Exh. ANH-1T
Dockets UE-190334, UG-190335, and UE-190222
Witness: Aimee N. Higby

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

Aimee N. Higby

STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Pro Forma Policy;
Pro Forma Rate Base Adjustments;
Pro Forma O&M Offsets

October 3, 2019

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Aimee N. Higby, 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 aimee.higby@utc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission ("Commission") as a Regulatory Analyst in the Energy Regulation Section of the Regulatory Services Division.

Q. How long have you been employed by the Commission?

A. I have been employed by the Commission since October 2018.

Q. Please state your qualifications to provide testimony in this proceeding.

A. I earned a Bachelor of Arts degree in History from Columbia University in 2007. I earned a Master of Public Administration degree from Portland State University in 2013. Prior to my employment with the Commission, I held multiple positions at Bonneville Power Administration, a federal power marketing administration within the U.S. Department of Energy.

Q. Have you testified previously before the Commission?

A. No.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the scope and purpose of your testimony?

A. I address Avista Corporation's d/b/a Avista Utilities ("Avista" or "Company") adjustments 3.10 (pro forma capital additions) and 3.11 (O&M offsets). I respond to Avista witness Ms. Schuh and address the treatment of pro forma 2019 major threshold capital additions and O&M offsets. In general, my testimony will provide an overview of the Commission's ratemaking policy and Staff's application of those standards to pro forma capital additions. However, Staff witness Mr. Gomez addresses the pro forma treatment of the Smart Burn project.

Q. Please summarize your recommendations.

A. From a policy perspective, I recommend a modest but meaningful modification to the materiality threshold used to assess whether a pro forma plant addition is "major." More specifically, when determining whether a pro forma plant addition qualifies as "major," I recommend that the Commission consider the depreciable life of the asset. My recommended adjustment incorporates into rates short-lived projects that do not meet the more traditional definition of "major."

For electric service, I recommend electric pro forma rate base include two projects and programs through July 31, 2019, with actual amounts totaling $6.2

million. The Company initially included 17 projects with forecasted totals through 2019 of $84.9 million. No O&M offsets are included for these two projects.

For natural gas service, I recommend pro forma rate base adjustments include six projects and programs for natural gas operations through July 31, 2019, with actual amounts totaling $14 million. The Company initially included nine projects, with forecasted totals through 2019 of $26.5 million. I include O&M offsets for one project totaling $10,086.

III. COMMISSION RATEMAKING POLICY AND STANDARDS

A. Background

Q. What is the Commission's historical ratemaking practice for Pro Forma adjustments?

A. The Commission's regulatory framework is grounded in two components: a modified historical test year and limited pro forma adjustments.

Q. Please describe the modified historical test year component.

The historical test year captures a snapshot of the different components the Company contends with for a defined period of time. The Commission has said:

> The Commission's long-established and well-understood ratemaking practice requires companies filing for revised rates to start with an historical test year. . . . There is a fundamental reason for this starting point in every case: costs, revenues, loads and all other pertinent factors are known and can be measured with a high degree of certainty because they have, in fact, occurred. The

> practical value of the historical test year is that the cost, revenue and plant data are available for audit, and the test year captures the complex relationships among the various aspects of utility costs, revenue, load, and other factors over a uniform period of time.[1]

As a single look at the costs, revenue, load, and other factors in a specific time period, the Commission allows certain restating adjustments. These adjustments to the test year capture changes between actual test year results and results under "normal" circumstances.

Q. Please describe limited pro forma adjustments.

A. As a general matter, pro forma adjustments are "limited." To be included for ratemaking purposes, pro forma must conform to the Commission's rules on pro forma adjustments.[2] That is, they must be limited to only "known and measurable" changes, not reflected in the test year, that are not offset by other factors.

With respect to plant additions, a pro forma adjustment is an adjustment to test year plant balances to account for significant capital projects completed after the test year. To the extent that significant post-test year capital additions, and the revenue and expense effects of those capital additions, are not reflected in the revenue requirement calculation, a utility might not have a reasonable opportunity to recover its costs or a return on its investments. Pro forma adjustments to plant help to resolve this issue.

[1] *Wash. Utils. & Transp. Comm'n. v. Avista Corp*., Dockets UE-160228 & UG-160229, Order 06, p. 47, ¶ 80 (Dec. 15, 2016).
[2] WAC 480-07-510(3)(c)(iii).

However, whether a post-test year project warrants pro forma treatment typically depends on whether the project is determined to be "major." In the next section, I discuss this criterion, as well as other criteria commonly employed by the Commission to determine whether a project is appropriate for pro forma treatment.

B. Commission Standards for Pro Forma Adjustments

Q. What standards have historically been applied to determine whether a post-test year plant addition is appropriate to include as a pro forma adjustment?

A. The Commission historically has relied on five basic ratemaking standards in determining whether a post-test year plant addition merits a pro forma treatment:

1. Known and Measurable Standard – Are the costs of the project known and measurable?
2. Offsetting Factors Standard – Have offsetting factors been identified and incorporated into the revenue requirement calculation?
3. Used and Useful Standard – Is it certain that the plant will be in service and providing benefit to ratepayers during the rate-effective period?
4. Prudency Standard – Have the costs been prudently incurred?
5. Materiality Standard – Does the project meet a reasonable definition of "major?"

