

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-090134

DOCKET NO. UG-090135

DOCKET NO. UG-060518

(consolidated)

REBUTTAL TESTIMONY OF

TARA L. KNOX

REPRESENTING AVISTA CORPORATION

1 **I. INTRODUCTION**

2 **Q. Please state your name, business address and present position with Avista**
3 **Corporation?**

4 A. My name is Tara L. Knox and my business address is 1411 East Mission Avenue,
5 Spokane, Washington. I am employed as a Senior Rate Analyst in the State and Federal
6 Regulation Department.

7 **Q. Have you previously provided direct testimony in this case?**

8 A. Yes. My testimony covered the Company's electric and natural gas cost of
9 service studies performed for this proceeding, the electric and natural gas revenue normalization
10 adjustments to the test year results of operations, and the proposed retail revenue credit rate to be
11 used in the Energy Recovery Mechanism.

12 **Q. What is the scope of your rebuttal testimony in this proceeding?**

13 A. My testimony addresses the Company position regarding the proper calculation of
14 the production property adjustment and the objections raised by Commission Staff. I also
15 provide an analysis of the Public Counsel and Staff versions of the adjustment.

16 **II. PRODUCTION PROPERTY ADJUSTMENT**

17 **Q. What is the production property adjustment and what is its purpose?**

18 A. The production property adjustment is designed to adjust pro forma rate year costs
19 to match historical test year billing determinants. The purpose is to provide a proper "matching"
20 of revenues, expenses and rate base for the test year ratemaking. Correctly applied, it allows
21 historical test year rates to recover expected rate year costs in the rate year.

1 The purpose of pro forma adjustments are to reflect the costs necessary to serve customers
2 during the rate year. However, retail rates are set based on the number of customers and their
3 usage during the historical test period. We know we will have additional customers, and
4 additional retail sales, in the future rate year as compared to the test year, which will provide
5 recovery of a portion of the pro forma period costs.

6 The production property adjustment reduces the pro forma rate year costs down to the
7 amount to be recovered by the historical test year customer sales level, thereby matching test year
8 rate base and expenses with test year revenue.

9 **Q. How does it work?**

10 A. A ratio is determined from the test year sales volumes divided by the pro forma
11 rate year sales volumes (test year load ratio). Since the test year sales volumes are less than the
12 rate year sales volumes, this ratio represents the percentage of pro forma rate year costs that
13 match with historical test year loads. In order to bring rate year costs back to the test year, total
14 pro formed costs are multiplied by the production factor (one minus the test year load ratio) to
15 compute the reduction.

16 **Q. What is the proper application of the production property adjustment?**

17 A. The production property reduction should be applied to costs that have been pro
18 formed to reflect what is expected to occur in the pro forma rate period. Historical test year rate
19 base and expenses do not require any adjustment in order to match historical test year revenues in
20 the revenue requirement determination, because they already have a proper matching with the test
21 year billing determinants. Consequently, if the production factor adjustment is applied to

1 historical test year costs that have not been pro formed to the rate year, it creates a mismatch for
2 ratemaking purposes. Therefore, the production property adjustment should only be applied to
3 rate base and net expense items that have been pro formed for the future rate year.

4 **Q. Do the parties in this case agree on some aspects of the production property**
5 **adjustment in this case?**

6 A. Yes. All the parties agree that a production property adjustment completes the pro
7 forma adjustment process by reducing the pro formed costs for the rate year to the amount to be
8 properly collected from historical test year customer billing determinants. The parties are also in
9 agreement that the production property adjustment is dependent upon the final resolution of the
10 other production or transmission-related adjustments, and therefore must be updated upon final
11 resolution of the pro forma adjustments in this case. There is disagreement, however, regarding
12 whether it should be applied to all production and transmission costs even if they were not pro
13 formed to a future period, as well as the level of the adjustment factor if costs were only pro
14 formed part way to the rate year (i.e. December 31, 2009 rather than 2010).

15 **Q. How has the Company applied production property adjustment in this case?**

16 A. The Company's production property adjustment applies the production factor
17 reduction to those production and transmission costs which have been pro formed beyond the
18 historical test year. The production factor varies depending on the time period for which the
19 costs were pro formed, i.e., if costs were pro formed for 2010, they were adjusted back
20 approximately two years to the test period October 2007 to September 2008. If costs were only
21 pro formed to 2009, they were reduced through the production property adjustment back

1 approximately one year to the test period. If a cost has not been pro formed beyond the test
2 period, it is not included in the production property adjustment. Test year historical amounts
3 already have a proper matching with the test year billing determinants.

