BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, dba AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-150204 and UG-150205** ***(Consolidated)***

BRIEF ON BEHALF OF COMMISSION STAFF

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I. INTRODUCTION

1 Avista seeks extraordinary relief from the Commission, but offers nothing extraordinary to justify its requests. It argues for attrition, but abandons its own attrition study mid-case. It trumps up its increased capital expenditures, but offers little more than a budget to justify them - a budget that says very little about *why* these capital expenditures are necessary to support the safety and reliability of the system. Upon close examination, the Commission will see budget line item after line item of increased spending.[1] Most of this forecasted spending is addressed with a simple explanation of the project - nothing more. The Commission is then placed in the position of having to *assume* that the Company has a specific need for these large increases in capital spending, as the Company did not provide it. This is neither fair nor supportable.

2 Avista seeks Commission "permission" to retire its functioning meter system, and replace it with a new Advanced Meter Infrastructure. This extraordinary "ask," as it turns out, is built on nothing more than aspirational goals - perhaps colored by the Company's stated belief that the Commission should be its "partner" in this endeavor.[2] Like Avista's attrition relief, it abandons its goal of a hybrid form of pre-approval mid-case, and instead seeks to write off its entire meter infrastructure at ratepayer expense. Remarkably, all of this would occur in advance of a well-developed plan, a robust and reliable budget, and a positive cost-benefit study. Again, the Company asks more from the Commission than it is willing to give in return.

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[1] Cox, Exh. No. BAC-1T at 20-33; Schuh, Exh. No. KSS-5. Some program areas project cost increases of up to 700% over a short period.

[2] Norwood, Tr. 114: 17-21. Although loosely used by Mr. Norwood, a "partnership" implies two parties involved in running a business for profit. Unlike Avista's management, the Commission owes no fiduciary duty to Avista's shareholders to operate the company solely for the benefit of the shareholders, as manifested in increased earnings, higher stock prices, and programs designed to enhance shareholder value. The duty of Avista's management to operate the company for the benefit its shareholders cannot be reconciled with the Commission duty to regulate Avista to protect ratepayers. As a result, the Commission and Avista's management are not and cannot be "partners."

3 Avista also seeks from the Commission full cost recovery for Project Compass, a complete overhaul of its internal systems. Staff has performed a comprehensive and detailed review of this project and its history. Based on its review and analysis, Staff has concluded that the Company failed to justify $11.2 million of Project Compass' costs. At hearing, Avista raised as a partial defense the "cone of uncertainty" associated with the project's management. It used this term to portray the uncertainty associated with bringing Project Compass on line, on time, and at the cost it once professed to the Commission - an uncertainty if failed to bring to the Commission's attention in prior filings.

4 In summary, Avista filed a case with little documentation or support for its advocated outcomes. It was left to Staff to extract material data and information. Once in hand, this information led directly to Staff's recommended outcomes. The Company's failure to provide adequate support for its rate increase undermines the Commission's efforts to protect due process and to set rates expeditiously. The Company complains about regulatory lag. Yet, it draws out the discovery process with an original filing that seeks in the end, clearly aspirational and then abandoned objectives, with little or inadequate supporting documentation. Given precious discovery time, Staff can largely overcome this deficiency, and produce a case that adheres to the Commission's enunciated principles of regulation. To this end, Staff diligently researched and wrote testimony on the critical issues presented here. It has provided the Commission a fair and frank analysis of Avista's case, without overreach or hyperbole. In sum, the Commission can rely upon Staff's recommendations in order to set Avista's rates.

II. ATTRITION ALLOWANCE

A. Overview of Attrition in This Case

1. Avista, Attrition, and Recent History

5 One of the principal issues before the Commission is whether Avista should be awarded an attrition allowance. In general, an attrition allowance provides additional revenue to a company over and above its calculated revenue requirement using a modified historical test year. Attrition is an extraordinary mechanism used only when extraordinary future circumstances can be demonstrated to negatively impact a utility's financial integrity during the rate effective year.[3]

6 The attrition allowance sought by Avista is in addition to other mechanisms used by the Commission to address the Company's revenue recovery risk and regulatory lag. These mechanisms include the Energy Recovery Mechanism (ERM),[4] the Purchased Gas Adjustment mechanism,[5] the general use of deferred accounting petitions, the use of an End-of-Period (EOP) accounting method to allow additional capital projects in rates beyond the as-filed test year, and recently the approval of full decoupling for Avista's electric and natural gas utilities.[6]

7 Avista's recent earnings' achievements are directly attributable to the Commission's support for these mechanisms. Evidence presented at hearing indicates that Avista has either earned at or above its approved rate of return in 2013 and 2014, and may possibly do so in 2015.[7] The Company's recent earnings success indicates that the mechanisms currently in place provide

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[3] *See Wash. Utils. & Transp. Comm'n. v. Wash. Natural Gas Co.*, Docket No. UG-920840, 4th Supplemental Order, Final Order, pp. 29-30 (Sept. 27, 1993).

[4] *See Wash Utils. & Transp. Comm'n. v. Avista Corp., d/b/a Avista Utilities,* Docket No. UE-011595, Fifth Supplemental Order, Final Order, Fifth Supplemental Order (June 18, 2002) (2002 Wash. UTC LEXIS 92)

[5] The PGA approved by the Commission allows Avista to recover 100% of its purchased gas costs, without sharing bands, a dead band, or other mechanism designed to incent efficient gas purchasing practices.

[6] *See Wash. Utils. & Transp. Comm'n. v. Avista Corp., d/b/a Avista Utilities*, UE-140188 et al., Order 05 (November 25, 2014).

[7] McGuire, TR. 441:19-24.

the Company a reasonable opportunity to earn its allowed rate of return - even without an attrition allowance.

8 On these facts, Avista seeks Commission approval to use an attrition allowance to set its rates. Under Staff's analysis, the Company's benefit from attrition would approximate $15 million dollars. Attrition is, by far, the single largest adjustment testified to by Staff. Should the Commission use *Avista's* attrition study to set rates, the Company's revenues would increase by more than $20 million over the pro forma accounting results, even if all of Staff's proposed adjustments are accepted.

9 Staff's attrition analysis can be best characterized as a review of Avista's historical costs and revenues. Staff uses these historical results to reach the conclusion that Avista will see a mismatch between costs and revenues in the rate year. However, Staff's attrition study offers no opinion on whether Avista's rate year capital expenses will actually materialize.[8] Nor does it opine on whether Avista can otherwise control its costs in the rate year. Simply said, Staff's attrition analysis looks only at Avista's history to project the future. Given this historical look-back, Staff's attrition analysis represents an alternative analysis of attrition. Importantly, it does not specifically address the Commission's long-standing test for attrition. To reach a finding that Avista should be granted an attrition allowance in this case, the Commission must conclude that Avista has demonstrated that the conditions causing the alleged attrition are indeed extraordinary and cannot be controlled by the Company.

10 This brief will address the test for attrition, as set forth in a series of cases over different time periods. It will then address Avista's as-filed attrition case, and the problems associated with it. The brief will then turn to Mr. McGuire's testimony in support of granting an attrition

[8] McGuire, TR. 458:5-11.

allowance and its conclusions. In sum, this brief intends to provide the Commission a path forward to deciding whether Avista should be granted an attrition allowance in this case.

2. Attrition And This Commission Go Way, Way Back

11 Attrition is not a new idea. The use of an attrition allowance extends across multiple states and decades, and well-respected treatises on utility ratemaking include definitions and discussions of the concept.[9] This Commission has even had its own process to evaluate attrition going back decades.[10] There is simply no reason for the Commission to reinvent the attrition wheel. This case does not require the Commission to displace or permanently alter traditional ratemaking. There is also no reason for the Commission to referee a general policy debate where each party takes the "policy position" on attrition that predictably corresponds to an economic interest. Attrition's existing standards provide a principled basis upon which the Commission can reasonably determine whether and to what extent to grant an attrition adjustment.

3. Commission Standard To Assess The Use And Duration Of Attrition

12 Evaluating attrition is a multistep process. First, the Commission must address the threshold legal test: whether the company is facing extraordinary circumstances beyond its control. To satisfy the Commission's long-standing attrition standard, Avista must demonstrate *what* would cause its future earnings to deteriorate (the causal factor), and *why* it cannot be expected to control the causal factor with discipline sufficient to suppress its forecasted earnings deterioration (the control factor). Second, when the causal and control factors have been convincingly demonstrated, the Commission must then determine how much of the Company's

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[9] LEONARD SAUL GOODMAN, THE PROCESS OF RATEMAKING Vol. I 290-292 and 636-638 (1998).
[10] *See Wash. Utils. & Transp. Comm'n. v. Wash. Natural Gas Co.*, Docket No. UG-920840, 4th Supplemental Order, Final Order, pp. 29-30 (Sept. 27, 1993).

future revenue will be affected by attrition and the duration of the forecasted revenue deterioration. In other words, how much and for how long?

13 In the instant case, Staff's attrition analysis covers only the rate effective period. Thus, any attrition adjustment approved by the Commission here should only remain in effect until the end of 2016. Absent an intervening filing, Avista's then-current rates should be reduced at the end of the rate effective period, thus acknowledging attrition for what it is: an extraordinary and temporary adjustment to rates.

4. Scope Of The Parties' Disagreement And Staff's Attrition Analysis

14 For purposes of this case, the Commission should understand where and how the Parties disagree within the context of attrition. It is clear that the Parties disagree on whether Avista has met the Commission's threshold test. There is less significant disagreement on certain qualitative assumptions for measuring attrition. The purely quantitative portion of attrition, however, is not seriously in dispute. No party legitimately questioned the accuracy or statistical methods included in Staff's analysis. Measuring historical data and issuing projections on the basis of regression analysis and correlation calculations reflects a well-recognized and very credible mathematical process. No expert disagrees.

15 It is also important for the Commission to recognize what Staff's attrition case is and what it is not. To that end, Staff's attrition study is best represented as a statistical analysis of the changing relationships among revenues, rate base, and expenses. It is built upon historical data that is used to project nominal amounts of both net plant and expenses for the rate effective period. Mr. McGuire's attrition proposal *is not* and *should not* be construed to represent a pro-forma examination of specific future capital expenditures.[11] Rather, it is based on his judgment

[11] McGuire, Exh. No. CRM-1T at 33:1-21. *See also* McGuire TR. 458:5-11.

and analysis of the Company's historical trends, including forecasted capital spending not otherwise accounted for in Staff's case.[12] Importantly, he did not examine the likelihood of Avista's specific forecasted capital projects actually going into service in the rate year.[13] Nor does Avista's recent earnings history affect the results of Staff's attrition study given that Mr. McGuire's attrition analysis is forward looking. Mr. McGuire also does not address whether Avista can control its forecasted costs during the rate year.

16 The amount of Staff's attrition adjustment is also not static; the attrition-related revenue requirement can and does reflect the disallowance recommended in Mr. Hancock's testimony.[14] Should the Commission allow or disallow pro forma adjustments beyond those in Mr. Hancock's testimony, basic arithmetic confirms that those changes could increase or decrease Staff's proposed attrition allowance and revenue requirement.

