Exh. CRM-1T
Dockets UE-190334, UG-190335, and UE-190222
Witness: Chris R. McGuire

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-190334, UG-190335, and UE-190222 (*Consolidated*)**

TESTIMONY OF

Chris R. McGuire

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Overview of Staff's Case;
Multi-Year Rate Plan – Year Two Revenues;
Recovery of Remaining Costs for Colstrip Units 3 and 4

October 3, 2019

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Chris R. McGuire, and my business address is 621 Woodland Square Loop SE, Lacey, Washington, 98503. My business mailing address is P.O. Box 47250, Olympia, Washington, 98504-7250. My business email address is chris.mcguire@utc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I work in the Regulatory Services Division of the Washington Utilities and Transportation Commission ("Commission") as Assistant Director of Energy Regulation. I have worked at the Commission since May 2012, and in my current position since April 2018.

Q. Would you please state your educational and professional background?

A. I graduated from the University of Washington in 2002 with a Bachelor of Science degree in Cell and Molecular Biology. I graduated from the University of Colorado in 2010 with a Master of Business Administration and a Master of Science in Environmental Studies. Prior to my employment with the Commission, I held various research and analytical positions at the University of Washington, the University of Colorado and the National Renewable Energy Laboratory.

Q. Have you previously testified before the Commission?

A. Yes. I testified previously in the following issues in Avista Corporation d/b/a Avista Utilities ("Avista" or "Company") rate cases: the attrition studies in Avista's 2014 general rate case, Dockets UE-140188 and UG-140189; policy and attrition studies in Avista's 2015 general rate case, Dockets UE-150204 and UG-150205; interest rate hedging in Avista's 2017 general rate case, Dockets UE-170485 and UG-170486; and revised attrition allowances in Avista's remanded 2015 general rate case, Dockets UE-150204 and UG-150205. I have also testified on pro forma plant additions in Pacific Power's 2013 general rate case, Docket UE-130043; depreciation and cost recovery for Colstrip Units 1 and 2 in Puget Sound Energy's 2017 general rate case, Dockets UE-170033 and UG-170034; and testimony in support of settlement in Puget Sound Energy's 2018 expedited rate filing, Dockets UE-180899 and UG-180900.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. Please describe the scope of your testimony.

A. My testimony first provides a broad overview of Commission Staff's (Staff's) case. I also sponsor testimony as Staff's witness on (1) the revenue increases for year two of the rate plan, and (2) the plan for recovery of undepreciated balances for Colstrip Units 3 and 4.

Q. What has Staff concluded with respect to revenue increases for year two of the rate plan?

A. For year two of the rate plan, Staff recommends an increase of $7,154,000 for electric operations and an increase of $2,310,000 for natural gas operations. These amounts do not include escalations of rate base, but do include escalations for other expense items identified in the Company's revenue growth models, including escalations for depreciation expense.

Q. What has Staff concluded with respect to Avista's proposal to recover remaining costs for Colstrip Units 3 and 4?

A. Avista's proposal – which Staff agreed with in Docket UE-180167 – will need to be revised such that it conforms to new parameters created by the Clean Energy Transformation Act (CETA).[1] Avista already will need to update its case to capture the impact of an accelerated depreciation date of 2025.

At a minimum Avista will need to add some specificity to (1) which accounts compose the remaining depreciable balance and which are transferred to a regulatory asset, (2) which accounts included in the depreciable balance are accelerated to 2025, and (3) which accounts and amounts are being offset by the Tax Reform liability. Avista also will need to explain how its proposal conforms to the requirement that certain costs may not be included in rates beyond 2025, and how amounts collected for estimated decommissioning and remediation costs will be trued up to actuals.

[1] Laws of 2019, ch. 288, §§ 1-13, 26, codified in chapter 19.405 Revised Code of Washington.

Q. Have you prepared any exhibits in support of your testimony?

A. Yes. I prepared Exhibits CRM-2 and CRM-3.

Exh. CRM-2 is the Electric Revenue Requirement Growth Model, incorporating Staff's modifications to Avista's Exh. EMA-4. Exh. CRM-2 is used to calculate Staff's electric revenue increase for year two of Avista's rate plan.

Exh. CRM-3 is the Natural Gas Revenue Requirement Growth Model, incorporating Staff's modifications to Avista's Exh. EMA-5. Exh. CRM-3 is used to calculate Staff's natural gas revenue increase for year two of Avista's rate plan.

III. INTRODUCTION OF STAFF WITNESSES

Q. Please introduce the other Staff witnesses testifying in this proceeding and the subjects of their testimony.

A. The following witnesses present testimony and exhibits for Staff:

- Ms. Joanna Huang presents Staff's overall revenue requirement calculations for electric and natural gas rates effective April 1, 2020. Ms. Huang also presents Staff's position on a number of contested restating and pro forma adjustments.
- Ms. Aimee Higby addresses pro forma plant adjustments. Ms. Higby presents the criteria for evaluating pro forma plant adjustments and applies those criteria to the post-test year plant additions Avista includes in its direct case.
- Mr. David Gomez addresses Avista's capital additions to production rate base, including capital additions associated with the 2019 outages at Colstrip Units 3

and 4 and Coyote Springs 2, as well as Avista's investment in SmartBurn at Colstrip Units 3 and 4.