I discuss these standards individually below.

1. Known and Measurable and Offsetting Factors

Q. What are the Commission's rules on pro forma adjustments?

A. The Commission's pro forma adjustment rule states:

> Pro forma adjustments give effect for the test period to all known and measurable changes that are not offset by other factors. The company and any other party filing testimony and exhibits proposing pro forma adjustments must identify dollar values and underlying reasons for each proposed pro forma adjustment. Pro forma adjustments must be calculated based on the restated operating results. Pro forma fixed and variable power costs, net of power sales, may be calculated directly based either on test year normalized demand and energy load, or on the future rate year demand and energy load factored back to test year loads.[3]

Q. What two ratemaking standards are established by the Commission's rules on pro forma adjustments?

A. The Commission's rules on pro forma adjustments[4] yields the first two standards used by the Commission to determining the appropriateness of rate base additions: the known and measurable standard and the offsetting factors standard.

Q. What is the importance of the known and measurable standard in pro forma adjustments?

A. The Commission has stated:

> The known and measurable concept requires that an event that causes a change in revenue, expense or rate base must be *known* to have occurred during or after the historical 12 months of actual results of operations. It must also be demonstrated (*i.e.*, *known*) that the effect of the event will be in place during the 12-month period when rates will likely be in effect.[5] The actual amount of the change must be *measurable.* This means the amount

[3] WAC 480-07-510(3)(c)(ii).
[4] *Id*.
[5] This is also known as the "rate year."

> cannot be an estimate, a projection, the product of a budget forecast, or some similar exercise of judgment—even informed judgment—concerning future revenue, expense or rate base. Costs that are documented by actual expenditure, invoice, contract, or other specific obligation usually meet this test. Costs that are the product of forecasts, projections, or budgets generally will not qualify.[6]

Q. What are the practical implications of the known and measurable standard?

A. To be included in rates through a pro forma adjustment, a capital addition must be known to have been placed in service and the final project cost must be measurable. This means that from a practical standpoint, forecasts of costs do not meet the current interpretation of the "known and measurable" standard.[7]

Q. What is the importance of offsetting factors in pro forma adjustments?

A. A strict interpretation of the Commission's rules on pro forma adjustments requires that, in order to be included as a pro forma adjustment and included in rates, a capital addition must not be offset by other factors. That is, if the capital addition produces incremental revenues, or if it in some way reduces expenses, it is disqualified from receiving pro forma treatment. The logic is that the increased revenue or decreased expense associated with the capital addition would offset the need for rate relief associated with the investment.

[6] *Wash. Utils & Transp. Comm'n v. Avista Corp.*, Dockets UE-090134 & UG-090135, Order 10, p. 21 ¶ 45 (Dec. 22, 2009) ("Avista GRC 2009").

[7] The Commission recently opened an "Inquiry into the Valuation of Public Service Company Property Used and Useful after Rate Effective Date" in Docket U-190531. Staff filed written comments on August 5, 2019, requesting that the Commission provided guidance on how to apply the "known and measurable" standard going forward.

Q. Does the Commission apply this strict interpretation of the offsetting factors standard?

A. Typically not. The Commission recognizes that the annual benefits of a project cannot perfectly offset the annual cost of the investment. Therefore, the Commission typically allows pro forma plant adjustments as long as the offsetting factors that are reasonably expected to exist have been identified, quantified, and included in the revenue requirement calculation.

Q. What are the practical implications of the Offsetting Factors Standard?

A. With the offsetting factors standard, utilities have the burden of demonstrating *for each and every post-test year plant addition* that either (1) there are no offsetting factors, or (2) offsetting factors have been accurately quantified and incorporated into the revenue requirement calculation.

The practical implication of the Offsetting Factors Standard is that pro forma adjustments are limited to those for which offsetting benefits can be identified and reasonably evaluated. Indiscriminate adjustments to pro forma plant, including aggregate levels of projected plant-in-service, generally fall short of meeting this standard.

Q. How do utilities typically attempt to capture offsetting factors?

A. For pro forma plant, utilities typically include an associated adjustment for operations and maintenance (O&M) offsets. This adjustment accounts for O&M expenses in the test period that will be reduced or eliminated during the rate-effective

period as a result of placing specific plant in service after the test year. Each O&M offset is matched to the associated transfer of plant in service; that is, an offset should only be included in the revenue requirement calculation if the associated plant is also included in the calculation.

2. Used and Useful Standard

Q. What is the Commission's used and useful standard?

A. RCW 80.04.250 creates a statutory requirement that property must be "used and useful for service in this state" to be recovered in rates. The Commission has historically interpreted the used and useful standard to mean that (1) the plant *will be* in service by the rate-effective date,[8] and (2) the plant provides benefits to ratepayers. [9]

Q. What is the importance of the used and useful standard?

A. The Commission's interpretation of the used and useful provides important and necessary boundaries for what plant is allowed into rates. The used and useful standard also yields the existing ratemaking framework by providing a foundation for the Commission to "ascertain or determine the fair value for rate making purposes of the property of any public service company."[10]

[8] Avista GRC 2009 at p. 22, ¶ 48.
[9] *Wash. Utils & Transp. Comm'n v. Pacific Power & Light Co.,* Docket UE-050684, Order 04, pp. 21-22, ¶ 50 (Apr. 17, 2006).
[10] RCW 80.04.250(2).

