

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

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**AVISTA CORPORATION, d/b/a
AVISTA UTILITIES,**

Respondent.

**DOCKETS UE-190334, UG-190335,
and UE-190222 (*Consolidated*)**

TESTIMONY OF

Aimee N. Higby

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

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

October 3, 2019

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- Exh. ANH-2 Attachment A to Avista's 2nd Supplemental Response to UTC Staff Data Request No. 23 (with Staff Analysis)
- Exh. ANH-3 Avista's Response to UTC Staff Data Request No. 26

1 **I. INTRODUCTION**

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Q. Please state your name and business address.

A. My name is Aimee N. Higby, and my business address is 621 Woodland Square Loop SE, Lacey, Washington, 98503. My business mailing address is P.O. Box 47250, Olympia, Washington, 98504-7250. My business email address is aimee.higby@utc.wa.gov.

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

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

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

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

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

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

1 **Q. Have you testified previously before the Commission?**

2 A. No.

3

4 **II. SCOPE AND SUMMARY OF TESTIMONY**

5

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

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

14

15 **Q. Please summarize your recommendations.**

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

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

1 million. The Company initially included 17 projects with forecasted totals through
2 2019 of \$84.9 million. No O&M offsets are included for these two projects.

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

8

9 **III. COMMISSION RATEMAKING POLICY AND STANDARDS**

10

11 **A. Background**

12

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

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

17

18 **Q. Please describe the modified historical test year component.**

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

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

1 practical value of the historical test year is that the cost, revenue
2 and plant data are available for audit, and the test year captures the
3 complex relationships among the various aspects of utility costs,
4 revenue, load, and other factors over a uniform period of time.¹
5

6 As a single look at the costs, revenue, load, and other factors in a specific time
7 period, the Commission allows certain restating adjustments. These adjustments to
8 the test year capture changes between actual test year results and results under
9 “normal” circumstances.
10

11 **Q. Please describe limited pro forma adjustments.**

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

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

¹ *Wash. Utils. & Transp. Comm’n. v. Avista Corp.*, Dockets UE-160228 & UG-160229, Order 06, p. 47, ¶ 80 (Dec. 15, 2016).

² WAC 480-07-510(3)(c)(iii).

1 However, whether a post-test year project warrants pro forma treatment
2 typically depends on whether the project is determined to be “major.” In the next
3 section, I discuss this criterion, as well as other criteria commonly employed by the
4 Commission to determine whether a project is appropriate for pro forma treatment.
5

6 **B. Commission Standards for Pro Forma Adjustments**
7

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

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

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

21 I discuss these standards individually below.

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1. Known and Measurable and Offsetting Factors

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

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

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

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

A. The Commission’s rules on pro forma adjustments⁴ yields the first two standards used by the Commission to determining the appropriateness of rate base additions: the known and measurable standard and the offsetting factors standard.

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

A. The Commission has stated:

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

³ WAC 480-07-510(3)(c)(ii).

⁴ *Id.*

⁵ This is also known as the “rate year.”

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

7
8 **Q. What are the practical implications of the known and measurable standard?**

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

13
14 **Q. What is the importance of offsetting factors in pro forma adjustments?**

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

22

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

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

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

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

8

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

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

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

19

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

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

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

6 2. Used and Useful Standard

7
8 **Q. What is the Commission’s used and useful standard?**

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

14
15 **Q. What is the importance of the used and useful standard?**

16 A. The Commission’s interpretation of the used and useful provides important and
17 necessary boundaries for what plant is allowed into rates. The used and useful
18 standard also yields the existing ratemaking framework by providing a foundation
19 for the Commission to “ascertain or determine the fair value for rate making
20 purposes of the property of any public service company.”¹⁰

21

⁸ Avista GRC 2009 at p. 22, ¶ 48.

⁹ *Wash. Utils & Transp. Comm’n v. Pacific Power & Light Co.*, Docket UE-050684, Order 04, pp. 21-22, ¶ 50 (Apr. 17, 2006).

¹⁰ RCW 80.04.250(2).