- Mr. Jason Ball addresses Avista's electric and natural gas cost of service studies, and presents Staff's recommendations on rate spread and rate design.
- Ms. Betty Erdahl presents Staff's adjustment to investor supplied working capital.
- Mr. David Parcell presents Staff's recommendation regarding cost of capital.

IV. OVERVIEW OF STAFF'S CASE

Q. Please provide an overview of Avista's direct case.

A. For the most part, Avista presents a traditional case, following the standard formula for the derivation of revenue requirement. Avista takes a standard hybrid approach, beginning with a modified historical test year but adding restating and pro forma adjustments.

The most notable difference between this case and a "normal" rate case is that Avista proposes a two-year rate plan. While Avista calculates revenues for year one of the rate plan using a conventional framework, Avista calculates revenues for year two of the rate plan by applying a revenue growth factor to the year one revenue requirement. Avista's approach to calculating a year two revenue requirement follows the same basic methodology Avista used for its attrition studies and rate plan proposals in recent cases.

Q. Does Avista's case present the Commission with any major policy issues?

A. The only major policy issue Avista's case presents concerns the appropriate framework for determining revenue increases across a multi-year rate plan. Most importantly, Avista asks the Commission to calculate year two revenue requirement using projected rate base supported only by mathematical extrapolation.

Avista's request that the Commission calculate revenue requirement using projected rate base is tantamount to asking the Commission to make the same decision that led to the remand of Avista's 2015 general rate case, which remains as of yet unresolved. Avista's request asks that the Commission communicate and apply a decidedly liberal interpretation of the recently revised used and useful standard. Avista wastes no time in testing the Commission on this issue.

Q. Does Staff raise any significant policy issues?

A. Just one. Staff witness Ms. Higby recommends a new criterion for evaluating the financial materiality of post-test year plant additions. Ms. Higby argues that the materiality standard should also include consideration of depreciation expense, and not continue to be limited to the traditional assessment of a project's proportional contribution to rate base.

As a first step to incorporating a depreciation metric in the materiality threshold, Ms. Higby recommends including in rates post-test year plant additions with a short depreciable life – in this case six years or less – even if those investments don't meet the traditional definition of "major" (i.e., at least 0.5 percent of net plant in service).

Ms. Higby's testimony is of significant policy relevance as it presents a novel solution to a developing ratemaking problem: utilities that are investing in short-lived plant – such as information technology and grid modernization – struggle to cope with regulatory lag. Thus, Ms. Higby proposes a surgical policy solution to what is likely a significant driver of serial utility rate case filings.

Q. Are there any other potentially significant policy issues Staff wishes to flag for the Commission?

A. Yes. Avista provides a proposal for the recovery of the remaining costs associated with Colstrip Units 3 and 4. However, the proposal does not yet reflect an accelerated depreciation schedule to 2025, nor does it demonstrate conformance to other legal parameters created by CETA. The record awaits a revised proposal that addresses CETA requirements. Therefore, Avista's forthcoming cost recovery framework proposal for Colstrip Units 3 and 4 will likely generate complicated legal and policy questions. I discuss some of the potential issues in Section VI, below.

Q. What was Staff's approach to reviewing Avista's direct case?

A. Given that the bulk of Avista's case followed a reasonably conventional methodological framework, Staff performed a largely conventional review.

There is nothing particularly noteworthy about Staff's approach to the case, excepting the review included an evaluation of proposed revenue increases for year two of a rate plan as well as a reevaluation of the materiality standard and its qualifying criteria.

Q. What are the major contested issues in this case?

A. Aside from the policy issues associated with rate plan revenues and the criteria for evaluating the materiality of plant additions, Staff contests (1) rate of return, (2) amounts included as pro forma adjustments to plant, (3) Avista's investment in Smart Burn, (4) a variety of accounting adjustments, including investor-supplied working capital, and (5) rate spread.

Q. What is Staff's recommendation on revenue requirement, and how does that compare to the Company's as-filed proposal?

A. Staff recommends year one revenue increases of $17.6 million for electric operations and $7.0 million for natural gas operations. This compares to Avista's requested year one revenue increases of $45.8 million for electric operations and $12.9 million for natural gas operations.

For year two of the rate plan, Staff recommends additional increases of $7.2 million for electric operations and $2.3 million for natural gas operations. This compares to Avista's requested year two increases of $18.9 million for electric operations and $6.5 million for natural gas operations.

Q. What significant recommendations does Staff make in this case?

A. Mr. David Parcell recommends an overall rate of return of 7.16 percent, as compared to Avista's requested rate of return of 7.52 percent. Mr. Parcell's recommended rate of return includes a 9.3 percent return on equity, as compared to Avista's requested return on equity of 9.9 percent.

Mr. David Gomez recommends the Commission reject the Company's test year capital additions and expenses for the 2018 outages at Colstrip Units 3 and 4 and Coyote Springs 2. Mr. Gomez also recommends that the Commission disallow costs of the installation of SmartBurn at Colstrip Units 3 and 4.