B. The Commission's Threshold Test Remains Applicable to Avista's Attrition Proposal

17 As discussed above, the Commission's longstanding test for attrition is crystal clear. The Commission has granted an attrition allowance when a Company is: 1) facing extraordinary circumstances (causal factor) that are 2) beyond its control (control factor).[15] The purpose of the causal factor is straightforward: an extraordinary cause is necessary to justify extraordinary rate treatment. The reason for the control factor is less intuitive. In addition to supporting the

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[12] *See* McGuire, Exh. No. CRM-1T at 33-42.
[13] McGuire, Exh. No. CRM-1T at 33:1-21. *See also* McGuire TR. 458:5-11.
[14] McGuire Exhibit Nos. CRM-2 and CRM-3 include an adjusted amount for Project Compass that reflects Mr. Gomez's recommended disallowance. McGuire, Exh. No. CRM-1T at 54:21-22. *Compare* McGuire, Exh. No. CRM-2R (Revised – Oct. 13, 2015) at 4-5 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column L ("After Adjustment – Project Compass") *with* Andrews Rebuttal, Exh. No. EMA-6 at 5-6 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column L ("After Adjustment – Project Compass"). *Compare* McGuire, Exh. No. CRM-3R (Revised – Oct. 13, 2015) at 4-5 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column K ("After Adjustment – Project Compass") *with* Andrews Rebuttal, Exh. No. EMA-7 at 5-6 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column K ("After Attrition Adj. – Project Compass").
[15] *Wash. Utils. & Transp. Comm'n. v. Wash. Natural Gas Co.*, Docket No. UG-920840, 4th Supplemental Order, Final Order, pp. 29-30 (Sept. 27, 1993).

extraordinary nature of the cause and guaranteeing that attrition is not just the result of mismanagement, the control factor helps ensure an attrition allowance does not become a windfall to the Company. When the circumstances are beyond its control, the regulated entity cannot simply change practices or otherwise accommodate those circumstances to avoid the effects of attrition in the rate year. Of course, the above rationale necessarily requires a durational component; that is, the Commission must find that the extraordinary circumstances are more likely than not to continue during the rate year.

1. Attrition Cases And The Commission: The Characters Change, But The Story Is The Same

18 The Commission's history with attrition actually predates space travel and the JFK administration. In the late 1950s, this Commission rejected an attrition allowance on the basis of "no real necessity."[16] Another Commission order effectively concluded that a company's decision to give its executives raises is not a good enough reason for extraordinary treatment.[17] A separate case rejected the use of end-of-period rate base because new plant in service was not the cause of the regulated company's earnings attrition.[18] Underlying the Commission's rationale is a question of the legitimate and direct cause of attrition and lack of company control over that cause.

19 The Commission continued to apply the same rationale when the 1970s brought another round of attrition cases.[19] Orders dating to the mid-1970s consistently assessed: is there a good

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[16] *Wash. Pub. Serv. Comm'n v. West Coast Tel. Co.*, Cause No. U-9037, (Feb. 16, 1959) ("it has been demonstrated on the record before us that attrition has not been a significant factor affecting Washington operations." *and* "there is no real necessity for making an additional allowance for attrition.")

[17] *See Wash. Pub. Serv. Comm'n. v. The Pac. Tel. and Telegraph Co.*, Cause Nos. U-8971, U-9011, (July 11, 1958) (noting wage growth program as the only reason for attrition and denying the request).

[18] *Wash. Pub. Serv. Comm'n. v. Gen. Tel. Co. of the Northwest*, Cause No. U-9054, (Sept. 2, 1959).

[19] Those 1970s earnings attrition cases were labeled as adjustments for Allowance for Funds Used During Construction ("AFUDC") and Construction Work in Progress ("CWIP"). The concepts are identical to attrition.

reason for the earnings attrition (causal) and is there genuinely nothing the regulated entity can do about it (control)? For example, in one order, the Commission noted that construction work in progress had increased from $5 million to over $300 million annually within ten years because of the need for additional thermal plants to meet projected load.[20] That same pattern of dramatically increased plant costs to meet future loads applied to three other electric utilities operating within the state.[21] Another case order also focused on rapid inflation, the Pacific Northwest's population growth and the lack of remaining hydro capacity to serve projected load; the Commission concluded that the company had to either rapidly increase construction of thermal power plants or literally risk not having enough electricity to serve customers.[22] A subsequent order continued the same rationale, noting the "exceptional circumstances facing utilities and expressly stating that without a CWIP adjustment to rate base, the utility would not be able to access the capital necessary to construct the production plants necessary to meet future load."[23] Determinations as to population growth, rapid inflation, lack of hydro capacity, and the potential inability to serve customers represented extraordinary causal factors. Those factors were also all clearly outside the companies' control.

20 With the disco era (thankfully) complete, "attrition" re-arrived on the Commission scene in the early 1980s. Conceptually very similar to the CWIP cases of the mid-1970s, the attrition cases of the early 1980s continued to rely on the same underlying logical test: the presence of

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[20] *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Cause No. U-75-24 (Sept. 30, 1975) ("In 1964 construction work in progress was slightly in excess of $5,000,000, and in 1974 it was over $300,000,000.")
[21] *Id.*
[22] *Wash. Utils. & Transp. Comm'n. v. The Wash. Water Power Co.*, Cause No. U-77-53, Third Supplemental Order at Section D: CWIP Major Projects (Mar. 24, 1978).
[23] *Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause No. U-78-21 (March 8, 1979) ("Having for three years acknowledged the exceptional circumstances of electric utilities which require the inclusion of [CWIP] in rate base . . ." *and* "the continuation of the company's construction program is necessary to assure adequate future generating capacity and the company's ability to finance its construction program would be endangered absent inclusion of CWIP in authorized rates").

some type of extraordinary circumstance that was beyond the regulated entity's control.[24] The extraordinary circumstances of the 1980s were generally related to that era's high inflation and plant investment.[25] The double-digit inflation of the early 1980s greatly increased the cost of borrowing, annual commodity and plant construction costs, and operating expenses. Inflation and its consequences were also easily measured from independent third party sources, widely recognized across the country, and clearly beyond the control of any one utility company in Washington State. As the 1980s wore on and inflation ebbed, the Commission began to change direction when it allowed a much-reduced attrition allowance in 1986 because of "recent changes in economic factors."[26]

21 In the early 1990s, the Commission synthesized its longstanding rationale and several decades of attrition precedent as requiring extraordinary circumstances and defining attrition to mean that those causal circumstances must be beyond the company's control.[27] That same Commission order also expressly noted low inflation, declining interest rates, and the presence of a tracker mechanism reduced the need for further extraordinary rate treatment such as attrition.[28]

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[24] *See Wash. Utils. & Transp. Comm'n. v. Wash. Nat. Gas Co.*, Cause No. U-80-111, Section II.A Average v. Year-End Rate Base (Sept. 24, 1981).

[25] *See, e.g. Wash. Utils. & Transp. Comm'n v. Wash. Nat. Gas Co.*, Cause No. U-80-111, Section II.A Average v. Year-End Rate Base *and* Section III.G. P-11 Price Inflation Adjustment (Sept. 24, 1981) (noting "a 10 percent inflation rate is not unreasonable . . ."); *Wash. Utils. & Transp. Comm'n. v. Wash. Water Power Co.*, Cause Nos. 81-15 and 81-16, Section III. Test Year and Section VI.L. Attrition Allowance (Nov. 25, 1981) (noting an 8%-plus inflation rate and decision that attrition should be reserved for instances that "jeopardize the company's financial integrity . . . and ability . . . to render required service"); *Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause No. U-81-41, Section IV.F Attrition Adjustment (March 12, 1982) (discussing the connection between attrition and inflation and rejecting an attrition adjustment because of positive company performance and slowing inflation).

[26] *Wash. Utils. & Transp. Comm'n. v. Pacific Power and Light Co.*, Cause No. U-86-02, 2nd Supplemental Order, Section VII. Attrition (Sept. 19, 1986).

[27] *See Wash. Utils. & Transp. Comm'n. v. Wash. Nat. Gas. Co.*, Docket UG-920840, 4th Supp. Order (Final) at pp. 29-30 (Sept. 27, 1993).

[28] *Id.* at 30.

2. Avista's Attrition Analysis Is Insufficient To Support Its Sought After Result.

22 While the applicable test is clear, the question of whether Avista has carried its burden to meet that test is admittedly less clear. The Company's attrition analysis falls short in several areas. As Mr. McGuire testified, "the Company does not conclusively demonstrate that circumstances currently facing the Company are sufficient to warrant an attrition allowance."[29]

23 Most notably, the Company's witnesses do not explain the actual cause of why distribution plant expenditures are growing so quickly.[30] In a demand for extraordinary rate treatment, the record should have a clear explanation of an extraordinary cause. Instead, the Company, through a series of witnesses, presented a narrative of its capital budget. The Commission does not set rates on the basis of a company's budget, and a company's budget cannot, in and of itself, be an extraordinary circumstance.

24 Avista began its case for attrition by pointing to reliability and an obligation to serve customers.[31] The Company also noted the ever-increasing costs of utility infrastructure.[32] Both points are vague and unpersuasive. As Mr. McGuire noted in testimony, a quest for "reliability" does not excuse a company from demonstrating quantifiable benefits.[33] Increasing equipment and construction costs are also nothing new. Facilities now are more expensive than they were 50 years ago just as facilities 10 years ago were more expensive than 50 years before that.[34]

25 Other Company witnesses supported attrition with narratives and copies of Avista's capital budgeting documents. Mr. Cox offered paragraph-long descriptions of the Company's

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[29] McGuire, Exh. No. CRM-1T at 16:15-17.
[30] Distribution expenditures are the primary cause of Avista's attrition. McGuire, Exh. No. CRM-1T at 19.
[31] *See* Morris, Exh. No. SLM-1T at 10-11.
[32] Morris, Exh. No. SLM-1T at 6:18-19 and at 7.
[33] McGuire, Exh. No. CRM-1T at 20:17-21.
[34] McGuire, Exh. No. CRM1-1T at 19:21-22.

budgeted transmission and distribution projects.[35] Ms. Schuh's Exhibit KKS-5 documented the Company's business cases with a paragraph summary and series of charts for each project.[36] On rebuttal, Company witness Mr. La Bolle paradoxically argued that reliability is both a justification for accelerated capital investment in distribution plant expenditures to be approved by the Commission and, somehow, not an issue that merits the Commission's concern.[37] Again, the Company's case boils down to a narrative of its budgeting process but does not document why it is increasing those budgets by so much in such a short time.

26 A brief example illustrates the above point. Take one of the Company's favorite talking points, its Wood Pole Management Program. Mr. La Bolle testifies that a larger number of poles are reaching the end of their useful life.[38] Mr. La Bolle even includes a chart showing that the Company recently replaced a little over 2% of its poles annually.[39] Mr. Cox's testimony, however, includes a more than *seven-fold* increase in Distribution Wood Pole Management from 2014.[40] Both witnesses include a general discussion about aging poles and inspection processes, but neither Mr. La Bolle nor Mr. Cox explain *why* a six-hundred percent increase in wood pole management is immediately necessary. The necessity of such an increased replacement rate is certainly not evident from the patterns in Mr. La Bolle's chart.[41] It is also worth noting that any dramatic spike in replacing assets with a 74-year useful life should have been readily apparent decades ago, and does not signify unavoidable, extraordinary circumstances warranting extraordinary relief.

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[35] Cox, Exh. No. BAC-1T at 20-33.
[36] Schuh, Exh. No. KSS-5.
[37] *Compare* La Bolle Rebuttal, Exh. No. LDL-1T 20:18-20 *and* LDL-1T 25:4-6.
[38] La Bolle, Exh. No. LDL-1T at 24:10.
[39] La Bolle, Exh. No. LDL-1T at 24:1-9
[40] Cox, Exh. No. BAC-1T, 27:19-21
[41] *See* La Bolle, Exh. No. LDL-1T at 24:1-9 (wood pole installation rate appears to have varied from just over 1% to approximately 3% annually between 2000 and 2013).