Q. What is the practical implication of the used and useful standard?

A. If a capital addition is not in service by the time testimony is filed, Staff cannot attest with certainty that the plant will be used and useful by or during the rate effective period. Therefore, in order to be included in Staff's revenue requirement calculation, a project should be shown to be in service and providing benefit to ratepayers in advance of the filing date for response testimony.

3. Prudency Standard

Q. What is the importance of prudency in pro forma adjustments?

A. Prudency is a foundational element for rate treatment of capital expenditures; it is rooted in the Commission standards discussed above:

> Regulated public service companies bear the burden of proof that their decisions are prudent, just as they are required to demonstrate generally that their proposed rates are just and reasonable reflecting capital expenditures that are used and useful to end-users.[11]

To evaluate prudence, the Commission has clearly articulated appropriate parameters:

> Three factors are considered in our evaluation of whether the Company's decision was prudent: (1) Was the initiation of the project prudent? (2) Was the continued construction of the project prudent? and (3) Were the construction expenses prudently incurred? As the Commission explained in WUTC v. The Washington Water Power Company, the second and third factor are examined using the same prudence test as the first factor but 'applied at a different point in time and necessarily premised on a reevaluation of the project.' In other words, our examination of prudence on a specific capital expenditure is not limited to a single point in time, but is

[11] *Wash. Utils & Transp. Comm'n v. Pacific Power & Light Co.,* Docket UE-152253, Order 12, p. 33, ¶ 94 (Sept. 1, 2016).

considered in the continuum of the specifics of the terms of the contract at issue.[12]

These questions are the basis for determining eligibility rate recovery of a project.

Q. What are the practical implications of the prudency standard?

A. Providing evidence in line with the Commission's parameters is grounded in an *ex post facto* review of what was known at the time of the decision. This is a core component of the regulatory framework and is the cause of regulatory lag, which I discuss later. Given that prudency reviews are after-the-fact, forecasted rate base additions cannot, by definition, meet the Commission's standard for prudency.

4. Materiality Standard

Q. What is the Commission's materiality standard?

A. The Commission has indicated that proposed plant additions need to meet a "reasonable definition of 'major,'"[13] essentially limiting rate base additions that occur after the test period to those that have a meaningful financial impact on the Company.

[12] *Id*. at p. 34, ¶ 95 (internal citation omitted).
[13] *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.,* Docket UE-140762, Order 08, p. 13, ¶ 170 (Mar. 25, 2015).

Q. What is the importance of the materiality standard?

A. Pro forma adjustments to plant are limited to major projects because those are the projects likely to have a material effect on the overall revenue requirement calculation; hence "materiality" standard. Therefore, pro forma adjustments should include projects "relevant to the issue of the financial impact on the Company in the setting of rates."[14]

The Commission's materiality standard also is one of practicality. It is necessary that pro forma plant adjustments be limited in number; it is simply not feasible for a company to meet its burden of proof for each and every one of its post-test year projects and to conform to the Commission's rules for pro forma adjustments. Further, evaluating pro forma plant additions that are placed into service subsequent to the filing of a rate case could, theoretically, require a continuous audit during the pendency of the rate proceeding. This would lead to constantly evolving and fluctuating positions for the parties and the Commission. To this point, the Commission has acknowledged there are "limits imposed by the 'used and useful' and 'known and measurable' standards" while continuing to allow "the considerable discretion those standards allow in the context of individual cases."[15]

[14] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-150204 & UG-150205, Order 05, p. 17, ¶ 40 (Jan. 6, 2016) ("Avista GRC 2015").
[15] *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.,* Docket UE-130043, Order 05, p. 79, ¶ 198 (Dec. 4, 2013).

Q. How has the Commission applied the materiality standard?

A. In past cases, the Commission has relied on utility budget reporting rules for helping to define a "major" project. WAC 480-140-040 defines major projects in the following manner:

> Major construction projects will be determined for water, gas, and electrical companies, as all projects where the Washington-allocated share of the total project is greater than five-tenths of one percent of the company's latest year-end Washington-allocated net utility plant in service, but does not include any project of less than three million dollars on a total project basis. This determination for companies providing combined industry services will be done on an industry-specific basis.

As the Commission has indicated, WAC 480-140-040 is the only directly applicable legal standard for what constitutes a major project.[16] Moreover, the Commission has found the five-tenths of one percent threshold reasonable within the context of a general rate case, observing that:

> [The five-tenths of one percent threshold] has … 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. [17]

IV. RECOMMENDED MODIFICATION TO THE MATERIALITY STANDARD

Q. Do you recommend the materiality standard be modified?

A. Yes. I propose that short-lived assets be included in the materiality standard.

[16] *Wash. Utils. & Transp. Comm'n. v. Pacific Power & Light Co.*, Docket UE-140762, Order 08, p. 66, ¶ 152 n.222 (March 25, 2015) ("Among the 30 projects included in Pacific Power's filing in this case, only one, the Merwin Project, is indisputably a 'major' plant addition.").
[17] Avista GRC 2015 at p. 17, ¶ 40.