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

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

7

8 **3. Prudency Standard**

9

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

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

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

17

18 To evaluate prudence, the Commission has clearly articulated appropriate

19 parameters:

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

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

1 considered in the continuum of the specifics of the terms of the contract at
2 issue.¹²
3

4 These questions are the basis for determining eligibility rate recovery of a
5 project.
6

7 **Q. What are the practical implications of the prudence standard?**

8 A. Providing evidence in line with the Commission’s parameters is grounded in an *ex*
9 *post facto* review of what was known at the time of the decision. This is a core
10 component of the regulatory framework and is the cause of regulatory lag, which I
11 discuss later. Given that prudence reviews are after-the-fact, forecasted rate base
12 additions cannot, by definition, meet the Commission’s standard for prudence.
13

14 **4. Materiality Standard**
15

16 **Q. What is the Commission’s materiality standard?**

17 A. The Commission has indicated that proposed plant additions need to meet a
18 “reasonable definition of ‘major,’”¹³ essentially limiting rate base additions that
19 occur after the test period to those that have a meaningful financial impact on the
20 Company.

¹² *Id.* at p. 34, ¶ 95 (internal citation omitted).

¹³ *Wash. Utils. & Transp. Comm’n v. Pacific Power & Light Co.*, Docket UE-140762, Order 08, p. 13, ¶ 170 (Mar. 25, 2015).

1 **Q. What is the importance of the materiality standard?**

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

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

18

¹⁴ *Wash. Utils. & Transp. Comm’n v. Avista Corp.*, Dockets UE-150204 & UG-150205, Order 05, p. 17, ¶ 40 (Jan. 6, 2016) (“Avista GRC 2015”).

¹⁵ *Wash. Utils. & Transp. Comm’n v. Pacific Power & Light Co.*, Docket UE-130043, Order 05, p. 79, ¶ 198 (Dec. 4, 2013).

1 **Q. How has the Commission applied the materiality standard?**

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

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

12
13 As the Commission has indicated, WAC 480-140-040 is the only directly
14 applicable legal standard for what constitutes a major project.¹⁶ Moreover, the
15 Commission has found the five-tenths of one percent threshold reasonable within the
16 context of a general rate case, observing that:

17 [The five-tenths of one percent threshold] has ... the advantage of being
18 proportional to the size of the Company's rate base and therefore relevant to
19 the issue of the financial impact on the Company in the setting of rates.¹⁷
20
21

22 **IV. RECOMMENDED MODIFICATION TO THE MATERIALITY STANDARD**

23
24 **Q. Do you recommend the materiality standard be modified?**

25 A. Yes. I propose that short-lived assets be included in the materiality standard.
26

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

¹⁷ Avista GRC 2015 at p. 17, ¶ 40.

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

2 A. Yes. I rely specifically on the Commission’s statement that major projects are
3 “relevant to the issue of the financial impact on the Company in the setting of
4 rates.”¹⁸

5
6 **Q. Why do you recommend modifying the materiality standard?**

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

16
17 **Q. Why is this a problem?**

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

¹⁸ *Id.*

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

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

7
8 **Q. How are serial rate cases used to reduce regulatory lag?**

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

16
17 **Q. How does your proposed modification address this problem?**

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

23

1 **Q. How does this improve the Commission’s ability to review pro forma capital**
2 **additions?**

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

14
15 **Q. Do you recommend establishing a specific threshold for determining what**
16 **qualifies as a short lived asset?**

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

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

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

- 5 1. 0.5 percent of net plant in service (i.e. the traditional definition of a “major”
6 project); or
- 7 2. A depreciable life of 6 years or less.

