

Exhibit No. ___ T (TWZ-1T)

Docket UE-130043

Witness: Zawislak

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

**PACIFICORP D/B/A PACIFIC POWER
& LIGHT COMPANY,**

Respondent.

DOCKET UE-130043

TESTIMONY OF

Timothy W. Zawislak

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

*Investor-Supplied Working Capital
and
Miscellaneous Rate Base Adjustments*

June 21, 2013

TABLE OF CONTENTS

I. INTRODUCTION 1

II. SCOPE AND SUMMARY OF TESTIMONY 2

III. INVESTOR-SUPPLIED WORKING CAPITAL 4

IV. REFINEMENT FOR POST-RETIREMENT BENEFITS 7

V. REFINEMENT FOR DERIVATIVES 8

VI. RESULTING UNCONTESTED ADJUSTMENTS 9

List of Exhibits

Exhibit No. ____ (TWZ-2), Balance Sheet Approach Summary

Exhibit No. ____ (TWZ-3), Investor-Supplied Working Capital Calculation Details

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Timothy W. Zawislak. My business address is the Richard Hemstad
5 Building, 1300 S. Evergreen Park Drive S.W., Olympia, WA 98504.

6

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

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

11

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

13 A. I have been employed by the Commission for over 23 years.

14

15 Q. What are your educational qualifications and work experience?

16 A. In December 1989, I earned a Bachelor of Arts degree in Accounting from Saint
17 Martin's College. In January 1990, I began my career with the Commission.

18 My experience at the Commission has included providing expert witness
19 testimony on accounting issues and issues specific to telecommunications, such as
20 Access Charges, Extended Area Service (“EAS”), Inter-carrier Compensation
21 (“ICC”), Payphone Deregulation, Toll Imputation, and Universal Service.

22

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

2 A. Yes. I have submitted testimony in the following Commission dockets: UT-950200
3 (U S WEST Communications, general rate case accounting issues), UT-940701 (U S
4 WEST Communications, sale of rural exchanges), UT-921259 (Toledo Telephone
5 Company, EAS), UT-970658 (U S WEST Communications and GTE Northwest
6 Inc., Payphone Deregulation), UT-980311(a) (Telecommunications General,
7 Universal Service); UT-990672 (GTE Northwest Inc., Access Charges), UT-020406
8 (Verizon Northwest Inc., Access Charges, Universal Service, and Toll Imputation);
9 UT-031472 (WECA, VoIP, and ICC), UT-040788 (rate design in the interim rate
10 relief phase, revenue requirement adjustments in the revenue requirement phase, and
11 Interim Terminating Access Charge in the permanent rate design phase), and UG-
12 080546 (Staff lead witness in the Northwest Natural Gas Company general rate
13 case).

14 I have also participated on the Staff teams for Telecommunications Generic
15 Cost proceedings, including Dockets UT-960369, *et al.*, UT-003013, UT-023003,
16 and UT-033034. Additionally, I was the Staff lead in Docket UT-970325, which
17 was a rulemaking that established WAC 480-120-540, Terminating Access Charges.
18 I am currently the Staff lead for the CenturyLink Alternative Form of Regulation
19 proceeding in Docket UT-130477.

20

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

22

23 **Q. What is the purpose of your testimony?**

1 A. I respond to Mr. Douglas K. Stuver who addresses working capital on behalf of
2 PacifiCorp, d/b/a Pacific Power & Light Company (“PacifiCorp” or “Company”) in
3 this case. I also address the following adjustments that are impacted by the treatment
4 of working capital: 1) Adjustment 8.13, Working Capital; 2) Adjustment 8.5/8.5.1,
5 Miscellaneous Rate Base Adjustment; and 3) Adjustment 8.1, Jim Bridger Mine Rate
6 Base.