Ms. Aimee Higby recommends the Commission allow into rates only capital additions that conform to the Commission's standards on pro forma adjustments. Ms. Higby removes from Avista's pro forma plant adjustment 15 electric projects and three gas projects that do not meet the Commission's standards for ratemaking purposes.

Ms. Joanna Huang recommends changes to several restating and pro forma adjustments, including for pro forma labor expense and employee benefits.

I recommend the Commission modify Avista's revenue growth models by using regression analysis and by excluding the rate base escalator. These modifications result in much smaller revenue increases for year two of the rate plan.

Mr. Jason Ball recommends that rate spread be used to address the disparity in cost assignment between residential ratepayers and almost all other Avista ratepayers. Mr. Ball recommends that authorized revenue increases be allocated predominantly to residential ratepayers.

V. MULTI-YEAR RATE PLAN – YEAR TWO REVENUES

A. Summary and Recommendation

Q. Please summarize Staff's recommendation regarding revenue increases in year two of the rate plan?

A. For year two of the rate plan, Staff recommends an increase of $7,154,000 for electric operations and an increase of $2,310,000 for natural gas operations. These year two increases are shown on page 1 of Exh. CRM-2 and Exh. CRM-3 at Column (a), Line No. 12.

Q. What are the primary problems that you have identified in Avista's case for a revenue increase in year two of the rate plan?

A. There are two primary problems with Avista's request for additional revenues in year two of the rate plan. The first is a fundamental deficiency in Avista's case and the other is an analytical flaw.

First, Avista requests a year two revenue increase using a projected level of rate base – reflecting approximately $133 million in additional net plant[2] – yet the Company provides no evidence supporting this increased level (or any level) of investment. Avista provides no testimony or exhibits that could help the Commission evaluate whether this growth is reasonable or based on property that will be used and useful in the rate-effective period.

Second, Avista forces compound growth models over the historical data, ignoring that compounding growth functions do not fit the underlying time series

[2] Combined for electric and gas. Electric amount calculated by applying Avista's 5.95 percent growth rate (identified in Exh. EMA-4) to the Net Plant after DFIT amount of $1,664,406,000 used by Avista for its year one rate request (identified in Exh. EMA-2). Natural gas amount calculated by applying Avista's 9.11 percent growth rate (identified in Exh. EMA-5) to the Net Plant after DFIT amount of $377,660,000 used by Avista for its year one rate request (identified in Exh. EMA-3).

data. In using compound growth models, Avista artificially inflates the average annual rate of growth in the various cost categories in the Company's revenue growth models.

Q. What are the major differences between the analytical approaches used by Staff and Avista?

A. For its calculation of a year two revenue increase, Staff used Avista's revenue growth models, filed as Exh. EMA-4 (electric) and Exh. EMA-5 (natural gas). However, Staff made two modifications to those models in response to the two primary issues described above. Specifically, Staff modified Exh. EMA-4 and Exh. EMA-5 by:

1. Calculating annual growth rates using linear regression models rather than compounding growth models; and
2. Removing the escalation of rate base.

B. Staff's Calculation of Year Two Revenues

Q. What does Staff use as the basis for calculating the appropriate revenue increase for year two of the rate plan?

A. Staff uses Avista's revenue growth models, filed as Exh. EMA-4 (electric) and Exh. EMA-5 (natural gas), with two modifications. First, I calculated the annual growth rates using linear regression models rather than the compounding growth functions the Company used. Second, I removed the escalation of rate base.

Q. Are you sponsoring these modified revenue growth models as exhibits?

A. Yes. Exh. CRM-2 captures Staff's modifications to Avista Exh. EMA-4, and Exh. CRM-3 captures Staff's modifications to Avista Exh. EMA-5.

Q. Can you provide a comparison of the annual growth rates produced using a linear regression model to the annual growth rates produced using a compounding growth function?

A. Yes. See Tables 1 and 2, below, for a comparison of growth rates calculated using linear regression versus compounding growth functions. Table 1 shows the comparison for electric growth models, and Table 2 shows the comparison for the natural gas growth models.

Table 1. Comparison of Electric growth rates calculated using linear regression versus compounding growth functions.

	Regression (Staff)	Compounding (Avista)
Operating Expenses	2.18%	2.72%
Depreciation/Amortization	6.73%	8.34%
Taxes Other than Income	3.01%	4.00%
Net Plant after DFIT	5.28%	5.95%

Table 2. Comparison of Natural Gas growth rates calculated using linear regression versus compounding growth functions.

	Regression (Staff)	Compounding (Avista)
Operating Expenses	3.19%	3.99%
Depreciation/Amortization	8.26%	11.03%
Taxes Other than Income	6.92%	8.36%
Net Plant after DFIT	7.16%	9.11%

As is evident in each of these tables, Avista's compounding growth model generates a higher growth rate relative to the growth rate produced by linear regression.

Q. Why is a linear regression model more appropriate than a compounding growth model?

A. A regression model is a statistical model that produces the best fit to the underlying data. And with regression models, one can evaluate goodness of fit using metrics. Compounding growth functions are not statistical models in the sense that they are not fit to the underlying data and, as a result, cannot be evaluated with goodness of fit metrics.