8

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

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

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

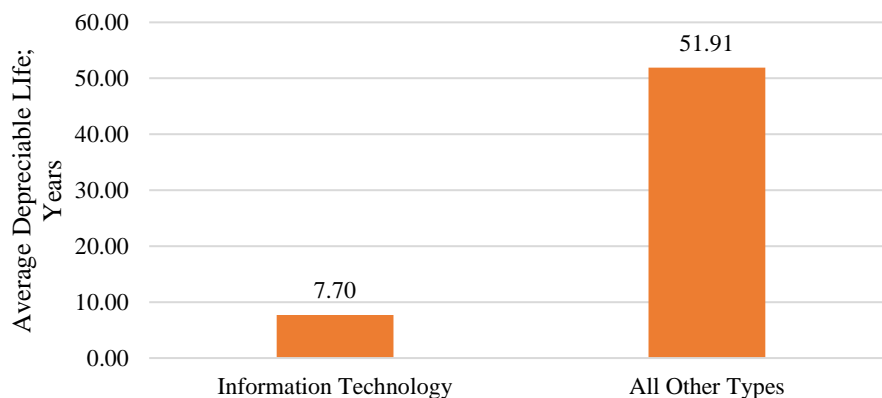
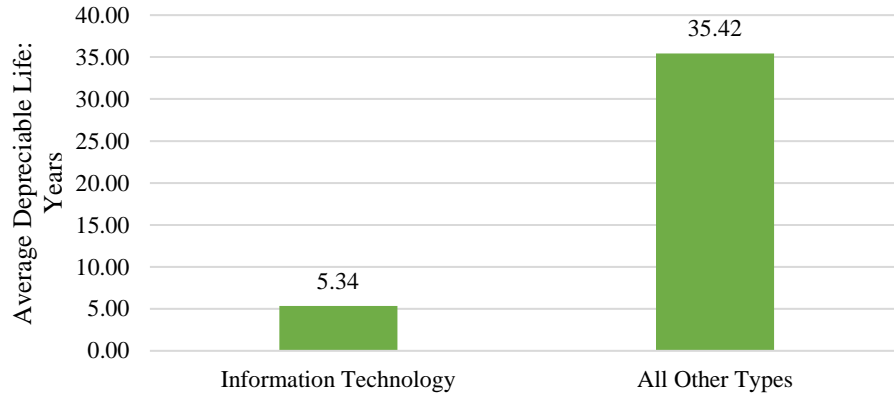


Figure 2
Natural Gas Average Depreciable Life: IT vs. All
Other Types of Capital Additions



1 **V. STAFF APPLICATION OF POLICY TO PRO FORMA ADJUSTMENTS**

2

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

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

7 1. Known and Measurable Standard – Staff applied a cut-off date of July 31,
8 2019 to evaluate projects and programs.

9 2. Offsetting Factors Standard – Offsetting factors were considered and
10 included for the projects and programs that Staff includes in the pro forma
11 adjustment.

12 3. Used and Useful Standard – Staff applied a cut-off date of July 31, 2019 to
13 evaluate projects and programs.

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

11

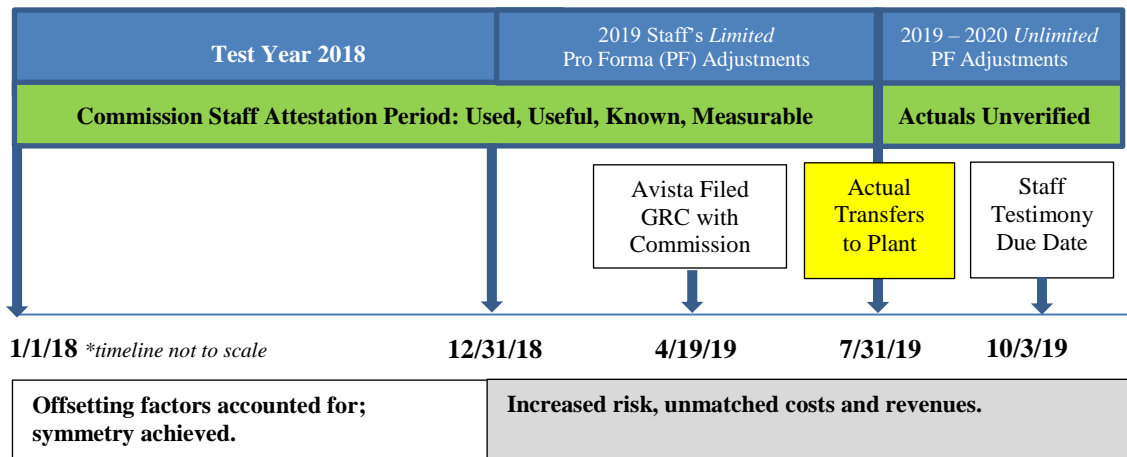
12 **Q. Why does Staff’s pro forma plant adjustments include transfers to plant only**
13 **through July 31, 2019?**