7
8 **Q. Please summarize Mr. Stuver’s testimony regarding working capital.**

9 A. Mr. Stuver adopts the investor-supplied working capital (“ISWC”) methodology,
10 which he acknowledges the Commission has adopted as the most appropriate
11 methodology for determining working capital.¹ However, he also proposes two
12 refinements to the calculation of ISWC involving: (1) pensions and other post-
13 retirement benefit liabilities including the associated regulatory assets (collectively,
14 “post-retirement benefits”); and (2) derivative assets and liabilities.

15 The result of his calculation of ISWC is a \$28.5 million addition to
16 PacifiCorp’s rate base for its Washington operations, as reflected in Adjustment
17 8.13, Investor Supplied Working Capital.

18
19 **Q. Do you agree with the refinements Mr. Stuver proposes?**

20 A. Yes. Mr. Stuver’s treatment of post-retirement benefits achieves a proper balance of
21 ratepayer interests and allows investors to earn a return on the net unamortized funds
22 they have contributed to Company employees’ post-retirement benefits.

¹ Stuver, Exhibit No. __ (DKS-1T) at 1:22-2:3. See also *WUTC v. PacifiCorp*, Docket UE-100749, Order 06 at ¶291 (March 25, 2011).

1 Mr. Stuver's treatment of derivatives properly protects ratepayers by keeping
2 these risky investments from having any impact on rates, which is consistent with the
3 Commission's Order Granting PacifiCorp's Accounting Petition in Docket UE-
4 010453.

5 Therefore, Adjustment 8.13 is uncontested as between Staff and the
6 Company.

7
8 **Q. Have you prepared any exhibits in support of your testimony?**

9 A. Yes. Exhibit No. ___(TWZ-2) is a one-page summary of the ISWC balance sheet
10 approach. Exhibit No. ___(TWZ-3) is a more detailed four-page analysis including
11 the calculation of ISWC and its allocation to Washington operations.

12
13 **III. INVESTOR-SUPPLIED WORKING CAPITAL**

14
15 **Q. Please generally describe working capital and its significance in ratemaking.**

16 A. Working capital is a measure of financial liquidity reflecting a company's ability to
17 meet its day-to-day operational requirements inherent in a business cycle. A
18 business cycle is made up of three basic stages – production, sales, and collection of
19 revenue from customers. The costs of production and sales are incurred prior to
20 collection of the related revenues. Working capital represents the funds needed by a
21 company to pay its current obligations while waiting for payment from its customers.

22 From the regulatory perspective, ISWC is measured to quantify that portion
23 of working capital that has been provided by investors. This measured amount is

1 then included in rate base in order to provide a return on this investment for the
2 Company's ongoing sustainability.

3
4 **Q. You stated earlier that PacifiCorp used the ISWC method to calculate its**
5 **working capital adjustment. Please explain the ISWC method.**

6 A. Broadly speaking, the ISWC method, or "balance sheet" approach, measures the
7 amount of invested capital provided by investors and available for the Company's
8 use, over and above the Company's investments in operating plant, non-operating
9 plant, and other specific items of investment. The excess of invested capital over
10 total investment represents ISWC. Essentially, this is the inverse of the typical
11 accounting formula for working capital which is current assets minus current
12 liabilities. However, the ISWC method allows for a more precise recognition of the
13 amount that investors have supplied by looking at the remaining aspects of the
14 balance sheet which are long-term assets, long-term liabilities, and owners' equity.

15 For PacifiCorp, ISWC is first derived as a total Company amount, which is
16 then allocated to the unadjusted results of operations for Washington using outputs
17 from the West Control Area inter-jurisdictional allocation methodology.

18 My exhibits detail the approach as applied in this case and show that the
19 ISWC method is a comprehensive analysis based upon a full review of the
20 Company's balance sheet. Exhibit No. ___(TWZ-3), page 4, summarizes the
21 calculations to arrive at a Washington-allocated basis.