27 Similarly, Avista has not shown that its investment in distribution capital is required. The record does not contain an order from the Federal Energy Regulatory Commission, the North American Electric Reliability Corporation, the Western Electricity Coordinating Council,[42] or this Commission ordering improvements to reliability or distribution infrastructure.[43] As Mr. McGuire further notes, there is no evidence for the implicit argument that the Company's service is somehow unreliable or on the brink of becoming unreliable absent the proposed growth in plant expenditures.[44] As a result, Avista necessarily fails to show that its projected plant expenditures are unavoidable and will result in actual plant in service during the rate year. The Company thus has not demonstrated the actual cause of its earnings attrition or shown how that cause is unavoidable.

28 Avista fails to explain the cause of its attrition or demonstrate that its forecasted earnings attrition cannot be eliminated or at least mitigated by actions within the Company's control. As described above, there is no evidence that the timing and expediency of Avista's capital expenditure program is absolutely necessary. One company witness even suggests that Avista is accelerating its capital expenditures program because of low interest rates.[45] The Company's evidence simply does not tell the story of an entity facing extraordinary circumstances beyond its control. Avista's story is simply a continuation of low load growth and the Company's decision to increase its capital expenditures program.

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[42] Federal Energy Regulatory Commission (FERC); North American Electric Reliability Corporation (NERC); Western Electricity Coordinating Council (WECC).

[43] This Commission has ordered replacement of Aldyl A pipe infrastructure for natural gas distribution service. Avista already has a recovery mechanism for replacement of Aldyl-A pipe. For the most recent example for Avista, *see In the Matter of Avista Corp.'s Pipe Replacement Program Plan*, Docket No. PG-131837, Order 01 (Oct. 30, 2013). *See also In the Matter of the Policy of the Washington Utilities and Transportation Commission Related to Replacing Pipeline Facilities with an Elevated Risk of Failure*,, Docket UG-120715, Policy Statement (Dec. 31, 2012).

[44] McGuire, Exh. No. CRM-1T at 23:10-11.

[45] Thies Direct, Exh. No. MTT-1T at 12:7-17.

C. Staff's Quantitative Attrition Analysis: Its Components and Conclusions

1. Staff Analysis Shows That Avista Is Likely to Experience Attrition In The Rate Year.

29 Within its analysis, Staff employed its own expertise to conclude that, assuming realization of the Company's cost forecasts, Avista will likely be facing circumstances that would merit extraordinary treatment in the form of an attrition allowance.[46] To reach this opinion, Staff relied upon its forecasts of Avista's operational expenses, capital expenditures, and revenues likely to occur during the rate year. Based on these forecasts, it opined that the Company's rate year expenses are likely to grow faster than its revenues.[47] While no Party presented evidence demonstrating that an attrition allowance would be necessary to avoid financial hardship, Staff did opine that without attrition, the Company would not likely earn its agreed upon rate of return in the rate year.[48]

'0 Avista's recent history also includes annual general rate cases, and the Commission has approved rate increases considering the Company's growth in capital expenditures.[49] Thus, Staff's conclusion relied on the Company's documented financial history, informed by the Commission-approved record of the changing relationship between revenues, costs, and rate base facing Avista. Commission precedent also suggests that the impact of increased year-over-year capital spending may justify an attrition adjustment.[50] Staff's statistical attrition study provides statistical affirmation of both the likelihood and extent of Avista's likely earnings attrition.[51]

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[46] McGuire, Exh. No. CRM-1T at 16:10-19 and at 28:8-14.
[47] McGuire, Exh. No. CRM-1T at 28:8-14. *See also* McGuire, Exh. No. CRM-1T at 33-44 *and* CRM-2 and CRM-3 (Staff's attrition studies).
[48] McGuire, Exh. No. CRM-1T at 27:14-28:14.
[49] McGuire, Exh. No. CRM-1T at 16:10-12.
[50] *See supra* Section III.B.1. Mr. McGuire's testimony also provides an extensive summary of Commission history involving attrition. McGuire, Exh. No. CRM-1T, 28:16-33:15.
[51] *E.g.*, McGuire, Exh. No. CRM-1T at 34 *and* at 43:10-17.

2. Staff's Qualitative Framework For Measuring Attrition Is Transparent And Reasonable.

31 Measuring attrition requires a series of qualitative decisions. As in any accounting or mathematical treatment, qualitative judgments are necessary to establish an appropriate framework. These qualitative factors include items such as the appropriate historical time period or the base year from which to calculate an attrition adjustment.

32 Staff's testimony provides discussion and explanation of every qualitative parameter included in its attrition study.[52] Mr. McGuire begins by discussing his use of 2014 end of year Commission Basis Report ("CBR") as the "base year" because the 2014 CBR is the most up to date and complete reporting data.[53] The 2014 CBR also necessarily complies with Commission reporting standards. Mr. McGuire then goes on to explain his choice of 2009-2014 as the appropriate historical time period due to the consistency in the underlying data.[54] Mr. McGuire's testimony then clearly documents where and why he deviates from that chosen time period in the instance of calculating an O&M escalation factor.[55] The Company's most senior executive had testified to institutional changes implemented in 2012 that decreased the rate of growth in operating expenses.[56] The data from before 2012 thus does not reflect those institutional changes or the Company's revised estimate for O&M growth going forward. Given the absence of relevant historical data, Mr. McGuire combined the increase in electric O&M expenses from 2013-2014 with Avista management's initial estimate.[57] Mr. McGuire also testified to his choice to rely on load forecasting and billing determinants to project Avista's retail revenues for the rate

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[52] *See generally* McGuire, Exh. No. CRM-1T, at 33-55 ("Staff's Attrition Analysis" *and* "Staff's Response to Avista's Attrition Analysis").
[53] McGuire, Exh. No. CRM-1T, 35:2-15.
[54] McGuire, Exh. No. CRM-1T, 37:19-38:2.
[55] McGuire, Exh. No. CRM-1T, 39:8-40:17.
[56] McGuire, Exh. No. CRM-1T, 39:11-14 (referring to Morris Direct, SRM-1T at 12:7-12).
[57] McGuire, Exh. No. CRM-1T, 40:3-5.

year.[58] Mr. McGuire subsequently testified to his adjustments that account for Project Compass and that portion of Project Compass the Commission should permanently disallow.[59] The combination of written testimony and detailed attrition exhibits show that Staff's qualitative framework for attrition is transparent, well-documented in the record, and reasonable.

33 The Intervenors' arguments against the qualitative judgments in Staff's study are unsupported and unpersuasive.[60] First, Public Counsel suggests that the choice of time period has too large of an impact on results and thus the entire attrition study is unreliable.[61] In addition to citing the data consistency from 2009-2014, however, Mr. McGuire further testified at the evidentiary hearing that he reviewed the overall impact of using 2007-2014 versus 2009-2014.[62] He determined that the choice of time period had very little impact on the results, which provides further quantitative support for Staff's position that the time period chosen was fair and reasonable.[63] Conversely, the intervenors did not provide a rationale to support the use of another time period, and Public Counsel's expert testified that she did not perform any type of sensitivity analysis on Staff's model.[64] Thus, there is no reasonable evidentiary basis to dispute Staff's

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[58] McGuire, Exh. No. CRM-1T, 35:21-37:5.
[59] CRM-1T, 54:18-55:10 ("only recommending recovery of the amount deemed prudent by Staff witness Mr. Gomez."). Mr. McGuire's attrition studies, Exhibit Nos. CRM-2 and CRM-3, include an adjusted amount for Project Compass that reflects Mr. Gomez's recommended disallowance. McGuire, Exh. No. CRM-1T at 54:21-22. *Compare* McGuire, Exh. No. CRM-2R (Revised – Oct. 13, 2015) at 4-5 workbook tab "Attrition 09.2014 to 2016" in electronic version, column L ("After Adjustment – Project Compass") *with* Andrews Rebuttal, Exh. No. EMA-6 at 5-6 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column L ("After Adjustment – Project Compass"). *Compare* McGuire, Exh. No. CRM-3R (Revised – Oct. 13, 2015) at 4-5 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column K ("After Adjustment – Project Compass") *with* Andrews Rebuttal, Exh. No. EMA-7 at 5-6 (workbook tab "Attrition 09.2014 to 2016" in electronic version), column K ("After Attrition Adj. – Project Compass").
[60] Only Public Counsel challenged the qualitative framework in Staff's attrition study. *See* Ramas, Exh. No. DMR-26T at 5-7. While they clearly disagree with attrition in principle, neither NWIGU's nor ICNU's testimony offered specific arguments as to the reasonableness or accuracy of qualitative judgments embedded in Staff's attrition study.
[61] Ramas, DMR-26T, 5:12-20 (referring generally to DMR-1T, 21:18-22:10)
[62] McGuire, TR. at 462:24-463:18.
[63] *Id.*
[64] *See* Ramas, TR. at 573:14-574:9.

choice of time period. To the contrary, all the evidence in the record supports Staff's choice as reasonable and accurate.

34 The Intervenors' allegations of inconsistency are also misguided. Public Counsel argues that Staff's attrition study is inconsistent because, while costs and rate base are projected based on historical data, the study uses load forecasting and billing determinants, rather than historical data, to project rate year revenues.[65] Public Counsel omits that this Commission regularly relies on Avista's load forecasting and billing determinants models, and those models are even more comprehensive than a regression analysis. Staff thus used Commission-approved, more complete figures for the revenue portion of its attrition study. Staff's recommendation to rely on the more complete and compliant calculations is reasonable.

3. Staff's Quantitative Analysis Is A Fair And Accurate Representation Of Avista's Data.

35 If the Commission finds an attrition adjustment is appropriate and establishes a qualitative framework, Staff's statistical analysis is a slam dunk. Mr. McGuire's regressions and correlation figures show that Staff's proposal reflects the relevant historical data to the best extent mathematically possible.[66] No Party can or does legitimately dispute that regressions confirmed by correlation calculations are a credible, well-recognized statistical methodology for measuring historical data and issuing projections. There is simply not a more credible method for measuring the relevant data in this case. Avista even adopted Staff's model on rebuttal despite a several million dollar reduction to its proposed revenue requirement.[67]

[65] Ramas, Exh. No. DMR-26T, 7:4-6.
[66] *See* McGuire, Exh. Nos. CRM-2 *and* CRM-3 (noting R^2 calculations). For brief narrative explanation, *see* McGuire, CRM-1 at 50:6-15.
[67] Andrews Rebuttal, Exh. No. EMA-5T, 3:17-18.

36 The Commission should take note that criticism from the intervening Parties as to Staff's quantitative analysis is conspicuously absent from the record. The Intervenors also fail to offer any alternative methodologies or studies. The reason for the lack of substantive criticism or an alternative study is simple: basic mathematics demonstrate the credibility and accuracy of Staff's quantitative methodology for measuring attrition.

a. The Mechanics of Staff's Attrition Studies Are Fair And Reasonable

37 Staff's attrition studies use historical rates of growth.[68] The historical data is, by definition, not speculative. Mr. McGuire then calculates best fit functions for each category of historical data.[69] The best fit function is the function with the highest correlation figure to the historical data. Staff's study next uses the growth rates embedded in those best fit functions as escalation factors to project non-retail revenues, expenses, and net plant for the rate year.[70] Staff's analysis is objective, mathematically sound, and reflects the data in the most credible and accurate way possible. Mr. McGuire's quantitative study is fair, just, reasonable, and sufficient.

b. Avista's Attrition Studies Are Incorrect And Unreasonable

38 The Commission should reject both of the Company's attrition studies.[71] As the late great Yogi Berra would say, Avista "made too many wrong mistakes." Mr. McGuire's testimony explained that the Company's initial attrition study did not correlate to the underlying data.[72] The Company's proposed regressions were not best fit functions, often forcing compounding growth curves on linear or quadratic formulae data.[73] The Company's initial attrition study also revised

[68] McGuire, Exh. No. CRM-1T at 34:15.
[69] McGuire, Exh. No. CRM-1T at 38:6-39:5.
[70] McGuire, Exh. No. CRM-1T at 37:15-17.
[71] Avista presented one attrition study with its initial filing. *See* Andrews, Exh. Nos. EMA-1T, EMA-2, and EMA-3. The Company filed a second attrition study on rebuttal. *See* Andrews, Exh. Nos. EMA-5T, EMA-6, and EMA-7.
[72] McGuire, Exh. No. CRM-1T at 50:6-22.
[73] McGuire, Exh. No. CRM-1T at 50:6-9.

its own expert's calculated escalation factors to achieve a higher revenue requirement.[74] Avista's proposed practices are not reasonable, objective, or mathematically sound.