Q. Do you rely on Commission guidance for this recommendation?

A. Yes. I rely specifically on the Commission's statement that major projects are "relevant to the issue of the financial impact on the Company in the setting of rates."[18]

Q. Why do you recommend modifying the materiality standard?

A. The typical application of the materiality standard focuses solely on rate base and ignores the financial impact of depreciation expense. This application limits the inclusion of projects that may have a material financial impact to rate base; for example, capital spending on projects with shorter depreciable lives. These investments will likely grow as the industry continues to undergo rapid transformation or as customer expectations evolve. Innovation, such as IT projects, are a key driver of this trend. They improve operational efficiency and provide new platforms to expand how a utility interacts with its customers. The useful life of these projects is often far shorter than more traditional investments.

Q. Why is this a problem?

A. When utilities invest in long-lived assets, with a low annual depreciation rate, the risk of under recovery due to regulatory lag is low. However when utilities invest in short-lived assets, the annual depreciation rate increases significantly. Therefore, depreciation expense for these projects has a greater financial impact to a utility, even if it does not meet the traditional 0.5 percent of net plant in service threshold.

[18] *Id.*

Q. What are the consequences of not considering the impact of short-lived assets in the materiality standard?

A. For utilities, they need to find ways to absorb a larger share of the assets depreciation. This increases the pressure to file serial rate cases. For the regulator, this burdens the process as fatigue builds from the never ending stream of rate case filings.

Q. How are serial rate cases used to reduce regulatory lag?

A. Within the current ratemaking process, serial rate cases are one of the only ways to reduce regulatory lag and the associated effect on short-lived assets. Regulatory lag is basically a bounded amount of time, generally from 11 to 24 months. The shorter an asset's life, the larger proportion of depreciable life regulatory lag places at risk. In contrast, longer lived assets have a relatively minor proportion of their depreciable lives subjected to regulatory lag; therefore the proportional risk related to cost-recovery is lower.

Q. How does your proposed modification address this problem?

A. I am proposing to include depreciable life as a criterion when determining materiality. This modification addresses the increase in investments in short-lived assets. Modifying the materiality threshold also allows a broader range of potential projects to meet the Commission standards while honoring the other standards for pro forma adjustments.

Q. How does this improve the Commission's ability to review pro forma capital additions?

A. There are multiple benefits to making a relatively modest modification to the already recognized materiality standard, which is only one of five standards that Commission employs when addressing pro forma capital additions. The modification I propose adheres to a reasonable interpretation of materiality while acknowledging the increasing rate of capital spending. In addition, the inclusion of short-lived projects merely expands the range of potential projects that *may* be considered in conjunction within the Commissions already established standards. I believe this will make meaningful and targeted progress in addressing regulatory lag for utilities investing in short-lived assets. It will also serve to relieve pressure on utilities to file serial rate cases, particularly when the rate case filing is driven by investments in short-lived plant.

Q. Do you recommend establishing a specific threshold for determining what qualifies as a short lived asset?

A. No. The adjustments in this particular case did not require a specific threshold; there was a clear line between long-lived and short-lived capital additions. However, to guide utility filings, the Commission may need to consider establishing specific criteria for this type of adjustment in the future. For example, the threshold could be based on a short-lived asset's proportional contribution to annual depreciation expense, similar to how the current materiality threshold is proportional to net plant in service.

Q. For this specific case, what are the appropriate materiality thresholds for major capital additions?

A. I propose two criteria for determining whether a project meets a materiality threshold:

1. 0.5 percent of net plant in service (i.e. the traditional definition of a "major" project); or
2. A depreciable life of 6 years or less.

Q. Why did you select six years or less for this case?

A. I analyzed the depreciable life of all the proposed pro forma capital additions and there was a clear delineation between short-lived and long-lived assets. The Figures below show the average depreciable life of the proposed IT projects compared to the depreciable life of all other projects. As these chart show, three IT programs all had depreciable lives under six years. One outlier had a longer depreciable life for electric service than it did for gas.

Figure 1
Electric Average Depreciable Life:
IT vs. All Other Types of Capital Additions