Additionally, a regression model makes use of all of the data points in a time series (which is how it is able to determine the best fit to the data). A compounding growth function ignores all data points in a time series except the first and the last points. As a result, it does not even attempt to fit the shape of the underlying data; rather, it just connects the first and last data point and assumes absolute growth is accelerating over time.

Q. How did you remove the escalation of rate base?

A. In Exh. CRM-2 and Exh. CRM-3, I simply substituted 0 percent for the calculated growth rate for Net Plant after ADFIT.[3] This modified growth rate is captured in the total revenue growth rate percentage which, in turn, is reflected in Staff's proposed year two revenue increase.[4]

[3] McGuire, Exh. CRM-2 and Exh. CRM-3, "Net Plant After ADFIT," at page 5. The 0% growth rate for Net Plant After ADFIT on pages 1 and 2 of these same exhibits each reference the cell on page 5.
[4] *Id.* at page 1.

Q. Why do you remove the escalation factor for rate base?

A. I discuss this issue in further detail later in my testimony. In short, Avista did not provide evidentiary support for the projected rate base, upon which it asks the Commission to base year two revenue increases.

Q. Does Staff advocate for tying Avista's growth in O&M expense to economic indices?

A. Yes, though in this case it is not necessary to include those indices in the calculation of O&M growth rates. Staff nevertheless includes certain indices here as they do lend some degree of credibility to the O&M growth rate calculated through linear regression.

Staff analyzed the 5-year average rate of growth, from Q1 2014 to Q1 2019 of two utility-specific economic indices: (1) the Employment Cost Index: Total compensation for Private industry workers in Utilities (ECI-Utilities),[5] and (2) the Producer Price Index by Industry: Utilities (PPI-Utilities).[6]

The average 5-year growth rate was 2.85 percent for ECI-Utilities and 0.77 percent for PPI-Utilities. The blended, annual rate of growth for these two indices was 1.81 percent.

Avista's actual rate of growth for O&M expense (produced by regression analysis) was 2.18 percent for electric operations and 3.19 percent for natural gas

[5] U.S. Bureau of Labor Statistics, Employment Cost Index: Total compensation for Private industry workers in Utilities, retrieved from FRED, Federal Reserve Bank of St. Louis. https://fred.stlouisfed.org/series/CIS20144000000000I.

[6] U.S. Bureau of Labor Statistics, Producer Price Index by Industry: Utilities, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PCU221221.

operations. Although these growth rates are higher than the blended index growth rate of 1.81 percent, the differences are not substantial enough to warrant corrective action. This is especially true given that index growth has trended upward in recent years. If one were to focus on index growth between 2016 and 2019, both the ECI-Utilities and the PPI-Utilities indices suggest a growth of around 2.8 percent. Avista's actual rate of growth for O&M expense, as understood through linear regression, is reasonably consistent with the rate of growth of these indices.

Q. Besides O&M expense and Net Plant after ADFIT, what other categories are included in the overall growth rate calculation?

A. The overall growth rate calculations also incorporate growth rates for depreciation/amortization expense and taxes (other than income), and is reduced by the annual growth rate for sales revenues.

Q. What are the results of your revenue growth analysis?

A. For electric operations, I calculate annual growth at 1.67 percent.[7] Applying this amount to the year one revenue base,[8] I calculate an increase of $7,154,000 for year two of the rate plan.[9]

[7] Exh. CRM-2 at 1, Line No. 6.
[8] The year one revenue base of $429,012,000 includes Staff's recommended year one revenue increase of $17,618,000. See CRM-2 at 1, Line Nos. 9-11.
[9] Exh. CRM-2 at 1, Line 12.

For natural gas operations, I calculate annual growth at 2.32 percent.[10] Applying this amount to the year one revenue base,[11] I calculate an increase of $2,310,000 for year two of the rate plan.

C. Alternative Recommendation(s)

Q. Does Staff have an alternative recommendation?

A. Yes. Two, in fact.

Alternative 1:

If the Commission agrees that it cannot authorize a year two revenue increase that includes an imaginary rate base, but it is concerned that revenues calculated without a rate base escalation may not be sufficient, Staff recommends that the Commission reject the rate plan, much as it did in Avista's 2017 GRC.

Staff wishes to emphasize, however, that Staff's recommended year two increases would provide the Company with an automatic increase in revenues 12 months after the year one rate effective date, and an increase that the Company would not receive absent a rate plan. Further, to the extent that Avista is willing to exercise control and moderate its current pace of investment, the Company will have a reasonable opportunity to earn its authorized rate of return in year two of the rate plan under Staff's proposed revenues.

Nevertheless, the Commission is under no obligation to approve a rate plan.

[10] Exh. CRM-3 at 1, Line 6.
[11] The year one revenue base of $99,766,000 includes Staff's recommended year one revenue increase of $7,044,000. See Exh. CRM-2 at 1, Lines. 9-11.

Alternative 2:

In the event the Commission determines that mathematical extrapolation of rate base is acceptable here, Staff still recommends that for calculating year two revenue increases the Commission use Exh. CRM-2 (electric) and Exh. CRM-3 (gas). Exhibits CRM-2 and CRM-3 are modified versions of Avista's revenue growth models (Exhibits EMA-4 and EMA-5), using linear regressions rather than compound growth functions to determine annual growth rates.