39 Avista's second attrition study continued the series of "wrong mistakes." The Company's proposed changes confirm a lack of objective analysis and should be rejected. Most notably, the Company revised the electric O&M growth rate upward to 5.16%, which was a direct contradiction of Avista's own initial testimony.[75]

40 The Company's calculation for a revised electric O&M on rebuttal is a tortured and unreasonable attempt to arrive at a positive revenue requirement.[76] A quick glance at the mechanics of the calculation confirms the absurdity: the second attrition study split electric O&M expenses into two categories, then ran linear regressions over two overlapping time periods for only one of those categories, and then averaged the growth rates for one category's regressions to calculate an escalation factor for both categories of electric O&M.[77] Avista justified its unusual calculation on the basis of volatility;[78] however, Avista's exhibit EMA-6 shows that benefit expenses did not experience any volatility until *after* the Company changed business practices at the end of 2012 and that volatility appeared as a *reduction* in expense.[79] Further, Mr. McGuire testified that the regressions Avista used to calculate its 5.16% electric O&M escalator on rebuttal are, again, not best fit functions.[80] A simple calculation reveals that if

[74] McGuire, Exh. No. CRM-1T at 49:4-17.
[75] *Compare* Andrews, Exh. Nos. EMA-1T at 28:8-9 and EMA-2 (proposing 3% electric O&M annual escalation factor) *and* Andrews, Exh. Nos. EMA-5T and EMA-6 (proposing 5.16% electric O&M annual escalation factor).
[76] The value of Avista's proposed electric O&M adjustment is approximately $7.27 million. Andrews, Exh. No. EMA-5T at 33:5-6.
[77] Andrews, TR. 151:20-153:16; Andrews, Exh. No. EMA-6 at 12 (workbook tab "Adj. Operating Exp-2007-2014" in electronic version).
[78] Andrews, Exh. No. EMA-5T at 31:17-18.
[79] Andrews, Exh. No. EMA-6 at 12 (workbook tab "Adj. Operating Exp-2007-2014" in electronic version) (Row 4 columns B through G show steady increases with little to no volatility; Row 4, columns H and I show a decrease in total benefits costs after 2012).
[80] McGuire, TR. at 461:22-462:4.

the Company had used a best fit regression, the growth rate even within the context of Avista's own calculation would have been only 0.6%.[81] The record shows, and statistical analysis proves, that the Commission should reject both of Avista's attrition studies as "wrong mistakes."

D. Conclusion And The Attrition Roadmap

41 Staff has provided the Commission with an "attrition roadmap." The Commission should simply apply that roadmap to the facts and evidence of this case. First, is the legal threshold question of whether Avista has met its evidentiary burden to show the Company is facing extraordinary circumstances beyond its control that are more likely than not to degrade the relationship among revenues, rate base, and expenses in the rate year. Avista's as-filed testimony does not conclusively prove these elements.[82]

42 As Staff has pointed out, it is Avista's burden and Avista's burden alone to prove that its proposed capital program and budget must, without question, be built in the rate year. It is also Avista's burden to prove that both these expenses and other Company costs cannot be efficiently managed to better fit its allowed return. Fittingly, an axiom of regulation has a place here: the Commission does not guarantee the Company a return; Avista must earn it.

43 Next, and as necessary, the Commission can determine the reasonableness and accuracy of the qualitative framework for measuring attrition. The Commission would then wade into the Staff-charted mathematical waters to measure the presence and extent of a potential attrition adjustment. Staff has provided a supporting record and explained its conclusions at each of the above steps. In the end, Staff's final position is an objective attempt to reach a fair and

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[81] *Id.*

[82] While no party raised the issue, use of an attrition allowance may result in an adjustment to a company's AFUDC. *See* Goodman at 636.

reasonable result, and should be used to set rates only if the Commission can conclude that Avista has effectively met the test for attrition.

III. CAPITAL ADDITIONS

44 Avista presents insufficient evidence to support the capital additions that the Company proposes to include in rate base. Because of the deficient evidence that Avista provided in support of its proposed capital additions, Staff had to conduct extensive discovery in order to audit the projected transfers to plant in the pro forma period and arrive at a suitable recommendation this case.[83] In large part, Avista relies on estimates of transfers to plant contained in Ms. Schuh's testimony and exhibits.[84] Ms. Schuh testifies in support of over 100 proposed capital additions, but the several hundred pages of expenditure requests and business cases in her testimony provide very little information on each individual project.[85] Although several other witnesses sponsored prefiled testimony for Avista in support of capital additions, their testimony is largely repetitive as well as summary. Such evidence is spread too broadly and too thinly to be of much use to parties trying to evaluate within the parameters of a rate case whether a capital addition should be included in rate base.[86]

45 From the approximately one hundred capital additions presented by Avista,[87] Staff's review focused on those capital additions that Staff identified as "major." Staff's methodology for determining which projects constituted major capital additions is discussed in Section V of this brief. The proposed capital additions not comprising these major projects should be excluded in their entireties from rate base because the Company simply has not met its burden of proof to

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[83] *E.g.,* Gomez, Exh. No. DCG-1TC 61:6-11, 18:7-8.
[84] *See* Gomez, Exh. No. DCG-1TC 6:9-17, 7:1-10.
[85] *See* Exh. No. KKS-5.
[86] *See* Gomez, Exh. No. DCG-1TC 64:1-4.
[87] Exh. No. KKS-5.

demonstrate that the capital additions are known and measurable and used and useful. Staff's major capital additions thresholds in this case are $6.4 million for Washington-allocated electric additions, and $1.3 million for Washington-allocated gas additions.[88] Applying these thresholds, Staff reviewed in detail 14 capital additions.[89] Staff's review of these 14 projects covered the capital additions in 2015 that Avista proposes to include in its rate base. In its examination, Staff analyzed whether these additions would be used and useful and whether the capital expenditures were known and measurable. Staff recommends disallowing all of the capital additions that Avista projected for 2016 because the expenses are not known and measurable and because Staff has low confidence in the accuracy of this company's projections.[90] Staff does not, however, contest Avista's adjustment to its test year reflecting transfer to plant of expenses for capital additions incurred between the end of the test year and the end of the 2014 calendar year, which are documented in Avista's 2014 Commission Basis Report.[91] Finally, Staff recommends that the Commission disallow a portion of the Company's proposed capital addition associated with Project Compass because Avista has failed to show that it acted prudently in incurring the entire expense.

A. Each Of Avista's Major Capital Additions Should Be Disallowed In Whole Or In Part

46 Avista has not shown that all of its proposed capital additions should be included in rates. For rate making purposes, the Commission has the authority to determine the fair value of the property of any public service company *used and useful* for service in this state. RCW 80.04.250. Accordingly, a utility may recover expenses for and earn a return on only those capital additions

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[88] Hancock, Exh. No. CSH-1T 12:17-19; DCG-1TC 13:1-2.
[89] Gomez, Exh. No. DCG-1TC 14:8-17.
[90] Gomez, Exh, No. DCG-1TC 10:12 – 11:13.
[91] Gomez, Exh, No. DCG-1TC 11:14-18.

that will be "used and useful." To be considered used and useful, plant must provide quantifiable benefits to ratepayers.[92] Avista bears the burden of showing that the investment actually occurred and that the new facilities will be providing service to customers in the rate year.[93] The Commission has stated that "there are times when it is appropriate to be more flexible in allowing post-test period *pro forma* adjustments and times when it is appropriate to be less flexible,"[94] but typically the plant must be in service by no later than the end of the rate proceeding if it is to be allowed in rate base.[95]

47 The Commission also considers whether pro forma adjustments to rate base and expenses are *known and measurable*. For this determination the Commission may look beyond the test year but will not go so far as to apply a future test year to rate making.[96] The Commission does not apply a bright line cut off but follows this general standard:

> The known and measurable test requires that an event that causes a change in revenue, expense or rate base must be known to have occurred during, or reasonably soon after, the historical 12 months of actual results of operations, and the effect of that event will be in place during the 12-month period when rates will likely be in effect. Furthermore, the actual amount of the change must be measurable. This means the amount typically 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.[97]

In its most recent general rate case order, the Commission noted that the record requires "increasingly concrete support for *pro forma* adjustments the later in time plant additions are put in service and claimed to be used and useful."[98]

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[92] *Wash. Utils. & Transp. Comm'n v. Pacific Power & Light Co.*, Docket UE-140762, Order 08 (Mar. 25, 2015) ("Pacific Power Order"), 71, ¶ 166.
[93] *See Wash. Utils & Transp. Comm'n v. Avista Corp.*, Docket UE-090134, Order 10 (Dec. 22, 2009), 22 and 33, ¶¶ 44 and 71.
[94] Pacific Power Order at 72, ¶ 168.
[95] *Wash. Utils & Transp. Comm'n v. Avista Corp.*, Docket UE-090134, Order 10 (Dec. 22, 2009), 22, ¶ 44.
[96] Pacific Power Order at 8, ¶ 3.
[97] Pacific Power Order at 71-72, ¶ 168.
[98] Pacific Power Order at 72, ¶ 169.

48 Avista has not met its burden with respect to the proposed amounts for any of these capital additions. Mr. Gomez explains clearly and succinctly in his prefiled written testimony why the proposed capital additions are not entirely known and measurable and used and useful, and the individual projects (except for Project Compass) will not be discussed further here. Mr. Gomez's Exhibit No. DCG-3 lists the capital expenditure amounts for each of the 14 projects proposed by the Company in its direct case and then also the Company's revised amounts provided through discovery. In his Exhibit No. DCG-4, Mr. Gomez lists Staff's recommended transfer to plant amounts for each proposed capital addition. His recommendation in Exhibit No. DCG-4 for Project Compass (based on imprudence) has changed following review of the Company's prefiled rebuttal testimony. He now recommends that the Commission authorize Washington allocated transfers to plant of $32.48 million for electric and $9.03 million for gas for Project Compass. This is further discussed below in the Project Compass prudence section.

49 It is important to note that the Project Compass expenditures that Staff deems to be imprudent are excluded from Staff's revenue requirement in its attrition case as well as in its pro forma case. The Company's case on rebuttal, however, does not include any inputs from its pro forma cross check analysis of capital additions.[99]

50 As a general matter, Avista's transfers to plant after June 30, 2015 should be disallowed, because these costs are not known and measurable. Although the Commission may include transfers to plant up to the beginning of the rate year, this would not be appropriate in this case. Avista's plant projections are subject to frequent revision and cannot be relied upon. Therefore,

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[99] *See* Schuh, TR. 213:7-15.

the Commission should consider only those transfers to plant that have been documented and reviewed by the Parties to be known and measurable.

B. Expanded Capital Reporting Is Necessary

51 In light of Avista's avowed policy to file back to back rate cases in recent years and the Company's decision to significantly ramp up its capital spending, Mr. Gomez proposes an expansion of capital reporting for Avista.[100] Pursuant to RCW 80.28.010(2), regulated utilities must "furnish and supply such service, instrumentalities and facilities as shall be safe, adequate and efficient, and in all aspects just and reasonable." In keeping with this provision, the Commission should require Avista to justify its increased capital spending and demonstrate how it benefits rate payers through lower cost of service or greater reliability.