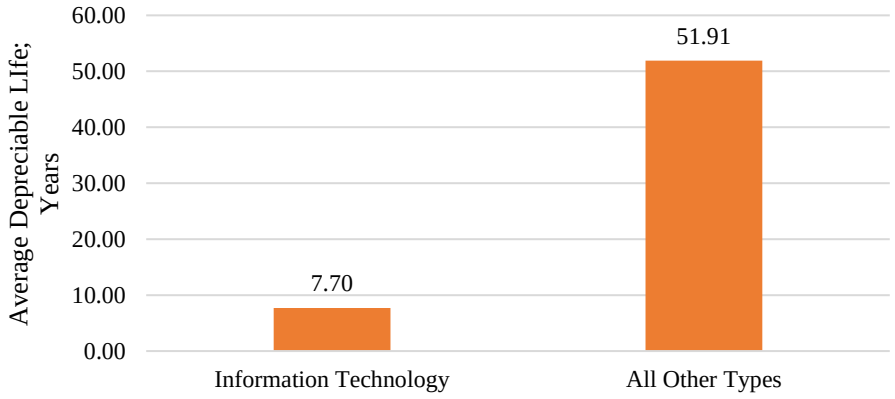
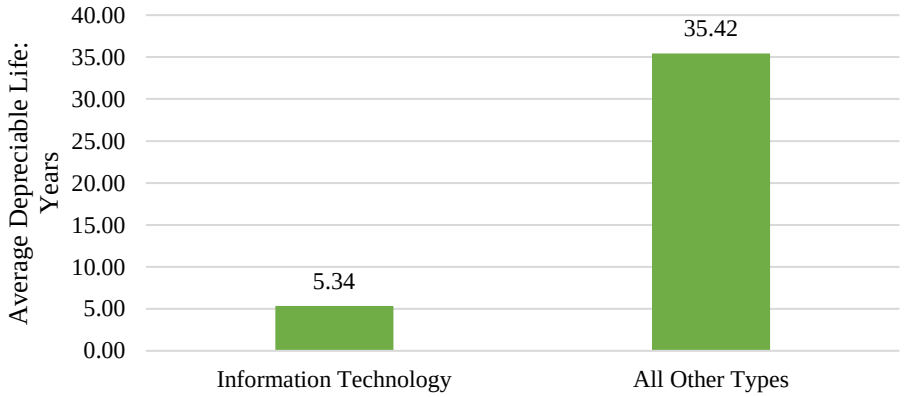


Figure 2
Natural Gas Average Depreciable Life: IT vs. All Other Types of Capital Additions



V. STAFF APPLICATION OF POLICY TO PRO FORMA ADJUSTMENTS

Q. How did Staff apply each of the Commission's standard for Pro Forma Adjustments in this case?

A. Inclusive of the modifications staff recommends to the materiality threshold, staff applied the Commission's standards as follows:

1. Known and Measurable Standard – Staff applied a cut-off date of July 31, 2019 to evaluate projects and programs.
2. Offsetting Factors Standard – Offsetting factors were considered and included for the projects and programs that Staff includes in the pro forma adjustment.
3. Used and Useful Standard – Staff applied a cut-off date of July 31, 2019 to evaluate projects and programs.

4. Prudency Standard – Projects were evaluated on an *ex post facto* basis based on the Commission factors.
5. Materiality Standard – Staff applied a modified materiality threshold including both major plant and plants with shorter depreciably lives.
    - For projects to meet the first criterion they must be greater than $9.8 million for electric operations and $2.1 million for gas operations. This is based on net plant in service amounts from the Company's most recent electric and natural gas Commission Basis Reports.[19]
    - For projects to meet the second criterion, projects or programs must have a depreciable life of six years or less.

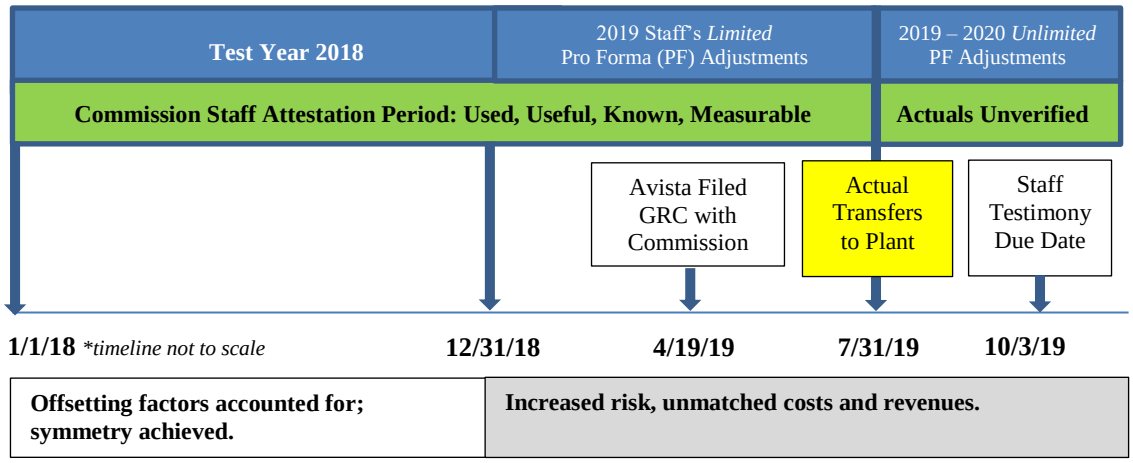
Q. Why does Staff's pro forma plant adjustments include transfers to plant only through July 31, 2019?

A. In order to recommend a project's cost be included in rates, Staff must possess the evidence to *attest* that (1) the project will be in service, providing benefit to ratepayers in the rate year, and (2) final project costs included in rates are known and measurable. Further, the Company must provide Staff with a reasonable opportunity to verify the costs and offsetting factors for these projects; the more time that has passed from the end of the test year to when a pro forma capital addition is placed in service, the less time Staff has to gather, review, and analyze supporting evidence provided by the Company.