4 **Q. Are there many production or transmission costs that the Company has not**
5 **pro formed to a future period?**

6 A. No. In the Company's direct case, all production and transmission rate base was
7 pro formed to December 2009, and most production and transmission revenues and expenses
8 were pro formed to 2010 levels in the various pro forma adjustments. One example of expenses
9 that were not pro formed to the rate year are transmission operation and maintenance expenses
10 which results in these costs remaining at historical test period levels for ratemaking purposes.

11 **Q. When a cost is pro formed to a future period, is the production property**
12 **factor applied to the incremental change (the adjustment amount) or the total pro formed**
13 **cost?**

14 A. The Company adjustment is applied to the total future period pro formed cost. As
15 an example, the combined capital adjustments place total adjusted production and transmission
16 plant, related accumulated depreciation, deferred federal income tax, depreciation expense and
17 property taxes subject to the production factor reduction.

18 **Q. Staff witness Mr. Kermode objects to the Company production property**
19 **adjustment on the grounds that it “fails to match properly pro forma plant additions and**
20 **production related expenses with the test year” and “does not include production related**
21 **test year expenses or assets”. He also objects to the use of two load factors because it**

1 **supposedly “does not provide a matching of costs with rate year loads when rates will be in**
2 **effect”. Do you agree with his assessment?**

3 A. No. The Company’s calculation provides a proper matching of the pro formed
4 costs to the test year by using load adjustment factors that are directly related to the period for
5 which costs are pro formed. As I explained earlier, for those costs pro formed to 2010 the
6 production property factor that the Company applied appropriately reduced the 2010 pro forma
7 costs back to the October 2007 to September 2008 test year, based on the ratio of test year loads
8 to 2010 pro forma rate year loads. In the case of Avista’s rate base adjustments that were pro
9 formed to December 2009, the production property factor reduced the pro forma rate base from
10 2009 to the test year using 2009 loads versus test year loads¹. It is appropriate to apply a different
11 production property factor when the pro forma time frame is different. Costs that have not been
12 pro formed beyond the test year have an implied production factor of zero (test year load divided
13 by test year load equals one) which results in no adjustment.

14 **Q. Can you illustrate what happens when the production property adjustment is**
15 **applied to expenses that are already at the historical test period level?**

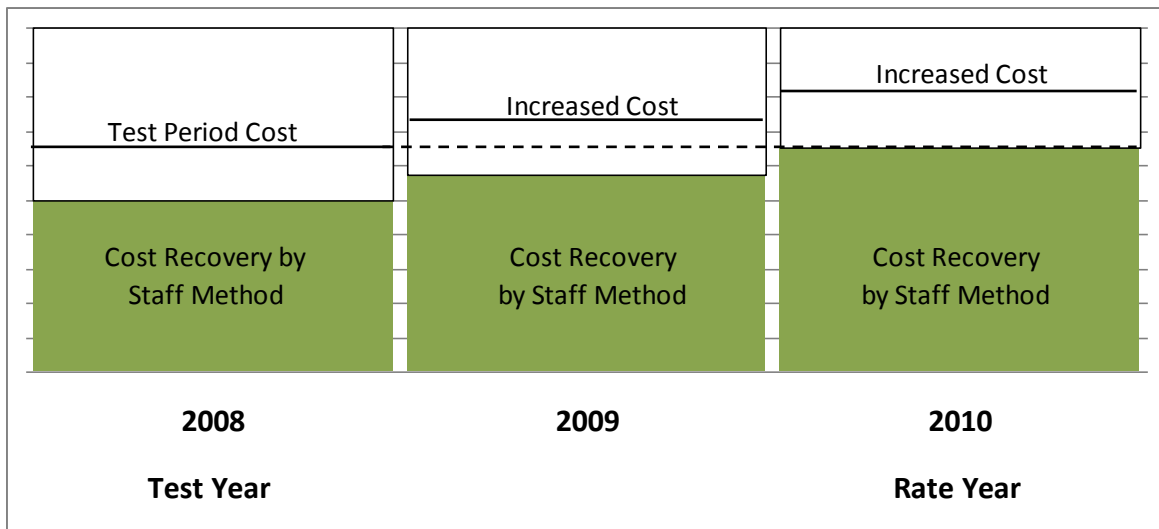
16 A. Yes. As I noted earlier, no pro forma adjustment was made for test period
17 transmission operation and maintenance expenses. If you apply the 2010 pro forma rate year
18 production factor to these test year costs, the amount included in the test year for ratemaking

¹ The Company acknowledges that there is a reasonable argument that the production property factor that should be applied to the Company’s 2009 ending balance rate base should be based on 12-months ended June 2010 loads as compared to test year loads, instead of 2009 calendar year loads compared to test year loads. Use of a production property factor based on 12-months ended June 2010 loads would have produced a net reduction to revenue requirement including the impact of debt synchronization of \$400,000. However, as the Company has explained in its testimony, the Company has understated its revenue requirement by not including pro forma rate base additions for 2010 and therefore an adjustment for the \$400,000 has not been reflected in the Company’s rebuttal case.