52 It is true that Avista already reports on its capital spending. The problem, however, is that the current reporting and the Company's as-filed case, taken together, do not answer vital questions concerning the need for and benefit of Avista's capital spending program.

C. Prudence And Project Compass

1. Introduction

53 Ratepayers should not have to pay all of the costs of Project Compass. It is Avista's burden to prove that all of its capital expenditures are prudent. Avista has not met its burden with respect to Project Compass, and the Company should receive neither a return of nor on the entire amount. What the evidence shows is that Avista's contract management was imprudent and that there is insufficient documentation to show that its decisions to extend the budget and timeline for Project Compass were prudent. The costs of the resulting delays and additional agreements should not be born solely by the ratepayers. Staff does not dispute the prudence of replacing

[100] Gomez, Exh. No. DCG-1TC 62:10 – 63:18.

Avista's aging back-office as well as customer-facing systems. In fact, the amount that Staff recommends that the Commission disallow and exclude from rate base is a small percentage of the overall Project Compass capital expense. But these costs are significant in that Avista has not shown it was prudent to incur them. Staff's recommendation is a commonsense response to Avista's poor vendor management, which ensured that the project would be delayed and that additional expenses would be incurred. The amounts that Staff recommends that investors rather than ratepayers shoulder represent those additional expenses as well as the employee bonuses for Project Compass.

2. Legal Standard

The Commission's prudence standard evaluates what "a reasonable board of directors and company management [would] have decided given what they knew or reasonably should have known to be true at the time they made a decision."[101] The company bears the burden of proving the reasonableness and prudence of the expenses under review.[102] To meet its burden, "the utility must set forth appropriate evidence that management acted with care and diligence in controlling the project."[103] This means that "a company must continually evaluate a project as it progresses to determine if the project continues to be prudent from both the need for the project and its impact on the company's ratepayers."[104] The Commission has found such evidence lacking when the company's decision-making process was not adequate and was not adequately

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[101] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket No. UE-031725, Order No. 14, Rejecting Tariff Filing, Authorizing and Requiring Compliance Filing, and Requiring PCA Account Adjustment (May 13, 2004), *citing Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.,* Cause No. U-83-54, Fourth Supplemental Order (September 28, 1984), 32; Goodman, The Process of Ratemaking, 856-57.
[102] *E.g., Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Docket No. UE-920499, UE-921262, Eleventh Supplemental Order (Sept. 21, 1993), 19.
[103] Goodman at 861.
[104] *Wash. Utils. & Transp. Comm'n v. The Wash. Water Power Co.*, Cause No. U-83-26, Fifth Supplemental Order (Jan. 19, 1984), p. 13.

documented.[105] For example, a "company's 'robust discussions' . . . with 'a consensus' on the decisions, are not sufficient to demonstrate prudence." The "parties and the Commission . . . should be able to follow the company's decision-making process, knowing what elements the company used, and the manner in which the company valued those elements," and "[s]uch a process should certainly be documented."[106] Documentation should include a record of a company's contemporaneous evaluation of the decision-making process.[107]

3. Background

54 "Project Compass" is Avista's name for the project that consisted of replacing Avista's legacy Customer Information and Work Management System.[108] The replacement incorporates two applications, Oracle's Customer Care & Billing (CC&B), and IBM's Maximo work and asset management application (Maximo).[109]

55 Avista began the research and planning for this system replacement in 2010.[110] Avista hired Five Point Partners (Five Point) to support its selection and procurement of other vendors. Subsequently Avista contracted with a number of other vendors to carry out the project.

56 [redacted].[111] Avista selected EP2M as the System Integrator (SI) for the CC&B solution.[112] According to Mr. Kensok's testimony in the last rate case, Avista selected EP2M "for implementing the Oracle Customer Care & Billing application,

[105] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket No. UE-031725, Order No. 14, Rejecting Tariff Filing, Authorizing and Requiring Compliance Filing, and Requiring PCA Account Adjustment (May 13, 2004), 8.
[106] *Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Docket No. UE-920499, UE-921262, Nineteenth Supplemental Order (Sep 27, 1994), 16.
[107] *See Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Docket No. UE-920499, UE-921262, Nineteenth Supplemental Order (Sep 27, 1994), 15.
[108] Kensok, JMK-1T 18:3-8.
[109] *Id.* at 6-8.
[110] *Id.* at 18:5-6.
[111] Exh. No. DCG-15C, p. 1.
[112] Gomez, Exh. No. DCG-1TC 51:10-11.

and integrations with the IBM Maximo application and the host of other applications and systems required to support Avista's customer service and operations business."[113] The contract was for [redacted]

[redacted][114] [redacted][115] [redacted][116] [redacted][117] [redacted][118] [redacted][119] [redacted][120] [redacted][121] Five Point, Avista's procurement contractor, acquired EP2M in January of 2013.

[113] Exh. No. DCG-15C at 1.
[114] Exh. No. DCG-15C at 5 ("Deal Sheet").
[115] Exh. No. DCG-15C at 5-6.
[116] *Id.* at 10-11.
[117] *Id.* at 17.
[118] *Id.* at 8.
[119] *Id.* at 28.
[120] *Id.* at 94.
[121] *Id.* at 41..

57 In support of the prudence of its expenditures in developing the new system, Mr. Kensok provides approximately four pages of prefiled direct testimony[122] accompanied by a 15-page report, titled Revised Project Timeline and Budget Forecast, dated June 2014 (Exh. No. JMK-2). Mr. Kensok testifies that the discussion contained in the report describes the factors responsible for adjustments to the Go Live date and the project budget.[123] According to the report, the "Go

58 The report explains that the delay occurred primarily due to the "high degree of complexity" of installing and integrating two major systems (CC&B and Maximo) simultaneously.[124] In December 2013, "the Project Compass team assessed the relationship between the complexity of Avista's code requirements, the project schedule, and the level of staffing," and the "end result was that Avista's integration contractor retained additional resources to bolster its overseas code-development team."[125] Avista tried to mitigate the delay. For example, it made sure that other activities were ready for system testing once the CC&B extension code became available,[126] and it conducted multiple testing phases at the same time.[127] The Company concluded ultimately that overlapping the test phases did not save time because it resulted in additional code defect management.[128]

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[122] *See* Kensok, Exh. No. JMK-1T 18:1 – 21:30.
[123] Kensok, Exh. No. JMK-1T 20:7-10.
[124] *Id.* at 7.
[125] *Id.* at 8.
[126] *Id.* at 8-9.
[127] *Id.* at 9.
[128] *Id.* at 9-10.
[129] Exh. No. JMK-9C, PCR No. AVA 23, dated December 16, 2013.

[130] [131] [132] [133] [134] [135]

61 [136] [137] Mr. Kensok was not able to identify documentation that the board ever considered withholding payments to Five Point.[138] Nor was he able to point to any

[130] Exh. No. JMK-10C, Confidential Attachment C to Staff DR 140, p. 47.
[131] *Id.* at 15.
[132] *Id.* at 51.
[133] *Id.* at 49.
[134] *Id.* at 50.
[135] *Id.* at 56.
[136] Kensok, TR. 248:7-9.
[137] Kensok, TR. 244:21-25.
[138] Kensok, TR. 248:11 – 249:14. Mr. Kensok referenced a Data Request response that was accepted into the record as Exh. No. JMK-14-CX.

documentation in the record that Avista considered pursuing any remedies against Five Point.[139] Rather, Mr. Kensok testified that "these things were actively discussed."[140]

62 [141] [142] [143] [144]

63 [145] [146] [147] Although Mr. Kensok indicated at hearing that Avista had rejected deliverables and/or milestones,[148] there is no documentation that the Company followed the process set forth in its contract with EP2M/Five Point. Staff specifically asked Avista in discovery to provide documentation "relating to any rejection by

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[139] Kensok, TR. 249:17 – 251:3.
[140] Kensok, TR. 250:1.
[141] Exh. No. JMK-10C, Confidential Attachment B to Staff DR 140, p. 5, Figure 1.
[142] Exh. No. JMK-10C, Confidential Attachment B to Staff DR 140, p. 5.
[143] Exh. No. JMK-10C, Confidential Attachment C to Staff DR 140, p. 11.
[144] Exh. No. JMK-10C, Confidential Attachment C to Staff DR 140, p. 71.
[145] Exh. No. JMK-10C, Confidential Attachment C to Staff DR 140, p. 89.
[146] *Id.* at 93.
[147] *See* Exh. No. JMK-9C, PCR No. IBM 23N dated July 2014.
[148] Kensok, TR. 245 5-11.

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Avista of a deliverable or milestone provided by a contractor for Project Compass—for example, the non-performance by Five-Point (EP2M/Ernst and Young) to deliver code and test cases as required in its SOW."[149] The response contains no documentation of any rejection by Avista.

64 The report in Mr. Kensok's testimony, the Revised Project Timeline and Budget Forecast, explained that, because of the delay and because of "additions to the Project," an additional $18 million needed to be added to the budget, bringing the total to $100 million, excluding a $7 million contingency.[150] Avista's officers and Board of Directors approved the $100 million on May 8, 2014.[151] At this point the "Go Live" date for Project Compass was pushed out from third quarter 2014 to first quarter 2015.[152] When Mr. Kensok was asked at hearing if Avista's board had considered seeking any remedies from Five Point at this time, Mr. Kensok answered, "I'd have to refer back to how I answered before."[153] Earlier, Mr. Kensok had testified that "these things were actively discussed." When asked if he could point to documentation anywhere in the record that the board considered any alternatives at this point to simply sending more money on Project Compass, Mr. Kensok stated, "Again, the board not only just considered spending more money, they also considered stopping the project. But again, from what's in exhibits today for—no. . . ."[154]

65 In the June 2014 report comprising Exhibit No. JMK-2, the Company asserts that the Project Compass costs are reasonable and prudent and that the Company believes that its revised implementation plan and budget "simply reflect[ed] a more accurate assessment of the true cost

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[149] Exh. No. JMK-11C.
[150] Exh. No. JMK-2 at 12-13
[151] Exh. No. JMK-2 at 12.
[152] Exh. No. JMK-2 at 2 and 13.
[153] Kensok, TR. 258:10-13.
[154] Kensok, TR. 258:18-20.

of implementing the Project." The report suggests that if the Project team had known beforehand how hard the coding would be, how many coders would be needed, and how complicated it would be to fix all of the code defects, it might have added resources and budget to the Project.[155]

66 Avista learned in May or June 2014 that Five Point was being acquired by Ernst and Young.[156] The acquisition occurred in June 2014.[157] At the time of the acquisition, Avista's contract with Five Point was nearing its conclusion.[158] [159] [160] There is no documentation to show what Avista considered when it negotiated the new contract with Ernst & Young. Avista entered into a time and materials contract with Ernst & Young in October 2014 [161] At hearing, Mr. Kensok could not point to anything in the record to show what Avista actually considered when it decided to sign the contract with Ernst & Young.[162] Even though Mr. Kensok testified at hearing that Avista considered alternatives to the contract it entered into with Ernst & Young, he could not identify anything in the record to document this.[163] Staff could not find any documentation either in the materials received from Avista through discovery.[164]

[155] Exh. No. JMK-2 at 14.
[156] *See* Kensok, TR. 231:17-22; c.f. Kensok, Exh. No. JMK-6CT 21:23 – 22:1.
[157] Kensok, Exh. No. JMK-6CT at 5, n. 3.
[158] Kensok, Exh. No. JMK-6CT 28:1-2.
[159] Exh. No. JMK-10C, Confidential Attachment C to Staff DR 140, Executive Steering Committee Reports of June 16, July 15, and August 25, 2015.
[160] Exh. No. JMK-10C, Confidential Attachment C to Staff DR 140, p. 196.
[161] Kensok, TR. 262:8-20; Gomez, Exh. No. DCG-1TC 57:6-7.
[162] Kensok, TR. 264:21 – 265:6.
[163] Kensok, TR. 263:20 – 265:6.
[164] Gomez, Exh. No. DC-1TC 57:11-17.

