase or decrease relative to existing rates), for later amortization, between existing depreciation rates and the updated depreciation rates. Other jurisdictions in which Avista operates have allowed similar rate adjustments or deferrals for later recovery, to reflect the impact of new depreciation rates.

[47] Exh. BGM-1T, p. 34, ll. 9-12.
[48] The depreciation study review is based on plant in service as of December 2016, using the same plant included by the Company in its historical 2016 test period included in this general rate case.

Q. Does Avista's approach, as outlined above, address Mr. Garrett and Mr. Mullins' concerns?

A. The Company believes this approach addresses Mr. Mullins' concern that a decline in depreciation expense as a result of the depreciation study would result in a windfall to the Company—it would not; any reduction would be passed through to customers. Additionally, with regard to Mr. Garrett's concern that a multi-year rate plan should not be approved when uncertainty exists around depreciation rates, the Company would like to clarify that the rate plan proposal in this case establishes a revenue requirement for Year 1 of the Rate Plan, along with revenue escalation factors for Years 2 and 3. With this structure in place, a subsequent rebate or surcharge would simply be subtracted from, or added to, the base revenue requirement determined through this docket and the revenue escalation factors would be applied to this updated revenue balance.

Further, with regard to Mr. Mullins' question about reflecting the impact of updated depreciation rates on the pro forma plant adjustments, these adjustments are based on a weighted average depreciation rate for the functional category. Accordingly, the calculation of depreciation expense associated with these adjustments can be easily updated to reflect updated depreciation rates. The Company's application would include consideration of the outstanding pro-forma adjustments, as well.

These considerations should fully resolve any issues surrounding the alleged uncertainty and appropriately reflect the impact of changes in depreciation rates on retail rates in Years 2 and 3.

Q. Should there be concern by the Commission that the depreciation study was not included as a part of the Company's general rate case, and is therefore tantamount to "single issue rate making"?

A. No. First, there was no requirement to include the depreciation study within the Company's general rate case in Washington. The Company's prior depreciation study, completed in 2012, reviewing plant as of December 31, 2010, was approved by the Commission in 2013. Due to the length of time to complete a depreciation study, and the fact a utility typically would not expect its assets to change so significantly to require a depreciation study sooner, the Company typically completes its depreciation studies approximately every five years. The timing of this depreciation study is consistent with that plan: utilizing 2016 plant balances, completion of study in late 2017, with expected changes in rates in each of its jurisdictions in 2018.

Furthermore, the depreciation study in progress, based on a review of plant as of December 31, 2016, is the same period as reflected in this case using a 2016 historical test period. All parties to this proceeding have been able to review the Company's 2016 historical test period data, as well as review the level of costs expected during the rate effective period. Therefore, there are no level of costs or offsetting factors that are unknown by a party just because the Company did not include a depreciation study adjustment in this case.

The Company will file its depreciation study in the first quarter of 2018, prior to completion of the current general rate case proceeding. The parties will have the time they need to review the study, and any changes can be approved and included by the Commission as appropriate. The depreciation rates approved through the separate depreciation study, or the ultimate depreciation adjustment, will be no different whether the study had been included within the general rate case or outside of the general rate case.

Q. Does Avista agree with Mr. Garrett and Mr. Mullins that the in-process depreciation study precludes the establishment of a revenue requirement and a multi-year rate plan in this docket?

A. No. As I have described above, the planned application to update depreciation rates upon the conclusion of the depreciation study provides avenues that address all of the concerns raised by Mr. Garrett and Mr. Mullins with respect to the pending depreciation study.

VI. <u>CAPITAL REPORTING</u>

Q. Has the Company's proposal for Capital Reporting changed from your direct filed case?

A. Yes. The Company still proposes to file with this Commission an Annual Washington Electric and Natural Gas Capital Report by February 15, 2019 and February 15, 2020 (approximately 75 days) prior to new rates going into effect in order to provide the Parties' ample time to review prior to the rate effective date. The annual report would provide actual year-end balances for the calendar year as of December 31st (EOP net plant balances including impact of A/D and ADFIT) and would be compared to the level of plant approved in this case. The Company will also provide transfer to plant detail by expenditure request of the transfers that occurred during the previous year to reconcile with the gross plant balance provided in the summary balances. This would provide assurance to the Commission that the rate increases approved effective May 1, 2019 and May 1, 2020 include net plant which actually is in-service and serving customers prior to new rates going into effect.

Additionally, the Company also will provide a report by February 15, 2018, including actual year-end balances for the calendar year as of December 31, 2017 (End of Period) for comparison with the level of plant proposed by the Company on rebuttal. This would provide additional reassurance to the Commission regarding the level of capital included in the rate increase proposed by the Company to be effective May 1, 2018.

Q. If the Company's plant balances are materially below the level approved for the rate years beginning May 1, 2018, May 1, 2019 and May 1, 2020, will the Company adjust these rate increases?

A. Yes. If the reports provide that actual net plant in service prior to rates going into effect on May 1, 2018, May 1, 2019, or May 1, 2020 were to be below that supporting the approved revenue increases of each respective year, the Commission would have an opportunity to make modifications prior to rates going into effect, and reduce the revenue requirement accordingly.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.