1 purposes is approximately 2% less than the actual test year expenses. When the future rate year
 2 occurs, if the expected loads materialize in 2010, the Company would only recover historical test
 3 year costs and no more. Since transmission operating and maintenance expenses are expected to
 4 be higher in 2010 than they were during the October 2007 to September 2008 test year, the
 5 Company would not have the opportunity to recover this additional cost through expected load
 6 growth.

7 As illustrated below, Staff’s application of the production property adjustment to test
 8 period costs, with no pro forma adjustment, results in cost recovery beginning at a level below
 9 the actual amount for the test period. As loads grow from the test period to the rate year, cost
 10 recovery reaches the historical test year level in 2010 and would not allow recovery of the
 11 increase in costs that will occur for transmission operation and maintenance expenses from the
 12 test year to the 2010 rate year.

13 Illustration 1



14

1 **Q. Did other parties object to the Company's approach to the production**
2 **property adjustment?**

3 A. They did not object to the process. Mr. Larkin of Public Counsel addressed the
4 production property adjustment. His concern appears to be that the adjustment should reflect
5 only the plant and expenses utilized in the calculation of power costs. His version of the
6 production property adjustment calculation shown on page 10 of Exhibit No.__(HL-3) uses the
7 Company methodology with pro formed values revised to reflect Public Counsel's other
8 recommended adjustments that affected production costs.

9 **Q. Was Mr. Larkin's production property adjustment consistent with his**
10 **testimony?**

11 A. From my understanding of his adjustments, no. For example, in regards to capital
12 additions, he correctly picked up his adjusted pro forma values, but he did not adjust the
13 production factor to match with the June 2009 AMA period that the production plant had been
14 adjusted to. Also, since he eliminated any transmission plant additions, I would have expected
15 the transmission rate base to have been excluded from the production property adjustment.

16 **Q. How does commission Staff approach the production property adjustment?**

17 A. The Staff uses a global approach which encompasses all production and
18 transmission costs included in the revenue requirement. The 2010 production factor is applied to
19 all production and transmission costs with no recognition that some of the costs reflect the
20 historical test year, and some reflect a 2009 pro forma period.

21 **Q. Was the Staff adjustment computed correctly, given their approach?**

1 A. No, even apart from the improper application of the production property
2 adjustment to all production and transmission costs, there were a number inconsistencies in the
3 application of their own calculations.

4 **Q. Please explain.**

5 A. The following discussion refers to the Exhibit No.__(DPK-6) Revised September
6 1, 2009. The first inconsistency pertains to the revenues that are included on line 1 (Per Results
7 Report) and the adjustment to those revenues on line 30 (PF1 Pro Forma Power Supply). On line
8 1, only Sales for Resale revenue is included in Mr. Kermode’s exhibit, whereas the power supply
9 adjustment on line 30 deducts both the change in Sales for Resale revenue and also the
10 elimination of Other revenue (primarily Sales of Gas Not Consumed). To be consistent, either
11 the \$27,028,000 needs to be included in the revenue value on line 1 or the “Other Revenue”
12 portion needs to be excluded from the power supply adjustment on line 30. The impact of this
13 inconsistency in the production property adjustment is Staff’s net income before tax was
14 overstated by \$540,000.

15 The second inconsistency also pertains to “Other Revenue”. Mr. Kermode picks up the
16 expense associated with the PF5 Pro Forma Transmission Adjustment on line 34, but does not
17 include the impact of Wheeling revenue in the pro forma adjustment nor the test year Per Results
18 amount. If the Wheeling revenue had been included in the production property adjustment, net
19 income before tax would have been lower by \$123,000.

20 A third inconsistency occurs on line 37 where the PF8 Noxon Generation adjustment
21 picks up all the rate base pieces, but no related expense. Inclusion of Noxon Generation

1 adjustment expenses in the production property adjustment would have increased net income
2 before tax by \$3,000. The combined impact of these three items would have changed the net
3 income before tax from \$4,733,000 to \$4,073,000. The resulting NOI adjustment should have
4 been \$2,647,000 instead of the \$3,077,000 shown on Exhibit No.__(DPK-2) page 8 (or a
5 \$690,000 increase in revenue requirement.