22

1 **Q. Is the Company's ISWC calculation performed on an Average of Monthly**
2 **Averages ("AMA") basis?**

3 A. Yes.² This is appropriate because AMA balances for rate base, including ISWC, are
4 an important tool used to correlate the balance sheet with the income statement by
5 averaging the balances over the course of the year. This follows the matching
6 principle of ratemaking, which traditionally represents the relationship of revenues,
7 rate base, and expenses for the historic test period results of operations. Staff
8 witness Betty Erdahl elaborates on the use of AMA balances and the matching
9 principle in her testimony.

10

11 **Q. What effect does ISWC have on PacifiCorp's rate base?**

12 A. Based on the last litigated general rate case (Docket UE-100749), the calculation
13 adopted by the Commission³ (*which used the AMA test period for the twelve months*
14 *ended December 31, 2009*) resulted in a negative working capital adjustment of \$7
15 million on a Washington-allocated basis. Based on the AMA test period in the
16 instant case (*using the test period twelve months ended June 30, 2012*), the
17 calculation results in a positive working capital adjustment of \$7 million, also on a
18 Washington-allocated basis, using the same classifications (*with updated balances*).

² Stuver, Exhibit No. ___ (DKS-1T) at 4:17.

³ See Mr. Thomas E. Schooley's Exhibit No. TES-2 in Docket UE-100749. That calculation resulted in a negative \$7,023,737 working capital adjustment, on a Washington-allocated basis. Nonetheless, Appendix I of the Initial Brief, filed on February 11, 2011, on behalf of Commission Staff, reflected a zero value in its revenue requirement summary, and the Commission Order at ¶296 incorporated this zero value recommendation. The use of a zero value, instead of the negative \$7 million that the calculation produced, indicates that the overall magnitude was relatively minor and was not unreasonable due to the gradual changes in the make-up of the Company's balance sheet over time. Indeed, this was less than one percent of the Company's rate base. The important thing to recognize here is that the Commission, at the same time, accepted the calculation and its methodological basis, for purposes of that case. The Company is using the same ISWC methodology in this case, with refinements that Staff does not contest.

1 In this case, with the refinements that the Company is proposing, the
2 calculation based on the same methodology results in a positive working capital
3 adjustment of \$28.5 million on a Washington-allocated basis.
4

5 **IV. REFINEMENT FOR POST-RETIREMENT BENEFITS**
6

7 **Q. What refinement to the ISWC calculation does Mr. Stuver propose regarding**
8 **post-retirement benefits?**

9 A. Mr. Stuver proposes that the regulatory assets and liabilities for post-retirement
10 benefits (along with the associated accumulated deferred federal income tax
11 balances) be included in the current assets and current liabilities columns of the
12 ISWC calculation rather than in the investment columns where they resided in the
13 last litigated rate case. The resulting impact is a \$7.5 million increase in Washington
14 ISWC.
15

16 **Q. Why do you agree with Mr. Stuver's proposal for post-retirement benefits?**

17 A. As Mr. Stuver explains in his direct testimony beginning at page 7, line 18, this
18 proposal allows the Company to earn a return on its shareholders' contributions that
19 remain unrealized due to the way in which expenses are accrued.

20 Reclassifying post-retirement benefits to the current assets and liabilities
21 columns is also consistent with Commission precedent in Docket UT-950200. In
22 that case, the Commission allowed U S WEST Communications, Inc. a \$70 million

1 increase in rate base for the prudently incurred Pension Asset (offset by a \$38
2 million decrease in rate base as a result of a negative ISWC calculation).⁴

3 Mr. Stuver's proposed treatment has the added benefit of including both
4 adjustments within the single, self-contained, calculation of ISWC.

5 I have highlighted the changes that result from the treatment of post-
6 retirement benefits in Exhibit No. ___ (TWZ-3).⁵

7
8 **V. REFINEMENT FOR DERIVATIVES**

9
10 **Q. What is Mr. Stuver's proposal regarding derivatives?**

11 A. Mr. Stuver proposes that derivatives, on a net basis, be included in the investments
12 column (as non-operating or "non-utility" investment) rather than the current assets
13 and current liabilities columns. The resulting impact is a \$14 million increase to
14 Washington ISWC.