[19] Dockets UE-190309 & UG-190310 (electric net plant $1,962,509,000; natural gas net plant $416,324,000).

In other words, in order to be included in Staff's recommended revenue requirement, the Company must provide evidence that the project is in service in advance of Staff's filing of responsive testimony. At the time of filing for this testimony, Avista provided actual transfers to plant amounts and supporting evidence through July 31, 2019. These are the amounts Staff can reasonably attest to as summarized by Figure 3.

Figure 3: Staff's 2019 Attestation Period



VI. STAFF ADJUSTMENTS TO PRO FORM CAPITAL ADDITIONS

A. Adjustment 3.10 – Electric and Natural Gas Major Pro Forma Capital Additions

Q. Which 2019 projects or programs did Staff include as pro forma capital additions?

A. Staff's proposed Adjustment 3.10 includes two electric expenditure requests (ERs) and six gas ERs. These are the only projects that qualify under Staff's modified materiality standard.

Table 1: Electric Adjustment 3.10
2019 Major Pro Forma Capital Additions Staff Proposed

ER	ER Title
5016	Endpoint Compute and Productivity Systems
5151	Customer Facing Technology

Table 2: Gas Adjustment 3.10
2019 Major Pro Forma Capital Additions Staff Proposed

ER	ER Title
3005	Gas Distribution Non-Revenue Blanket
3008	Aldyl-A Pipe Replacement
5016	Endpoint Compute and Productivity System
5020	Enterprise & Control Network Infrastructure
5151	Customer Facing Technology
7132	Dollar Road Service Center Addition and Remodel

Staff's proposed adjustment is based on actual amounts transferred to plant-in-service for each qualifying project. Avista's actual transfers to plant are included in my Exh. ANH-2.[20]

Q. What is the difference between Staff's recommendation and Avista's proposed Adjustment 3.10?

A. For electric operations, Staff's recommendation results in a $10.7 million reduction in revenue requirement relative to Avista's initial request. For gas operations Staff's recommendation results in a $1.8 million reduction in revenue requirement relative to Avista's initial request. This is summarized in the tables below.

Table 3: Electric Adjustment 3.10
Avista vs. Staff Proposed

Party	Rate base	Net Operating Income	Revenue Requirement
Avista	$ 81,243,000	$ (3,284,000)	$ 12,443,000
Staff	$ 5,354,000	$ (952,000)	$ 1,769,000
Difference (Avista-Staff)	$ 75,889,000	$ (2,332,000)	$ 10,674,000

[20] Higby, Exh. ANH-2, Attachment A to Avista's 2nd Supplemental Response to UTC Staff Data Request No. 23 (with Staff Analysis).

Table 4: Gas Adjustment 3.10
Avista vs. Staff Proposed

Party	Rate Base	Net Operating Income	Revenue Requirement
Avista	$ 25,258,000	$ (1,144,000)	$ 4,031,000
Staff	$ 13,457,000	$ (686,000)	$ 2,184,000
Difference (Avista-Staff)	$ 11,801,000	$ (458,000)	$ 1,847,000

Q. What were the reasons for excluding the remaining projects from Staff's Adjustment?

A. The remainder of Avista's proposed pro forma capital additions did not meet the modified materiality threshold for a number of reasons: 1) These projects did not meet the 0.5 percent threshold based on actual transfers to plant as of July 31, 2019 or; 2) These projects have a depreciable life greater than 6 years.

B. Adjustment 3.11 – Electric and Natural Gas O&M Offsets

Q. How do O&M offsets interact with pro forma plant adjustments?

A. O&M offsets attempt to capture the offsetting benefits associated with specific post-test year plant additions. Therefore, each O&M offset is matched to the associated post-test year project. This means that for each post-test year plant addition that does not meet the standards for pro forma plant adjustments, the associated O&M offset (if one exists) should be excluded from the revenue requirement calculation.

Q. What O&M offsets are included in Staff's electric revenue requirement calculation?

A. For electric revenue requirement, Staff did not included any O&M offsets, as neither of the projects that met the standards for pro forma plant adjustments have any associated offsets.

Q. What O&M offsets are included in Staff's natural gas revenue requirement calculation?

A. For natural gas revenue requirement, Staff included O&M offsets associated with one project: the Dollar Road Service Center of roughly $10,000.

Q. What is the effect of Staff's recommendations for pro forma O&M offsets?

A. For electric operations, Staff eliminated Avista's proposed adjustment for Pro Forma O&M Offsets (Adjustments 3.11). Avista initially proposed electric O&M offsets of $151,000 resulting in a revenue requirement increase of $158,000.

For gas operations, Staff reduced the gas O&M offsets to roughly $10,000 from Avista's proposed $14,000, resulting in a revenue requirement increase of $5000.