6 **Q. Were there problems with the rate base part of the adjustment as well?**

7 A. Yes. There were several errors or inconsistencies that impacted rate base.
8 Production related Deferred Federal Income Tax (DFIT) was included both on line 1 and again
9 on line 3. Since no DFIT is included in column b Per Results Report, the line 3 DFIT amount
10 should have been the -\$84,607,000 shown on line 1 with \$0 in the DFIT column on line 1. This
11 correction reduces rate base in the production property adjustment by \$1,179,000.

12 The PF6 Pro Forma Capital Addition 2008 adjustment was eliminated in Staff's
13 recommendation, however -\$7,750,000 in accumulated depreciation and -\$1,289,000 DFIT was
14 included on line 35. Correction of this inconsistency reduced rate base in the production property
15 adjustment by \$180,000.

16 The other inconsistencies occur in the cell formulas for accumulated depreciation Per
17 Results on line 1 and plant, accumulated depreciation, and deferred FIT for PF7 Pro Forma
18 Capital Additions 2009 on line 36. Production and transmission depreciation Per Results was
19 reduced by a portion of intangible amortization when no intangible plant was included.
20 Eliminating this item increases rate base in the production property adjustment by \$42,000.
21 Finally, in the 2009 Capital Additions line 36, transmission plant was not included and all

1 accumulated depreciation and DFIT was included even though a portion is related to distribution
2 plant. The impact of correcting for these inconsistencies is a reduction in rate base in the
3 production property adjustment by \$78,000. The combined impact of all the rate base errors is a
4 decrease to rate base of \$1,395,000 which reduces revenue requirement (at 8.25% rate of return
5 consistent with the partial settlement in this case) by \$185,000.

6 **Q. Are there any other problems with Mr. Kermode's production property**
7 **adjustment?**

8 A. Yes. The 2010 loads included in the Aurora modeling for the power supply
9 adjustment, and subsequently included in the partial settlement stipulation, were reduced by 3%
10 compared to the Company's original filing. Mr. Kermode has adjusted the "2010 WA retail load
11 in Power Supply" on line 52 by only 2.85% resulting in an understatement of the "Load-Adjusted
12 Production/Transmission Costs" on line 56 which in turn overstates the adjustment amount on
13 line 58. When a full three percent reduction is applied to 2010 forecasted Washington retail
14 loads, net income before tax is reduced by \$306,000 and net rate base is increased by \$891,000
15 resulting in an increase to revenue requirement of \$438,000.

16 **Q. What is the total impact of the corrections to Staff's production property**
17 **adjustment?**

18 A. The following table shows the impact of the cumulative effect of the corrections to
19 Staff's production property adjustment²:

20

² Revenue requirement calculations utilize the 8.25% rate of return agreed upon in the partial settlement and a 62.1901% conversion factor. The impact of debt synchronization is not included in these values.

\$000's	As Filed	Corrected	Change
Net Operating Income	\$3,077	\$2,449	-\$628
Rate Base	-\$10,501	-\$11,005	-\$504
Revenue Requirement	-6,301	-5,398	943

1

2 **Q. Have you prepared an Exhibit that shows Mr. Kermode's production**
3 **property adjustment calculation with all errors corrected?**

4 A. Yes. Exhibit No.__(TLK-9) is a corrected version of Staff Exhibit No.__(DPK-
5 6). The amounts in this Exhibit are representative of Staff's case, not the Company's.

6 **Q. The Company's rebuttal adjustments are different from the original filed**
7 **case. How has this changed the Company's calculation of the Production Property**
8 **Adjustment?**

9 A. I have prepared Exhibit No.__(TLK-10) which shows the calculation of the
10 production property adjustment for Ms. Andrews rebuttal revenue requirement. The input data
11 that has changed from the original filing is highlighted. One of the most important changes is the
12 level of pro forma 2010 loads that was adopted in the partial settlement stipulation. The rebuttal
13 power supply adjustment reflects Aurora modeling where system loads were reduced by 3% from
14 the original filing. In order to be consistent with the power supply assumptions, the forecasted
15 Washington jurisdiction 2010 retail sales volumes have been reduced by 3%. The 2009
16 forecasted loads were reduced by 1% resulting in just over half of the load growth between the

1 normalized test year and the revised rate year. The load calculations are shown on page 2 of this
2 exhibit.

3 **Q. Does this conclude your rebuttal testimony?**

4 A. Yes.