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

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

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

7 **Figure 3: Staff's 2019 Attestation Period**



1 **VI. STAFF ADJUSTMENTS TO PRO FORM CAPITAL ADDITIONS**

2

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

5

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

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

11

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

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

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

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

1 Staff's proposed adjustment is based on actual amounts transferred to plant-in-
2 service for each qualifying project. Avista's actual transfers to plant are included in
3 my Exh. ANH-2.²⁰

4

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

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

11

Table 3: Electric Adjustment 3.10
Avista vs. Staff Proposed

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

12

13

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

**Table 4: Gas Adjustment 3.10
Avista vs. Staff Proposed**

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

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

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

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

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

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

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

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

6

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

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

11

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

13 A. For electric operations, Staff eliminated Avista's proposed adjustment for Pro Forma
14 O&M Offsets (Adjustments 3.11). Avista initially proposed electric O&M offsets of
15 \$151,000 resulting in a revenue requirement increase of \$158,000.

16 For gas operations, Staff reduced the gas O&M offsets to roughly \$10,000
17 from Avista's proposed \$14,000, resulting in a revenue requirement increase of
18 \$5000.

19

**Table 5: Electric Adjustment 3.11
Avista vs. Staff Proposed**

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

1

2

**Table 6: Gas Adjustment 3.11
Avista vs. Staff Proposed**

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

3

4

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

6

ADDITIONS

7

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

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

1 Second, Avista adds a pro forma plant adjustment that includes projections
2 for 17 electric projects the Company expects to complete in 2019. This increases the
3 Company’s pro forma net electric plant balance by an additional \$84.9 million, and 9
4 gas projects, increasing Company’s pro forma net gas plant balance by an additional
5 \$26.5 million.

6

7 **A. Summary of Avista’s Proposal**

8

9 **Q. How does Avista define “major” projects?**

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

14

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

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

18

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

²¹ Schuh, Exh. KKS-1T at 8:14-9:1, n.12.

²² Schuh, Exh. KKS-1T at 6:17-19, 8:14-9:5.

²³ Schuh, Exh. KKS-1T at 9, Table 2.

1 A. Avista proposes an additional \$84.9 million for electric and \$26.5 million for gas
2 operations.²⁴

3

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

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

8 Neither the inclusion of only 5 projects nor, for that matter, the inclusion of
9 all 165 projects by Avista, are reasonable. Therefore, in order to reach a
10 sensible middle ground, Avista has employed a somewhat lower threshold
11 than the [0.5%] threshold. This middle ground limits the pro forma projects
12 included for 2019 to just 20 out 165 projects...all of which will be in service,
13 prior to rates going into effect.²⁵
14

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

17

18 **Q. How did Avista arrive at a \$5 million system-level threshold for determining**
19 **whether a project is a “major” project?**

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

²⁴ *Id.*

²⁵ Schuh, Exh. KSS-1T at 8:17-9:3 (emphasis omitted).

²⁶ Schuh, Exh. KSS-1T at 10:5-9.

²⁷ See Exh. ANH-3 to further see the lack of principle used to determine the \$5 million system level threshold.

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

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

5
6 **B. Staff Response to Avista’s Recommendation**

7
8 **Q. Is Avista’s definition of what constitutes a “major” project reasonable?**

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

14 Avista is correct in stating the Commission does not employ the use of a
15 bright line standard. However, the Commission has relied on and accepted the 0.5
16 percent threshold largely because this threshold is tied to the concept of materiality,
17 noting that it is “proportional to the size of the Company’s rate base and therefore
18 relevant to the issue of the financial impact on the Company in the setting of rates.”²⁸
19 Avista has failed to provide any reasonable justification for rejecting the
20 Commission’s materiality standard, and has failed to explain how the Company’s
21 own definition of a “major” project bears any relationship whatsoever to materiality.

22

²⁸ 2015 Avista GRC at p. 17, ¶ 40.