15
16 **Q. Why is Mr. Stuver's proposal for derivatives appropriate?**

17 A. This refinement is consistent with the accounting order in Docket UE-010453.⁶ The
18 Order authorized the establishment of a regulatory asset or liability to account for the
19 effects of certain derivative and hedging accounting rules. Paragraph 7 of that Order

⁴ *WUTC v. US WEST Communications, Inc.*, Docket UT-950200, Fifteenth Suppl. Order at 70 (April 11, 1996).

⁵ Zawislak, Exhibit No. ___ (TWZ-3), lines 73, 83, 123, and 160.

⁶ *In the Matter of the Petition of PacifiCorp for an Accounting Order Authorizing the Establishment of a Regulatory Asset or Liability to Account for the Effects of Certain Derivative and Hedging Financial Accounting Rules*, Docket UE-010453, Order Granting Accounting Petition (April 25, 2001).

1 makes clear that the future non-cash impacts based on that accounting should be
2 excluded from cost of service:

3 Therefore, the Commission accepts the proposed accounting for derivatives and
4 hedging activities as contained in PacifiCorp's petition. Acceptance of the
5 accounting treatment of these activities in no way makes determination on the
6 prudence of any energy contract or derivative for rate making purposes. The
7 future non-cash impacts of the accounting convention imposed by FAS 133/138
8 will be excluded from the Commission's determination of cost of service with
9 respect to the contracts.
10

11 Whether the Company finds itself in a net gain or net loss position on the balance
12 sheet is almost entirely dependent upon the timing of the valuations presented on the
13 balance sheet. Therefore, including these impacts in ISWC would artificially
14 overstate or understate rate base. The refinement Mr. Stuver proposes for derivatives
15 protects ratepayers from the unintended consequence of potential losses by allocating
16 these items to "non-utility" investments. In this way, the Commission can be assured
17 that a double-recovery (or, conversely, a double-penalty, as in this case) will be
18 avoided.

19 I have highlighted the changes that result from the treatment of derivatives in
20 Exhibit No. ____ (TWZ-3).⁷
21

22 VI. RESULTING UNCONTESTED ADJUSTMENTS

23

24 **Q. Does Adjustment 8.13, Investor Supplied Working Capital, proposed by the**
25 **Company reflect Mr. Stuver's calculation of ISWC with his refinements that**
26 **you have accepted?**

⁷ Zawislak, Exhibit No. __ (TWZ-3), lines 30, 126, and 145-147.

1 A. Yes. Adjustment 8.13 is, therefore, uncontested as between Staff and PacifiCorp.

2

3 **Q. Are there other adjustments that are implicated by the treatment of ISWC?**

4 A. Yes. In this case, the Company excludes through Adjustment 8.5/8.51 miscellaneous
5 rate base items such as materials and supplies, prepayments, and fuel stock because
6 these items have already been incorporated through ISWC. Therefore, Adjustment
7 8.5/8.5.1, Miscellaneous Rate Base Adjustment is uncontested as between Staff and
8 PacifiCorp, as well.

9

10 **Q. Does Adjustment 8.1, Jim Bridger Mine Rate Base also exclude materials and**
11 **supplies?**

12 A. Yes. In the last litigated case, the Company included materials and supplies in its
13 Jim Bridger Mine rate base adjustment, which Staff contested. In the current case,
14 the Company has acquiesced to Staff's position by including materials and supplies
15 in the ISWC calculation rather than in Adjustment 8.1. Therefore, Adjustment 8.1 is
16 uncontested with respect to the treatment of materials and supplies. Adjustment 8.1
17 remains contested only in so far as Staff uses test year AMA balances and the
18 Company uses end-of-period balances. Staff witness Erdahl addresses that issue, as I
19 explained before.

20

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

22 A. Yes.