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67 In the fall of 2014, Avista hired Gartner Consulting to review Project Compass. Gartner issued an assessment dated November 12, 2014. From its assessment, it is clear that Gartner understood that there were problems with the CC&B portion of the project that did not extend to the Maximo portion. The assessment stated, [165] [166] [167] The Gartner assessment included an audit by Oracle, the maker of the CC&B software, of Five Point's code.[168] Per the Gartner assessment,

68 Avista increased the Project Compass budget authorization again, to $110 million, in November 2014.[169] At hearing, Mr. Kensok was not able to point to documentation anywhere in the record of what Avista considered when it made this decision.[170] Avista placed Project Compass into service in February 2015.[171] Avista paid employee bonuses totaling $775,200.[172] The project closed at the end of June 2015.[173]

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165 Exh. No. JMK-13C, 4.
166 *Id.*
167 Exh. No. JMK-13C at 22. Mr. Kensok confirmed at hearing that these references concerned Five Point. Kensok, TR. 257:6 – 258:3.
168 Exh. No. JMK-13C at 4.
169 Kensok, Exh. No. JMK-1T, TR. 265:8-13.
170 Kensok, TR. 265:15-19.
171 Kensok, Exh. No. JMK-1T 19:13-15.
172 DCG-18C, p. 2.
173 *See* Gomez, DCG-1TC 46:19 – 47:13.

4. Avista Has Not Shown That It Prudently Managed the EP2M/Five Point Contract

69 Avista's management of Five Point (as EP2M and Five Point) appears unreasonable given Five Point's poor performance. Five Point's delays and defective deliverables, together with Avista's inaction in managing the contract, derailed the Project Compass schedule and ensured that Project Compass would exceed its budget. Avista shrugs off Five Point's performance issues with the excuse that Five Point was not the only reason the Go live date was extended. While Avista contends that [redacted],[174] this contention does not show that Avista prudently managed the contract with Five Point. Avista does not point out exactly which parts of the project extension were delayed due to Five Point's delays and which parts were not. It is unclear why other vendors might have been responsible for a delay and to what extent. On the other hand, there is plentiful evidence on the record that Five Point was responsible for parts of the project that encountered serious problems and caused delays.

70 The Company's Executive Steering Committee reported delays and defects in the code and services from Five Point. The Gartner assessment, including Oracle's audit, also reported serious issues with the code from Five Point. Defective code from Five Point blocked system integration testing. Yet there is no documentation that Avista ever pursued any remedies for this or other nonperformance. Instead, Avista continued paying EP2M, and then Five Point, as though there were no problems. Mr. Kensok testified that Avista discussed remedies but provided no record showing what was actually discussed. At the same time, Avista contends that the extended project timeline and increased budget were due to the complexity of the project. So, while Avista admits, on the one hand, that there were performance problems with Five Point,

[174] DCG-17C, 2 of 5.

which executive management apparently discussed, the Company continues to justify its budget increases with reference to the complexity and uncertainty of the project. What is unclear is why ratepayers should bear all of the additional costs of a project that Five Point potentially scoped improperly, that EP2M underbid, and that EP2M and Five Point under-resourced.

71 The evidence shows that none of the other parts of the project had the kind of serious issues that CC&B did, and Five Point's performance issues blocked the progress of the entire Project Compass. It is a reasonable conclusion, given the delay caused by Five Point, that at least some, if not all, of the additional contract amounts that were incurred when the Go Live date was extended were due to Five Point's performance problems and Avista's unwillingness to address them.

5. Avista's After-The-Fact Descriptions Of Its Decision Making Are Insufficient To Show That Its Decisions To Pay More For Project Compass Were Prudent

72 To determine whether Avista was prudent in increasing its budget and paying Five Point (Ernst & Young) even more, in spite of its poor record of deliverables, the Commission must be able to follow the Company's decision making process. Avista asserts that it should have full recovery because the cone of uncertainty makes it impossible to accurately budget IT projects.[175] The prudence standard, however, does not require clairvoyance; but it does require a certain amount of transparency in a company's decision making. This transparency, which allows a regulator to understand whether a utility's decision was prudent, is completely lacking in this case.

73 The Company presented no documentation in its direct case of what exactly Avista's board or management considered when it approved the budget increase and the extension of the

[175] *See* Kensok, Exh. No. JMK-6CT at 17.

Go Live date. The report comprising Exhibit No. JMK-2 is not evidence of prudent decision-making because it is an after-the-fact, historical account of the Project and is not a contemporaneous record that shows what the Company considered when it made these decisions. Mr. Kensok testified that the Company considered alternatives to spending more money on Project Compass but there is no documentation in the record of the alternatives that Avista may have considered. As to showing that Avista's decision to hire Ernst & Young for additional money, the June 2014 report predates that contract so provides no insight. Mr. Kensok's draft email with talking points, comprising the last two pages of Exhibit No. DCG-17C, is insufficient evidence to show what Avista's executives *actually* considered when they entered into the contract with Ernst & Young to complete Five Point's work on Project Compass. In addition, the Company's self-serving, after-the-fact, narrative response to Staff discovery, also contained in Exhibit No. DCG-17C, is not the kind of contemporaneous records that the Commission can rely on in a prudence determination.

74 Avista's contract with Ernst & Young was not a fixed price contract but a "time and materials" contract. Essentially, Ernst & Young could charge up to the $6.2 million ceiling in the contract. The amount that Avista ultimately paid was well below the ceiling but there is no information anywhere in the record documenting Avista's rationale in awarding such favorable terms to Ernst & Young.

6. A Disallowance Is Appropriate Based on Avista's Failure to Demonstrate That It Acted Prudently

75 In light of the Company's failure to prudently manage its contracts and the Company's failure to document its decision making when it decided to pay more for Project Compass, Staff recommends that the Commission disallow the amounts representing Avista's 2014 PCRs as well

as expenditures relating to the Project Compass bonus plan, which total $11.2 million[176] at the system level. In Staff's prefiled response testimony, Mr. Gomez had recommended that the Commission exclude the Washington-allocated portion of the $17.9 million in additional system-level project costs resulting from the project delay, recognizing, however, that this number likely would change in the Company's rebuttal testimony.[177] Mr. Kensok included project change requests in his Exhibit No. JMK-9C. Based on its review of the project change requests documented in Exhibit No. JMK-9C, Staff has changed its disallowance recommendation.

IV. AVISTA'S ADVANCED METER INFRASTRUCTURE PROPOSAL

76 In this section of the brief, Staff will address Avista's proposed regulatory treatment for its existing meters, and its request that the Commission effectively sanction what would amount to a total write-off of over $20 million in still useful assets. Avista makes this extraordinary request despite having withdrawn from Commission consideration the Company's as-filed business case for new Advanced Meter Infrastructure (AMI). For the reasons expressed below, the Commission should reject Avista's proposed accounting treatment. Avista's proposed accounting treatment clearly puts "the cart before the horse." It is offered without a viable and economically cost-effective business plan, and should not be used to spring board its flawed plan into reality.

A. Avista's As-Filed AMI Business Case Does Not Support Its Implementation

77 Avista has withdrawn its as-filed AMI business case.[178] Given the Company's lack of confidence in its own proposal, the Commission should not be put in the position of having to decide the disposal and accounting treatment of the Company's existing meters. However, the

[176] Staff's recommended disallowance for Project Compass on a Washington allocated basis is $5.5 million for electric and $1.6 million for gas.
[177] Gomez, Exh. No. DCG-1TC 49:8-16, n. 85.
[178] *See* Norwood, Exh. No. KON-1T at 39:25-40:2 (referencing La Bolle, Exh. No. LDL-1T at 3:10-4:7).

Company demands that the Commission make such a call, perhaps seeking some assurance that the prudence of a future AMI business plan will fare better with prior Commission acknowledgement that the existing meters should be replaced. Essentially, the Company seeks some hybrid form of pre-approval that would naturally and perhaps irreversibly lead to a new AMI system - without regard to its costs. Taken at face value, the Company's demand for this assurance is undeniably too much and too soon. It should be rejected.

78 First, Avista's overall AMI proposal is too premature and ill-defined to base any decision on its underlying development scheme; let alone the disposal of the existing meters. To this point, now eight months after its initial filing, the Company still does not know what advanced meter technology it wishes to install.[179] So, of course it has not selected any vendors.[180] It offers the Commission no plan for how it will deploy the new technologies or how it will implement new services. It has even failed to initiate the important process of customer education and engagement.[181] Avista defends these apparent weaknesses by acknowledging that: "The nature of [its] estimates should be considered preliminary since the technical requirements for the various systems have not been completed, and since none of the vendors' proposed configurations and final pricing for these systems is presently known."[182] However, Avista knows enough to now admit that the as-filed business plan does not reflect more recent cost forecasts. Costs for the project are going up - not down. By Avista's own admission, the estimated costs of AMI could soar 50% from that portrayed in its business case, thus completely eclipsing all of AMI's

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[179] Kopczynski, TR. 329:2 – 330:7 (Avista is considering two very different AMI technologies: one approaching obsolescence, the other at the very front end of the technology's life cycle)..

[180] Kopczynski, Exh. No. DFK-5 at 20.

[181] Kopczynski TR. 317:2-6.

[182] Kopczynski, Exh. No. DFK-5 at 20. *See also* Kopczynski, Exh. No. DFK-1T at 12:8-12 ("The Company has prepared a report summarizing the Washington advanced metering project, which provides an overview of advanced metering infrastructure, describes the expected benefits associated with the project, and provides an initial estimate of the project capital investment and maintenance costs. A copy of this report is at Exhibit No. ___ (DFK-5).").

quantifiable benefits.[183] As background, Avista's subject matter expert testified that the total cost of AMI implementation *was* estimated to be $223 million, which included a capital investment of $145.3 million, plus another $77.6 million for the net present value of annual operating expenses.[184] In contrast, the project's benefits *were* estimated to total $230.5 million over the 21-year life of the project.[185] In the end, Avista forecasted a total net benefit for customers of $7.5 million based on these assumed costs and benefits.[186] The Commission is now better informed, having heard this same witness testify that Avista's business case is far more costly than presented in its original filing.

79 As revealed by Mr. Kopczynski, the Company has *already increased* its estimated capital costs for AMI by $20 million.[187] Surprisingly, he also revealed that the uncertainty associated with Avista's cost estimates is "plus-or-minus-50-percent."[188] Thus, the Company now admits that the capital cost of AMI implementation could swell to $250 million. Despite these revelations, the Company still stands behind its accounting proposal.[189]

80 It is now clear that all as-filed quantifiable benefits of the project would be subsumed by the expected cost increases.[190] The project is therefore in the red from the start. It is also clear that the Company's proposed AMI project is laden with unacceptable financial risks. Until these risks are effectively addressed, Avista's AMI project should not move forward. The Company should not need the Commission to give it this direction.

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[183] Kopczynski TR. 307:17-19.
[184] Kopczynski, Exh. No. DFK-1T at 12:22 – 13:20 (of note, the Company stated the capital cost at $142.1 million at DFK-1T 12:2 and in its business case at DFK-5 at 22).
[185] Kopczynski, Exh. No. DFK-1T at 13:3-7.
[186] Kopczynski, Exh. No. DFK-1T at 13:8-9.
[187] Kopczynski TR. 306:20.
[188] Kopczynski TR. 306:20 – 307:11. It is highly unlikely that Avista's costs will *decrease* by 50%.
[189] If operating expenses are also included in the 50% cone of uncertainty, the total cost of the project could balloon to $365 million.
[190] It is important to point out here that these same quantifiable benefits are not subject to the same uncertainty as AMI's costs. *See* Kopczynski TR. 307:20 – 308:8.