Table 5: Electric Adjustment 3.11
Avista vs. Staff Proposed

Party	Net Operating Income	Revenue Requirement
Avista	$ 119,000	$ (158,000)
Staff	$ -	$ -
Difference (Avista-Staff)	$ 119,000	$ (158,000)

Table 6: Gas Adjustment 3.11
Avista vs. Staff Proposed

Party	Net Operating Income	Revenue Requirement
Avista	$ 11,000	$ (15,000)
Staff	$ 8,000	$ (10,000)
Difference (Avista-Staff)	$ 3,000	$ (5,000)

VII. COMPANY'S DIRECT CASE FOR 2019 PRO FORMA CAPITAL ADDITIONS

Q. How does Avista arrive at the net plant in service in the calculation of its requested revenue requirement increase?

A. First, prior to making any adjustments for post-test year plant additions, Avista makes an end-of-period (EOP) adjustment to test year plant balances. Relative to the actual test year results of operations, this EOP adjustment increases net plant in service by $61,892,000 for electric operations and $32,271,000 for natural gas operations.

Second, Avista adds a pro forma plant adjustment that includes projections for 17 electric projects the Company expects to complete in 2019. This increases the Company's pro forma net electric plant balance by an additional $84.9 million, and 9 gas projects, increasing Company's pro forma net gas plant balance by an additional $26.5 million.

A. Summary of Avista's Proposal

Q. How does Avista define "major" projects?

A. Avista argues that the use of WAC 480-140-040 has been incorrectly applied by the Commission as a bright line standard.[21] Instead of the existing 0.5 percent threshold, Avista proposes to use a $5 million system-level threshold as a "reasonable definition of major."[22]

Q. How many projects did Avista include as major additions for 2019 according to this threshold?

A. Avista includes 17 electric and 9 gas programs and projects.[23]

Q. How much does Avista propose as pro forma rate base for electric and gas operations due to this adjustment?

[21] Schuh, Exh. KKS-1T at 8:14-9:1, n.12.
[22] Schuh, Exh. KKS-1T at 6:17-19, 8:14-9:5.
[23] Schuh. Exh. KKS-1T at 9, Table 2.

A. Avista proposes an additional $84.9 million for electric and $26.5 million for gas operations.[24]

Q. Did Avista provide an explanation for why it rejected the 0.5 percent threshold that has been used by the Commission?

A. Yes, Avista said it did not believe the traditional 0.5 percent threshold was appropriate as it would only apply to five out of 165 projects and:

> Neither the inclusion of only 5 projects nor, for that matter, the inclusion of all 165 projects by Avista, are reasonable. Therefore, in order to reach a sensible middle ground, Avista has employed a somewhat lower threshold than the [0.5%] threshold. This middle ground limits the pro forma projects included for 2019 to just 20 out 165 projects…all of which will be in service, prior to rates going into effect.[25]

In other words, Avista rejects the traditional 0.5 percent threshold because the Company does not like the number of projects that qualify under that standard.

Q. How did Avista arrive at a $5 million system-level threshold for determining whether a project is a "major" project?

A. Avista claims this threshold produces a number of qualifying projects that the Company asserts is an appropriate number for parties to audit.[26] Rather than propose a threshold that is the result of the application of principle, or in some way relates to the concept of materiality, Avista selects its threshold to accommodate the results it would like to see.[27]

[24] *Id*.
[25] Schuh, Exh. KSS-1T at 8:17-9:3 (emphasis omitted).
[26] Schuh, Exh. KSS-1T at 10:5-9.
[27] *See* Exh. ANH-3 to further see the lack of principle used to determine the $5 million system level threshold.

Q. How did Avista identify which projects qualify as major under its own definition of major?

A. Avista used forecasted costs for each project to determine whether that project qualifies as major under its own definition.

B. Staff Response to Avista's Recommendation

Q. Is Avista's definition of what constitutes a "major" project reasonable?

A. No. The Company has created an arbitrary threshold disregarding entirely the notion of materiality. The standards for a major pro forma adjustments should not be abandoned simply because a company does not like the result. These standards are, and should be, based on underlying principles, legal thresholds, and the policy goals of the Commission.

Avista is correct in stating the Commission does not employ the use of a bright line standard. However, the Commission has relied on and accepted the 0.5 percent threshold largely because this threshold is tied to the concept of materiality, noting that it is "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."[28] Avista has failed to provide any reasonable justification for rejecting the Commission's materiality standard, and has failed to explain how the Company's own definition of a "major" project bears any relationship whatsoever to materiality.

[28] 2015 Avista GRC at p. 17, ¶ 40.

Q. Did Avista provide the necessary information for Staff and Parties to reasonably conduct audits of pro forma capital additions in its initial filing?

A. No. In its initial filing, Avista provided perfunctory documents through a mechanical and uninformative set of testimony. The documentation was vague and lacked significant, auditable data in which Staff could evaluate the used and useful and known and measurable standards. Overall, the Company's presentation lacked the information necessary to conduct a thorough analysis of the costs incurred, as well as the ongoing construction of the proposed capital additions.

Staff was able to procure more information regarding the status of the capital additions through discovery, such as verifying actual transfers to plant. However, it should be noted that even after requesting monthly updates to actual transfers to plant, Staff had to directly contact Avista to get updated numbers through the end of July.