Using Exhibits CRM-2 and CRM-3, but including an escalation of rate base, for year two of the rate plan, Staff calculates an increase of $14,509,000 for electric operations[12] and an increase of $4,463,000 for natural gas operations.[13] Staff wishes to reemphasize here that it does not recommend authorizing these amounts for year two revenue increases, as they include a return on a projected, but unexplained, increase in rate base.

D. Response to Avista's Year Two Revenue Proposal

Q. What does Avista request for a revenue increase for year two of the rate plan?

A. For electric operations, Avista requests an additional $18.9 million in year two of the rate plan.[14] This amount is based on an annual revenue requirement growth rate of 4.14 percent, as produced by the Company's electric revenue growth model.[15]

[12] Exh. CRM-2 at 1, Line 12 (shaded in gray).
[13] Exh. CRM-3 at 1, Line 12 (shaded in gray).
[14] Andrews, Exh. EMA-2 at 2, Line 14. This amount is in addition to the $45.8 million increase Avista requested for year one, shown at Line 7.
[15] Andrews, Exh. EMA-4 at 1.

For natural gas operations, Avista requests an additional $6.5 million in year two of the rate plan.[16] This amount is based on an annual revenue requirement growth rate of 6.11 percent, as produced by the Company's natural gas revenue growth model.[17]

Q. Does Staff agree with Avista's portrayal of its annual revenue requirement growth rates?

A. No. Avista's analysis inappropriately used compounding growth functions to calculate growth rates, and it used a projected increase to rate base which it does not explain and for which it does not provide evidentiary support.

Q. Why is it inappropriate to use compounding growth functions to calculate growth rates?

A. The underlying data that Avista purports to be analyzing does not grow in a compounding manner. When analyzing time-series data, it is important that the selected model fits the shape of the data. If a model is forced on the data without consideration of fit, the model will be of little use in predicting future data points. Yet that is exactly what Avista has done in this case. In using a compounding function without consideration of fit, the Company generates extrapolated future data points in which we can have no confidence.

[16] Andrews, Exh. EMA-3 at 2, Line 14. This amount is in addition to the $12.9 million increase Avista requested for year one, shown at Line 7.
[17] Andrews, Exh. EMA-5 at 1.

Q. Are there any other issues with using Avista's compounding growth functions?

A. Yes. Avista's compounding growth functions ignore the entire time-series except the first and the last data points. With its presentation of data for all years from 2014 through 2018, Avista gives the impression that is uses all of that data in its analysis. It does not. It uses only data from two years: 2014 and 2018. In using a compounding growth function, Avista's analysis tosses out data for 2015, 2016, and 2017. These years are essential for understanding how expenses change, on average, from year to year and, accordingly, how expenses can be expected to grow into the future.

Q. Please explain Avista's evidentiary support for its projected level of rate base.

A. Avista's year two revenue request includes an additional $133 million in net plant,[18] though Avista provides no explanation or evidentiary support for that amount. Thus, Avista's escalation for year two rate base is based on nothing more than a projection based on the compound growth rate calculated using two data points: 2014 and 2018. Avista provides no testimony or supporting documentation that could provide some legitimacy to this $133 million growth in net plant.

Staff cannot recommend the Commission accept this amount for the calculation of year two rates. Doing so would indicate that utilities need not provide

[18] For electric and natural gas combined, on a Washington-allocated basis. Electric amount of $99 million calculated by applying Avista's 5.95 percent growth rate (identified in Exh. EMA-4) to the Net Plant after DFIT amount of $1,664,406,000 used by Avista for its year one rate request (identified in Exh. EMA-2). Natural gas amount of $34 million calculated by applying Avista's 9.11 percent growth rate (identified in Exh. EMA-5) to the Net Plant after DFIT amount of $377,660,000 used by Avista for its year one rate request (identified in Exh. EMA-3).

evidentiary support for projections of rate base, and would suggest that naked mathematical extrapolations are good enough for us.

Q. Does Avista propose a reporting process for reviewing the actual level of net plant in service prior to year two rates going into effect on April 1, 2021?

A. Yes. Avista proposes to file with the Commission, 43 days before year two rates go into effect, a capital report of the actual level of net plant in service as of December 31, 2020. Avista asserts that "[t]his report will provide an opportunity for review of the level of net plant in-service prior to new rates going into effect on April 1, 2021."[19]

Q. Does Avista's proposed capital reporting process alleviate Staff's concerns with respect to the projected rate base used to determine revenues in this case?

A. No. Avista suggests that simply informing the Commission of its plant balances as of December 31, 2020, is sufficient for justifying a rate increase. The process Avista proposes does not provide an opportunity for parties to perform a meaningful review of the investments the Company requests be included in rates. Further, Avista asks that no limit be placed on the number of projects subject to consideration. Rather, Avista asks that every investment made by December 31, 2020, be included in rates without regard to ratemaking principles or regulatory standards.