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

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

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

14
15 **Q. What is the risk of accepting Avista's proposed major pro forma programs and**
16 **projects through December 2019?**

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

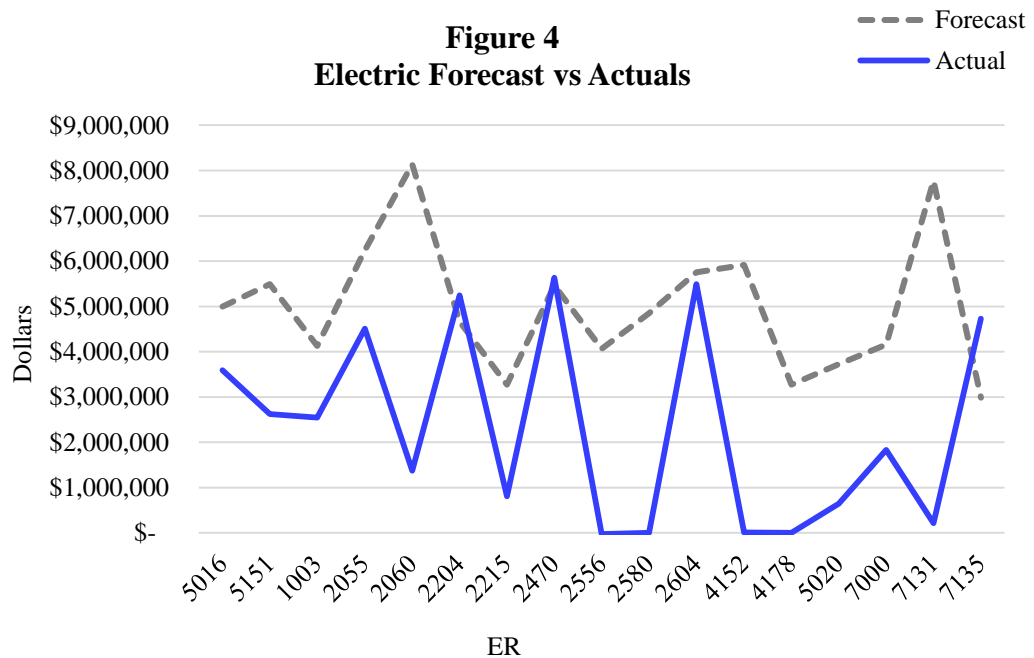
21 Second, accepting projects using Avista's definition of materiality, and
22 adding discrete project after discrete project, would severely undermine the concept
23 of materiality as an element of the Commission's pro forma standard. Moreover,

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

3

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

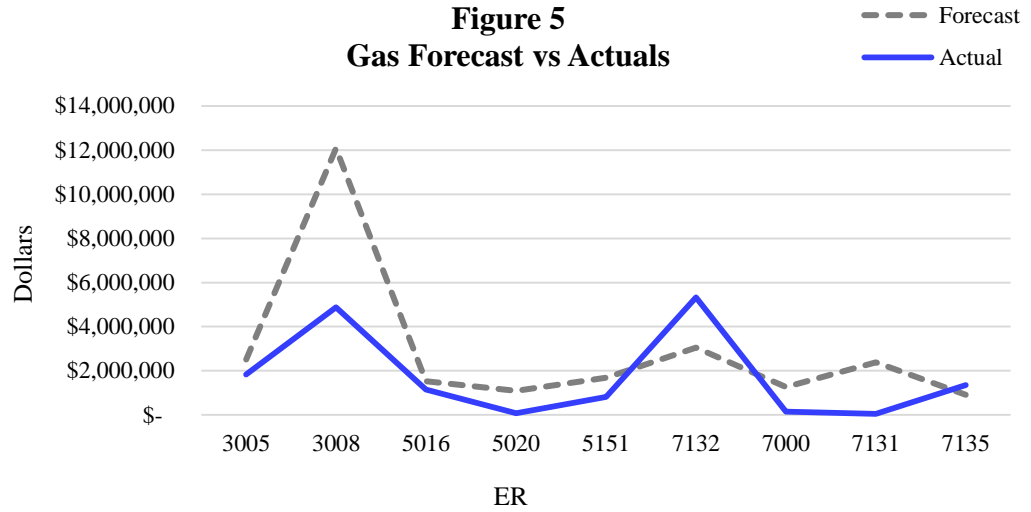
6 A. Very little. Using the actual dollar amount transferred to plant through July 31, 2019,
7 Avista’s forecast of plant in service is incorrect by an average of 62% for electric
8 projects and incorrect by an average of 57% for natural gas projects. The figures
9 below summarize these differences by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



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11

**Figure 5
Gas Forecast vs Actuals**



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

3

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5 **Q. Does this conclude your testimony?**

6 **A. Yes.**