Q. What is the risk of accepting Avista's proposed major pro forma programs and projects through December 2019?

A. First, the dollar amounts Avista's uses in its direct case are forecasted amounts that should not be accepted on faith. Accepting forecasted plant amounts, or projected in-service dates, puts the risk of forecast error or delayed transfers to plant entirely on ratepayers.

Second, accepting projects using Avista's definition of materiality, and adding discrete project after discrete project, would severely undermine the concept of materiality as an element of the Commission's pro forma standard. Moreover,

accepting Avista's definition of materiality would undermine the Commission's use of principle in establishing the materiality threshold.

Q. If the Commission were to accept the Company's threshold what level of accuracy can be expected from Avista's forecasts?

A. Very little. Using the actual dollar amount transferred to plant through July 31, 2019, Avista's forecast of plant in service is incorrect by an average of 62% for electric projects and incorrect by an average of 57% for natural gas projects. The figures below summarize these differences by project.

Figure 4
Electric Forecast vs Actuals

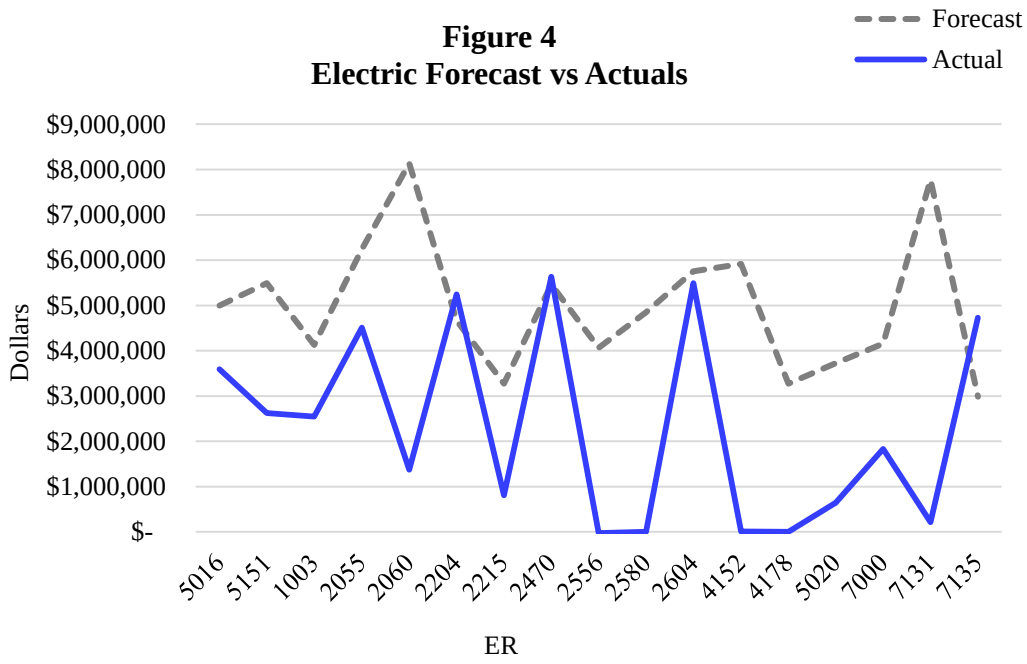
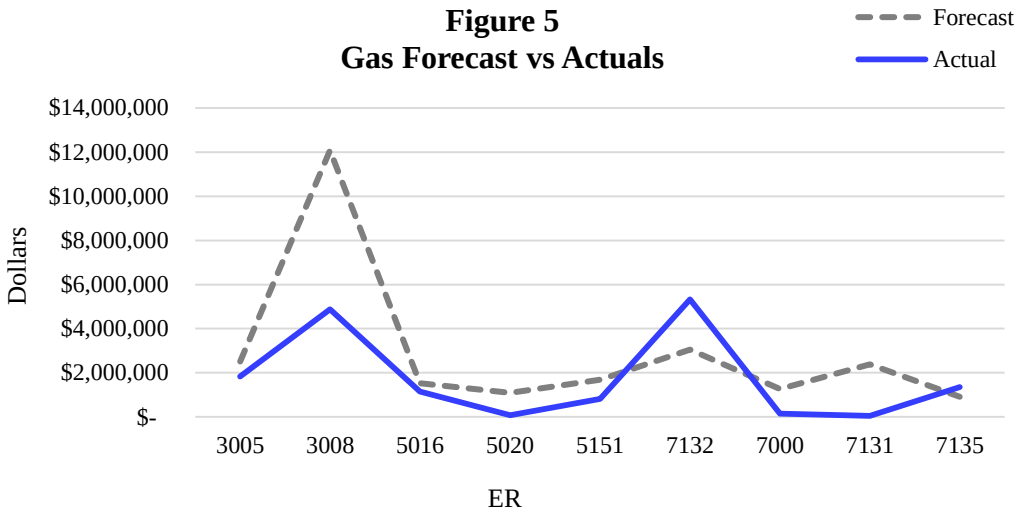


Figure 5
Gas Forecast vs Actuals



As these charts illustrate, the Company's forecasts contain an unacceptable level of uncertainty and should not be used for ratemaking purposes.

Q. Does this conclude your testimony?

A. Yes.