A process for reviewing investments for which a utility seeks recovery in years two, three, or four of a rate plan, should be consistent with the Commission's

[19] Andrews Exh. EMA-1T at 13:21-14:2.

standard process for evaluating post-test year plant additions and their appropriateness for rate recovery. To be included in rates, investments must be used and useful, final project costs must be known and measurable and proved by the company to be prudently incurred, and offsetting factors should be identified and incorporated into rates. Avista's proposed process falls short of most, if not all, of these standards.

The Commission should not abandon its standards; therefore, the process for reviewing investments included in multi-year rate plan rate increases should resemble the standard process for reviewing pro forma plant adjustments. Critically, parties must be given a reasonable opportunity to evaluate each investment's adherence to these standards.

Q. Are you being unreasonable by excluding a rate base escalator in your calculation of year two revenues?

A. No. Given the freshly elevated profile of the used and useful standard resulting from new legislation, and the heightened scrutiny on the Commission for its recent use of a statistically derived rate base for setting rates (in a currently active Avista case that was remanded because rate base was projected, no less), it is baffling to me that Avista is now, again, asking the Commission to authorize rates that include a projected rate base.

Even disregarding the awkward timing of again requesting revenues using a projected rate base, Avista bases its rate base escalation on *nothing more* than a projection. Avista's requested year two revenues include a return on approximately

$133 million of additional net plant, yet the Company provides not a word on what projects this amount is composed of, why this level of growth is necessary, or whether this projection bears any relationship to reality whatsoever. It is a purely imaginary number at this point, and it is not unreasonable to exclude imaginary numbers.

Additionally, it is important to note that Staff's recommended year two increases *include growth factors for depreciation expense*, so the Company in fact will have an opportunity to recover its investments if it continues its current pace of investment, and will have an opportunity to earn a return on those incremental investments if it is willing to moderate its current pace of investment. In that way, Staff's proposed year two revenues incentivize business discipline, which should be embraced as a feature of effective utility regulation.

Q. You mentioned earlier that the used and useful standard had been recently revised. Were you referring to the changes to the valuation statute, RCW 80.24.250, that became effective in May of this year?

A. Yes.

Q. Based on your understanding of the valuation statute, do the recent legislative changes affect your recommendation concerning the evidence that the Commission should require to support year two rates for Avista?

A. No. Recent changes to the valuation statute in no way require the Commission to abandon ratemaking principles or its fundamental standards for evaluating utility investment in plant.

Q. Does Avista have control over its pace of investment?

A. Yes. As the Commission has pointed out, "[Avista], by and large, decides (*i.e.*, controls) what projects it will undertake and when it will undertake them."[20] Further, the Commission previously has noted that Avista could exercise that control to reduce the need for additional revenue increases:

> It appears that Avista could avoid further increases in revenue requirements … if it moderates the pace of growth in its capital expenditures.[21]

Q. Has the Commission previously criticized Avista for failing to provide evidence supporting its growth in rate base?

A. Yes. In Avista's 2016 general rate case, the Commission stated:

> [Avista] has not presented adequate evidentiary support to demonstrate … that the pace of its capital investments is outside of the Company's control.[22]

Q. In the current rate case, has Avista presented evidence demonstrating that the pace of its capital investments is outside of the Company's control?

A. No. For year two of the rate plan, Avista seeks a return on an additional $133 million in net plant in service, but it does not identify for the Commission any of the

[20] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-160229 & UG-160229, Order 06, 43, ¶ 72 (December 15, 2016) (2016 Avista GRC Order).
[21] *Id.* at 44, ¶ 73.
[22] *Id.*

investments that are driving this substantial increase in rate base, let alone why those investments are outside of the Company's control. Avista provides the Commission with nothing more than a mathematical projection.

Q. Has the Commission previously expressed concern with mathematical projections of rate base?

A. Yes. Also in Avista's 2016 general rate case, the Commission stated:

> Statistical analyses do not identify or establish causal relationships. Indeed, for example, it is clear that a regression analysis performed on historical data projected into future years, no matter how statistically significant the results may be, simply will tell us nothing that would help determine whether some unspecified future investment will meet the used and useful test. Similarly, such a statistical analysis can tell us nothing about prudence, which is not a general, abstract inquiry, but rather one tied to individual projects the Company decides to, and does, undertake.[23]

Thus, the Commission has already warned Avista that a mathematical projection of rate base, by itself, is insufficient evidence for supporting a revenue increase. Nevertheless, Avista asks for just that – a revenue increase based on an otherwise unsupported mathematical projection of rate base – appearing to disregard the Commission's direction on this issue.

VI. COST RECOVERY FOR COLSTRIP UNITS 3 AND 4

A. Summary and Recommendation

[23] 2016 Avista GRC Order at 42-43, ¶ 71.

Q. Can you please summarize Staff's recommendation with respect to Avista's proposed recovery of Colstrip Units 3 and 4?

A. Yes. Staff recommends that when Avista updates its case to capture the impact of an accelerated depreciation date of 2025, it revise its cost recovery proposal such that it conforms to the parameters identified in the Clean Energy Transformation Act (CETA).