81 In the end, Avista alone bears the responsibility to demonstrate a viable, workable and enduring business plan for AMI. It has not done so here - far from it. Without a convincing showing that the benefits of AMI would outweigh its costs, the Commission need not rule on it or any ancillary accounting treatment related to the existing meters. In sum, Avista's AMI business case is simply too preliminary to merit serious examination, much less serve as the basis for adding millions of dollars to the Company's rate base. With the disclosures made at hearing, Avista's business case cost structure can be characterized as a speculative guess made at the time of filing and nothing more. As such, it is incapable of supporting any decision to create a regulatory asset from the meters still in service to its customers.

B. Avista's Proposed Accounting Order is Inextricably Tied to Its Premature Business Case and Should be Denied

82 Despite its insistence that the as-filed business case supports the decision to move forward with AMI, Avista abandoned its recovery of advanced meter costs in its rebuttal filing.[191] However, the Company put the Commission on notice that it will pursue a prudence determination for these costs in the rate case it anticipates filing in 2016.[192] Remarkably, the Company's pronouncement that it will move forward with AMI was made with the full knowledge that AMI's estimated costs were already $20 million higher than estimated and could increase again by an additional 50%.

83 Despite knowledge of the project's significant cost risk, Avista still seeks a Commission order "that supports Avista's decision to move forward, in principle, with the deployment of AMI."[193] To this end, it specifically demands that the Commission demonstrate *its* support by

[191] Norwood, Exh. No. KON-1T at 39:25-40:2 (referencing La Bolle, Exh. No. LDL-1T at 3:10-4:7)
[192] Norwood, Exh. No. KON-1T at 40:10-19.
[193] Norwood, Exh. No. KON-1T at 40:20-21.

approving the creation of a $20 million regulatory asset. This asset would represent the then current value of the existing undepreciated meters, including the Company's authorized rate of return.[194] Avista makes this extraordinary demand without apparent recognition of the infirmities of its business case. Its actions portray a Company that is either ignoring the risks involved in this endeavor or has found itself irreversibly locked into a course of action. Either way, Avista is now attempting to force the Commission into the proverbial corner with its new AMI proposal.

84 Operationally, the Company's proposed accounting treatment would result in an approximately $1.1 million net increase in rates over the accelerated 10-year amortization period. Importantly, the costs associated with the retirement of its still used and useful meters would be distinct from the separate cost of the new AMI technologies.[195] In essence, Avista's proposed accounting treatment seeks to recover the costs of both meter systems at the same time. Avista also warned the Commission: "Absent this accounting treatment, the AMI project would be delayed or terminated."[196]

85 Avista's requested regulatory treatment is even more extraordinary given the fact that its business case has been withdrawn by the Company. As it now stands, the Company is asking the Commission to create a regulatory asset that is no longer supported by *any* business case for AMI.[197] To this point, the Company has categorically acknowledged that it would not rely on the same business case the next time it seeks a prudence review for the costs of advanced meters.[198]

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[194] Norwood, Exh. No. KON-1T at 41:4 – 42:2; *See also* Kopczynski TR. 298:4-8 (". . . we are looking for affirmation from this Commission to move forward with the project. . . the affirmation we're looking for is really embedded in our request for the accounting treatment of the book value of the meters.").
[195] Andrews, TR. 155:9-23.
[196] Norwood, Exh. No. KON-1T at 42:3.
[197] *See* Norwood, Exh. No. 116:4 – 117:20.
[198] Kopczynski, TR. 306:18-19 ("[I] don't believe that the general components will change, but the costs will – will change."); s*ee also* La Bolle TR. 420:12-14 (". . . we will have to even update [our estimates of AMI] costs during the early term of the [next] rate case, because we'll be getting final contracts done then.").

In fact, even the benefits articulated in its as-filed business will likely change.[199] After the admissions made in cross-examination, there is absolutely no question that current cost estimates for the AMI project have exceeded the expected benefits.[200] These facts alone undermine the Company's proposed accounting treatment. The Company should not be allowed to create a regulatory asset from the undepreciated value of the existing meters without a clear and substantial showing that meter replacements are cost effective, including the cost of the regulatory asset. By combining these costs, the Commission will then have a true sense of the overall cost to ratepayers.

86 Importantly, Avista's request to create a regulatory asset upon execution of a contract for the advanced meters could contradict Generally Accepted Accounting Principles (GAAP). This issue was teed up by the Company's claim that : "Under [GAAP] accounting, once Avista selects a vendor and signs an agreement to replace its electric meters, absent an accounting order from the Commission, Avista would be required to write-off its existing $21 million net investment in electric meters."[201] The Company provides no support for this assertion, and cites no specific GAAP rule requiring such a result. Further, there is nothing in the record to determine whether Avista intends to abandon or retire the existing meters.[202] What *is* known is that absent their physical replacement on the distribution system, the existing meters are still used and useful - in fact, essential - to the Company's business operations. As set forth in the Company's as-filed business plan, the existing meters will remain in service until they are replaced, which could take

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[199] Kopczynski, TR. 314:13-19.
[200] It may be reasonable to assume that the project will not be cost effective in the foreseeable future.
[201] Norwood, Exh. No. KON-1T at 41:8-11; *see also* Norwood TR. 141:4-23.
[202] GAAP could *require* Avista to retain the meters on its books, so long as they remain in service. *See* FASB ASC 980-360-35-1 (An asset is considered abandoned when it becomes probable (likely to occur) that the operating asset will be abandoned); *See also* Kopczynski, Exh. No. DFK-1T at 5, FN 4; Kopczynski, Exh. No. DFK-1T at 20:14-22.

several years after the Company executes the vendor contract.[203] Any change in accounting treatment would appropriately occur after the existing meters are no longer used and useful for Company operations.[204]

87 The accelerated depreciation sought by Avista in the form of an accounting order is not needed to make the Company whole. There is certainly no evidence to support such a result. Furthermore, the existing meters should be disposed of in a manner that offsets the cost of the asset replacing it. How Avista intends to dispose of the still-useful analog meters is not clear, particularly in the context of its proposed accounting order. Without such clarity, it is impossible for the Commission to know whether Avista's GAAP claims are indeed true.

88 Critically, Avista presents no demonstrated need to replace the existing meters with new AMI meters. The standard meters currently in service have a Commission-approved useful life of 29 years.[205] Avista does not claim that these meters are no longer useful - it states they have an aggregated remaining useful life of 24 years.[206] Nor does the Company claim that its customers have expressed any desire for greater meter functionality. In fact, 37.5% of its customers have incomes that are 200% below the federal poverty line[207] and thus would be unlikely to adapt the supplemental smart technologies necessary to unlock the unquantified value potential of AMI. Importantly, Avista has not even begun to engage its customers regarding its plans to replace the existing meters with new AMI technology.[208]

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[203] Replacing the existing meters would allegedly occur over the six years subsequent to entering the vendor contract, and could even remain useful thereafter for a variety of conceivable purposes. *See* Kopczynski, Exh. No. DFK-1T at 5, FN 4; Kopczynski, Exh. No. DFK-1T at 20:14-22.

[204] FASB ASC 360-10-45-15; FASB ASC 360-10-35-47. The Generally Accepted Accounting Principles (GAAP) are quite clear that long-lived assets, such as electric or gas meters, which are being considered for replacement or disposal "shall continue to be classified as held and used until it is disposed of" per the Accounting Standard Codification (ASC) 360-10-45-15.

[205] Schuh, Exh. No. KKS-1T at 27:2-3.

[206] Meyer, TR. 205:11-15 (providing clarification to record); *see also* Andrews TR. 153:12-13.

[207] Williams, Exh. No. 1T at 6:14-15.

[208] Kopczynski, TR. 317:2-6.

89 Why then is Avista pursuing AMI? The Company maintains that "[it] is committed to achieving a greater degree of customer satisfaction, and offering information and choices that help customers better understand and manage their energy costs." These are largely qualitative measures that may fit some customers' profile and not others. The true test of meter replacement lies within the required cost/benefit study. It would take a lot of "customer satisfaction" to overcome an upside down business case. Frankly, qualitative measures such as those described by the Company are simply by-products of meter replacement - not reasons to pursue it without regard to cost.

90 In sum, Avista's request for an accounting order to create a regulatory asset once it executes a vender contract is not necessary to make its shareholders whole, and would result in additional and unnecessary costs to ratepayers. Such a result is fundamentally unfair, and is contrary to the public interest. Currently, Avista's customers are bearing all capital and O&M costs associated with the existing meters. These meters, on average, have only served customers for five of their 29-year useful life.[209] Over $20 million in undepreciated net book value related to these meters remains on the Company's books.[210] The Company seeks its accounting treatment without a demonstrated need to replace the meters. It offers only a speculative business plan. Staff can find no standard that justifies including AMI costs into customer rates at this time. In the end, Avista's proposed accounting treatment would not serve the public interest.

91 For the reasons expressed herein, Avista's request for an accounting order to create a regulatory asset for the undepreciated net book value of its existing meters should be denied.

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[209] Schuh, Exh. No. KKS-1T at 27:2-3; Meyer TR. 205:11-15 (providing clarification to record); *see also* Andrews TR. 153:12-13.
[210] Schuh, Exh. No. KKS-1T at 27:10-11.

C. Other Comments On Avista's AMI Proposal

92 AMI's value to customers resides in the potential of its unquantified benefits. Importantly, these benefits depend on the economy of scale created by the coordination and synchronization of many pieces of technology effectively communicating in an integrated network.[211] Moreover, benefits accrue over time as new applications and tools interface with customers to enable the system to operate in a new, more efficient way.[212] As Staff witness Mr. Nightingale attests: "Without affirmative action on both sides of the meter, the potential benefits of AMI may never be realized."[213]

93 Deploying AMI would require Avista to fundamentally transform both the services that it provides and how it engages with its customers. Successful deployment of AMI is more than infrastructure installation: Avista must ultimately implement dynamic rate structures, provide relevant feedback, and harness new technologies to effectively educate and engage its customers on energy issues, while further incentivizing these customers to alter their energy consumption behaviors in a manner that is aligned with system and societal needs.

94 Clearly defined policy goals for AMI are critically important, and enable productive debate among the Company, the Commission, and other stakeholders on the best means for achieving these goals, rather than what the goals should be in the first place. Cost recovery should reflect successful implementation, where customer responsibility for costs is matched by the Company's ability to deliver quantifiable benefits. Well-defined and independently verifiable metrics for success are necessary to be able to objectively evaluate the project and to inform how to refine implementation strategies going forward. A transparent customer data privacy policy

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[211] Nightingale, Exh. No. DN-1T at 15:17.
[212] Nightingale, Exh. No. DN-1T at 8:4 – 10:2.
[213] Nightingale, Exh. No. DN-1T at 9:8-9.

and effective cyber-security are essential for customers to trust and embrace AMI. Maintaining a compelling customer education and engagement strategy would be an ever-evolving challenge. AMI is not a simple endeavor. Premature deployment invites costly setbacks that would serve to impede AMI deployment throughout Washington State—ultimately disserving more than just Avista's customers.

95 Avista's AMI proposal, in the light most favorable to the Company, can be viewed as a request for assurance of cost recovery to pursue a project that it believes has the potential to provide real value to its customers. However, without Avista's comprehensive commitment to unlocking this value, the AMI project appears more like a brash attempt to grow rate base and not a project aimed at benefitting ratepayers. Finally, Avista's unsuccessful deployment could have grave repercussions for AMI that ripple throughout the state. Avista's rudimentary business case, lack of planning, and failure to engage its customers all demonstrate an insufficient commitment to AMI. If Avista's commitment is greater than this case demonstrates, Staff is open to a discussion about when and how to proceed with AMI.[214] Otherwise, deployment should wait.