To accommodate the parameters of CETA, Avista's revised Colstrip proposal will need to describe the proposed treatment separately for (a) production net plant and depreciation, (b) transmission net plant and depreciation, and (c) decommissioning and remediation. Avista will also need to explain how its proposal conforms to the CETA requirement that certain costs may not be included in rates beyond 2025, and how amounts collected for estimated decommissioning and remediation costs will be trued-up to actuals.

Q. Does Staff adjust its electric revenue requirement calculation to reflect a modification to Avista's proposal for Colstrip Units 3 and 4?

A. No, it does not. As the Company was unable to incorporate the requirements of CETA into its direct case,[24] the record does not contain sufficient detail on the cost elements of Colstrip Units 3 and 4, or the effect of CETA on account-level depreciation rates, for Staff to make a quantitative recommendation. As a placeholder, Staff includes Avista's as-filed proposal in its revenue requirement calculations as electric Adjustment 3.13. However, as noted by Staff witness Ms.

[24] Andrews, Exh. EMA-1T at 74:1-3.

Huang, Staff's Adjustment 3.13 incorporates two revisions provided by Avista through discovery.[25]

B. New CETA Requirements

Q. Can you please summarize how CETA affects the recovery of costs associated with Colstrip Units 3 and 4?

A. Yes. First, CETA does not include transmission plant or decommissioning and remediation costs in its requirement that depreciation schedules for coal-fired resources be accelerated to a date no later than December 31, 2025.[26] In fact, with respect to the facts of the current case, it appears that (1) depreciation schedules for transmission plant cannot be accelerated and (2) decommissioning and remediation costs should be removed from the remaining depreciable balances (to be accelerated).

Second, CETA requires that actual (rather that estimated) decommissioning and remediation costs be recovered in rates, effectively requiring a future true-up.

Third, CETA requires that certain costs may not be included in rates beyond 2025, likely confining the recovery of those costs to a period of less than six years.

Q. Please explain why the depreciation schedules for transmission plant likely cannot be accelerated?

A. Depreciation schedules for transmission assets are discussed in RCW 19.405.030(2):

[25] *See* Huang, Exh. JH-11.
[26] RCW 19.405.030(1)–(2).

> The commission may accelerate the depreciation schedule for any qualified transmission line owned by an investor-owned utility when the commission finds the qualified transmission line is no longer used and useful and there is no reasonable likelihood that the qualified transmission line will be utilized in the future. [Emphasis Added]

The law clearly requires that, prior to accelerating the depreciation schedule for Colstrip transmission assets, the Commission must first make findings that (1) those transmission assets are no longer used and useful, and (2) there is no reasonable likelihood that those transmission assets will be utilized in the future.

To Staff's knowledge, the record in this case does not contain the evidence that the Commission would need to make these findings. Therefore, it is Staff's understanding that the depreciation schedules for Colstrip transmission assets at this time cannot be accelerated to 2025.

Q. Please explain why estimated decommissioning and remediation costs should be removed from the remaining depreciable balances (to be accelerated).

A. Although CETA requires that Colstrip costs be eliminated from rates by the end of 2025, "[t]his does not include the costs associated with decommissioning and remediation."[27] Therefore, the recovery of projected decommissioning and remediation costs does not *need* to be accelerated to 2025.

Considering the law likely requires net production plant to be recovered in full over the next five years, ratepayers during those five years will likely already be asked to carry a disproportionate allocation of those costs. We should not expect those same ratepayers also absorb the entirety of decommissioning and remediation

[27] RCW 19.405.030(1)(a).

costs over the next five years, especially given that the law does not require us to do so.

Removing decommissioning and remediation costs from the depreciable balance allows flexibility in how, and over what timeline, those costs are recovered.

Q. Please explain why a true-up mechanism is needed for Colstrip decommissioning and remediation costs.

A. First, it's important to recognize that while estimated decommissioning and remediation costs are recovered from customers during a facility's operational life, the actual decommissioning and remediation costs are not known until well after the facility is retired. To the extent that the actual decommissioning and remediation costs has been higher or lower than the amount collected through rates, the utility historically has absorbed the difference.

Under CETA, this practice will change for coal-fired generation facilities. CETA states that "[t]he commission shall allow in electric rates all decommissioning and remediation costs prudently incurred by an investor-owned utility for a coal-fired resource."[28] Therefore, to the extent actual decommissioning and remediation costs exceed amounts previously collected from ratepayers, the utility may recover those costs. And to the extent amounts collected from ratepayers exceed actual costs, those amounts are owed back to ratepayers, as they do not represent prudently incurred costs. This type of arrangement argues for establishing a tracking and true-up mechanism.

[28] RCW 19.405.030(1)(b).

Further, in the absence of an established tracking and true-up mechanism, collection of estimated costs does not appear permissible under CETA, given that those costs have not yet been incurred and so clearly cannot be "prudently incurred." A tracking and true-up mechanism could solve this problem, much like it does for pipeline cost recovery mechanisms and purchased gas adjustments.

Q. Please explain why recovery of certain Colstrip-related costs may be prohibited beyond 2025.

A. RCW 19.405.030(1)(a) states that the utility must eliminate coal fired resources from its allocation of electricity on or before 2025. Under RCW 19.405.020(1), "allocation of electricity" means "for the purposes of setting electricity rates, the costs and benefits associated with the resources used to provide electricity to an electric utility's retail electricity consumers that are located in this state."

With RCW 19.405.030(1)(a) and RCW 19.405.020(1), CETA appears to prohibit costs associated with coal-fired resources from being included in electricity rates beyond 2025. As discussed above, the law provides certain exceptions for transmission assets and decommissioning and remediation costs. However, exceptions do not appear to exist for other categories of plant, suggesting that a significant portion of the net plant in service for Colstrip Units 3 and 4 may need to be recovered over the next six years.

However, it is unclear how the language of RCW 19.405.030(1)(a) comports with the language of RCW 19.405.030(3), which requires the Commission to allow in rates undepreciated investment in a fossil fuel generating resource that has been

retired from service, if the Commission finds that the retirement is in the public interest.[29]

C. Avista's Proposal

Q. What are the costs associated with Colstrip Units 3 and 4 for which Avista seeks recovery?

A. As shown in Ms. Andrews' Exh. EMA-1T, Table No. 6, Avista seeks recovery of an undepreciated balance of $105,000,000. This amount includes $38,350,000 in asset retirement obligations (AROs). The remaining $66,650,000 reflects net plant in service, and includes transmission assets.[30]

Q. How does Avista propose to recover the $105,000,000 undepreciated balance of Colstrip Units 3 and 4?

A. As shown in Exh. EMA-1T, Table No. 07, Avista proposes to (1) offset $11,709,000 using existing Tax Reform Liabilities, (2) defer and amortize a regulatory asset in the amount of $58,156,000, and (3) recover $35,135,000 through depreciation expense. The $58,156,000 regulatory asset would be amortized over approximately 34 years.

[29] RCW 19.405.030(3). "The commission must allow in rates, directly or indirectly, amounts on an investor-owned utility's books of account that the commission finds represent prudently incurred undepreciated investment in a fossil fuel generating resource that has been retired from service when: (a) The retirement is due to ordinary wear and tear, casualties, acts of God, acts of governmental authority, inability to procure or use fuel, termination or expiration of any ownership, or a operation agreement affecting such a fossil fuel generating resource; or (b) The commission finds that the retirement is in the public interest."

[30] This amount includes $2,528,000 associated with 2019 capital additions. Andrews, Exh. EMA-1T at 75.

Q. Is this consistent with the proposal Staff has previously agreed to?

A. Yes. Avista's proposal is consistent with what was agreed to in the settlement in Avista's depreciation study proceeding, Dockets UE-180167 and UG-180168. The Commission determined that the proposal was "properly considered in the context of a general rate case when the Commission can assess effects on and by other rate adjustments."[31] There are minor differences in Avista's proposal in this case to account for changes to net plant in service and interest on the Tax Reform liability.

Q. Has this proposal been updated to reflect a 2025 depreciable life for Colstrip?

A. No, it has not. Avista testifies that it was unable to incorporate the requirements of CETA into its direct case,[32] and that it will update its proposed impact of using an accelerated depreciation date of 2025 for its Colstrip assets in Washington during the process of this case.[33]

It should be noted Avista's as-filed proposal (which does not account for new CETA requirements) can easily accommodate this change by simply decreasing the remaining depreciable balance and increasing the regulatory asset by a corresponding amount. Avista estimates that this will increase revenue requirement by approximately $236,000.[34]

[31] *In re Petition for an Order Authorizing the Company to Revise its Electric and Natural Gas Book Depreciation Rates and Authorizing Deferred Accounting Treatment for the Difference in Depreciation Expense*, Dockets UE-180167 & UG-180168, Modified Order 04 at 11-13, ¶¶ 31-35 (2019 Avista Depreciation Order) (April 3, 2019).
[32] Andrews, EMA-1T at 74:1-3.
[33] *Id*. at 74:3-5.
[34] *Id*. at 74:7-8.

Q. Does Avista's as-filed proposal remain a viable solution?

A. Probably not. Given the new legal parameters under CETA, at a minimum Avista will need to add some specificity to (1) which accounts compose the remaining depreciable balance and which are transferred to a regulatory asset, (2) which accounts included in the depreciable balance are accelerated to 2025, and (3) which accounts and amounts are being offset by the Tax Reform liability.

Q. Can you please describe why the added specificity on these four items will be necessary?

A. Yes. For item (1), CETA appears to prohibit certain costs from being recovered beyond 2025. Since the proposed Colstrip regulatory asset would be amortized over 34 years, it appears that certain accounts must remain part of the depreciable balance and, therefore, cannot be included in the Colstrip regulatory asset.

For item (2), CETA appears to prohibit Colstrip transmission assets from being accelerated to 2025, at least until the Commission finds that these assets are no longer used and useful. To the extent that transmission accounts remain in the depreciable balance, annual depreciation expense will have to reflect that the depreciable lives of those assets are not accelerated to 2025.

For item (3), the Tax Reform liability should be used in a manner that best preserves the level of intergenerational equity provided by the agreement in Docket UE-180167. That could mean using it to offset a portion of the Colstrip regulatory asset, or that could mean using it to offset certain accounts that remain included in the depreciable balance.

Q. Does this conclude your testimony?

A. Yes.