V. MISCELLANEOUS ISSUES

A. Staff's End Of Period Methodology Better Reflects Avista's Plant In Service To Ratepayers In The Rate Year

96 The end of period methodology (EOP) is a regulatory tool that can address regulatory lag.[215] Simply stated, EOP is an extraordinary ratemaking tool designed to recognize "rate base balances that are likely to exist during the rate year."[216] In operation, EOP would recognize capital facilities placed into service outside the test year as revenue producing rate base. In

[214] Nightingale, Exh. No. DN-1T at 16:4-16.
[215] Hancock, Exh. No. CSH-1T at 16: 3-4.
[216] Hancock, Exh. No. CSH-1T at 15: 1-12. See also, CSH-1T at 16: 8-9.

contrast, strict application of the Commission-preferred Modified Historical Test Year methodology (MHTY) would limit revenue producing rate base to only those facilities in service before the end of the test year.[217]

97 As used in this case, Staff's EOP approach recognizes capital facilities placed into service before December 31, 2014. Essentially, these "EOP" facilities can be considered additions to the results of Staff's MHTY analysis, based upon the average of monthly averages methodology (AMA) generated during the test year.[218] Thus, Staff's EOP results reflect capital additions in service to ratepayers through the end of calendar year 2014.[219] The result of Staff's EOP analysis increases Avista's electric revenue requirement by $2,319,000[220], and Avista's natural gas revenue requirement by $579,000.[221]

98 Staff's decision to use EOP reflects its general concern that the Company would likely experience attrition during the rate year using only the MHTY approach.[222] While Staff understands the Commission's stated preference for the AMA methodology, Staff offers its EOP analysis for the purpose of providing the Commission an alternative to the use of an attrition allowance to set Avista's rates.[223]

B. Staff's Pro Forma Analysis Recognizes Avista's Major Plants In Service To Ratepayers Through June 30, 2015

99 In addition to the MHTY and EOP analyses presented above, Staff recommends the Commission approve certain major plant additions that were placed into service before June 30,

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[217] In this case, the test year ended on September 30, 2014. See Hancock, Exh. No. CSH-3 at 1.
[218] Hancock, Exh. No. CSH-1T at 14: 11-14.
[219] Hancock, Exh. No. CSH-1T at 19: 2-4.
[220] Hancock, Exh. No. CSH-3 at 9: Column 3.11 at line 50.
[221] Hancock, Exh. No. CSH-3 at 8: Column 3.07 at line 50.
[222] Hancock, Exh. No. CSH-1T at 16: 6-9.
[223] Hancock, Exh. No. CSH-1T at 16: 8-9.

2015. These projects and recommended allowed costs are listed in Mr. Hancock's Table 4.[224] Staff's recommendation in this case to include these projects in rates stems again from its interest in mitigating Avista's regulatory lag.[225]

100 As to the mechanics of Staff's analysis, its recommendations are built upon careful examination of projects that were verified to exceed a pre-determined economic threshold, reflected costs that are known, measureable and prudent, and were in service to customers by June 30, 2015.[226] Further, the criteria used by Staff to draw the line on projects considered in 2015 are both reasonable and well-understood, representing a disciplined and thoughtful analytical approach in the circumstances presented.

101 Staff's major project analysis is anchored in WAC 480-140-040.[227] Here, Staff pulled from the rule a general description of major construction projects, denoting projects "greater than five-tenths of one percent of the company's latest year-end Washington allocated plant in service ...." Staff's application of the rule's intent resulted in a major project threshold of approximately $6.4 million dollars for Avista's electric operations and $1.25 million dollars for its natural gas operations.[228] The projects meeting Staff's first eligibility criterion were then analyzed against each project's total cost. Any project with a cost greater than three million dollars "on a total project basis", was accepted for review by Staff. Again, Staff's selected monetary threshold is both founded in the rule and consistent with its plain language.[229] In practice, Staff's "major project" test looks first at whether the rate base addition is greater than

224 Hancock, Exh. No. CSH-1T at 21: 5-6.
225 Hancock, Exh. No. CSH-1T at 23: 17-20 and at 24: 1-5.
226 Hancock, Exh. No. CSH-1T at 9:19-22 and at 10: 1.
227 Hancock, Exh. No. CSH-1T at 11: 20-23.
228 Hancock, Exh. No. CSH-1T at 12: 17-21.
229 Hancock, Exh. No. CSH-1T at 12: 23-26 and at 13: 1-2.

three million dollars on a total project basis. If so, the project is then analyzed against the thresholds described above.

102 The results of Staff's application of the rule and analysis are listed on Table 4 of Mr. Hancock's testimony. All of the fourteen listed projects have met both elements of Staff's test for inclusion in rate base. These projects were thoroughly reviewed, audited as to cost, and determined to be prudent and in service prior to June 30, 2015.[230] As a result of Staff's thorough and detailed analysis, it is recommending a pro forma transfer to plant in the amounts of $56.7 million for Avista's electric operations service and $16.2 million for its natural gas operations for facilities in service before June 30, 2015.[231]

C. Dispute Over Regulatory Treatment Of Colstrip & CS2 Overhauls

103 The regulatory treatment of major maintenance expenses at particular generation plants of Avista's has, for some inexplicable reason, been a recurring issue for Avista. In the Company's 2011 rate case, it sought and obtained approval for a recovery mechanism to defer specific expenses incurred above a baseline amount related to overhauls at Coyote Springs 2 (CS2) and Colstrip. The amounts deferred would then be recovered over four years without carrying charges.[232] Approximately one year later, Avista agreed in a settlement to terminate the deferral program, but was allowed to recover any deferred amounts in subsequent years.[233]

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[230] Hancock, Exh. No. CSH-1T at 20: 6-7. See also CSH-1T at 20:10-14 and at 21: 1-5.
[231] Hancock, Exh. No. CSH-1T at 20: 10-12.
[232] *Wash. Utils. & Transp. Comm'n v. Avista Corp.,* Dockets UE-110876 and UG-110877 (consolidated), 294 P.U.R. 4th 414 at 420, Order 06 (December 16, 2011).
[233] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-120436 and UG-120437 (consolidated), 303 P.U.R. 4th 113 at 121, Order 09 (December 26, 2012).

104 From 2012 to the present, Avista's overhaul costs have been recovered in rates based on the historically modified test year approach, which is consistent with normalization. Avista, on rebuttal, now proposes to create a regulatory asset to pay for CS2 and Colstrip overhaul events.

105 Mr. Ball testified to Avista's overhaul proposals, and argues that the Commission's approved normalization approach will effectively provide Avista sufficient funds to accomplish the overhauls expected for CS2 & Colstrip.[234]

106 Mr. Ball's testimony describes the cost history of operations and maintenance expense for CS2 and Colstrip. His testimony shows that Avista's proposed adjustment exceeds the historical costs associated with the expected work.[235] He also points out that Avista's proposed expense adjustment "does not match the costs with the intervals of these maintenance events and violates the matching principle."[236] Further, Mr. Ball has shown how the Company's argument that normalization does not "take into account the effect the overhaul costs on the Company"[237] falls flat, as the company has the ability to defer such costs using standard accounting methodology.[238] This same accounting methodology is used by other utilities under the Commissions jurisdiction.[239] The bottom line - Avista's expense adjustment is not needed to fully recover its overhaul costs.

107 Mr. Ball testifies that Staff's preferred approach is normalization. No party questions the fact that normalization is a standard regulatory tool. As applied to the CS2 and Colstrip overhauls, normalization would adequately allow recovery of Avista's costs, as set forth above.

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[234] Ball, Exh. No. JLB-1T at 10:16-11:5
[235] Ball, Exh. No. JLB-1T at 12:13-21
[236] Ball, Exh. No. JLB-1T at 13:6-7
[237] Norwood, Exh. No. KON-1T at 44:19-20
[238] Staff Response to Bench Request No. 2 (Sept. 24, 2015).
[239] *See* Norwood, TR. 135:16-21 (discussing Puget Sound Energy's existing use of Staff's proposed accounting treatment)

The same is true for Avista's Rathdrum and Boulder Park facilities. Mr. Ball testified that overhauls for Rathdrum and Boulder Park can be completed without increasing the amounts already in Avista's rates.[240] In sum, Mr. Ball concludes that Avista's "test year expenses are in line with the recent average … [and] can be expected to pay for overhaul occurring in the rate year, including both the Rathdrum and Boulder Park maintenance."[241] Staff additionally noted that if any cost treatment is applied to Rathdrum and Boulder Park planned maintenance then normalization similar to CS2 and Colstrip is the appropriate method.[242]

108 On rebuttal, Avista proposes the use of regulatory assets for major overhauls instead of normalization, arguing that this approach would function the same as that proposed by Staff. As noted above, Avista's regulatory asset approach is not necessary for full cost recovery. However, this approach would be "the next best option."[243] Ultimately, the impact of either proposal is small. To this point, Staff's adjusted O&M for CS2 & Colstrip is $15.6 million, including overhauls. The actual test year O&M for CS2 & Colstrip was $15.9 Million on a Washington allocated basis and <u>included</u> an overhaul of one unit.[244] Ultimately, there is very little impact by Staff's proposal on the test year O&M.

109 In the end, little is gained by Avista's proposed changes to how CS2 and Colstrip O&M expenses are dealt with in rates. The normalization methodology effectively supports Avista's cost recovery, and is currently the approved methodology for dealing with these costs. While it recognizes the incidental difference Avista's proposal would have on this case, Staff believes the normalization methodology instills in Avista the incentive to effectively manage its O&M costs

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[240] Ball, Exh. No. JLB-1T at 9: 5-21.
[241] Ball, Exh. No. JLB-1T at 9: 25-26 and at 10: 1-2.
[242] *Ibid.* at 10:6-11
[243] Ball, TR. at 530: 5 and 531:10
[244] Johnson, Exh. No. WGF-5

within the parameters of its rate treatment. Unless there is a compelling reason to change, normalization is accepted, predictable and provides appropriate cost management incentives. Avista has shown no compelling reason to do so in this case. Further, it plans to file continuous rate cases for the foreseeable future. If its circumstances should change, then the rate treatment for generating plant O&M costs can be addressed in the future. As it stands, there is no reason to do so in this case.

D. Staff Supports Increased Resources For LIRAP

110 With regard to increased support for Avista's LIRAP program, Staff offers the following remarks and observations. First, Staff supports the 7 percent annual increase to LIRAP funding proposed by the Company.[245] Staff also supports Avista's clarification of the allocation of the LIRAP revenue requirement between electric and gas rates as proposed by the Company.[246] However, Staff believes it is unnecessary for the Commission to address how LIRAP grants are paid out to customers. This is an element of program design not addressed in the Company's rebuttal testimony, but follows an understood model based upon the needs of the affected population and funds available for dispersal.

VI. CONCLUSION

111 For the reasons set forth herein, Staff recommends that the Commission adopt the disallowance advocated for Project Compass and require Avista to participate in expanded capital reporting. It also recommends that the Commission deny the Company's request to create a regulatory asset representing the meters still in service to the Company. Staff further recommends that the Commission adopt its strategy for dealing with major maintenance events for CS2 and Colstrip. Finally, Staff recommends that the Commission follow the long-

[245] Reynolds, TR. at 541: 8.
[246] Reynolds, TR. at 540: 23-25.

established test for attrition to decide whether Avista should be awarded an attrition allowance. If it determines that Avista has met the test for awarding an attrition allowance, it should use Staff's attrition study to set the Company's rates. In the alternative, the Commission can use Staff's EOP analysis to capture plants determined to be in service before June 30, 2015.

DATED this 4th day of November 2015.

Respectfully submitted,

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