Exh. KMH-1T
Dockets UE-240006/UG-240007
Witness: Kristen M. Hillstead

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION,** **Respondent**	**DOCKETS UE-240006 & UG-240007 (Consolidated)**

TESTIMONY OF

KRISTEN M. HILLSTEAD

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Revenue Requirements: Electric and Natural Gas
Basic Charges: Electric and Natural Gas

July 3, 2024

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LIST OF EXHIBITS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kristen M. Hillstead, 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 email address is kristen.hillstead@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. I have been employed by the Commission since 1990.

Q. Would you please state your educational and professional background?

A. I received a Bachelor of Arts degree, with an emphasis in accounting, from The Evergreen State College in 1994. I have worked as a Regulatory Analyst since 1999, first in the Telecommunications Section and transferring to the Energy Regulation Section in July of 2013.

Q. Have you previously testified before the Commission?

A. Yes. I have filed testimony in a number of contested cases as well as presenting Staff's recommendation to the Commission in various open meeting agenda items.

II. SCOPE AND SUMMARY OF TESTIMONY

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

A. The purpose of my testimony is to present Staff's recommendations and calculations of Avista's revenue requirements for both the electric and natural gas operations for the rate year (RY) of 2025. My testimony also addresses the Company's proposed increases to its residential basic charges for both electric and natural gas service.

Q. Please summarize your recommendations.

A. Staff recommends a revenue increase of $8.3 million on electric operations for the 2025 rate year, as shown in Exh. KMH-2.[1] Staff also recommends a revenue increase of $11.3 million on natural gas operations for the rate year, as shown in Exh. KMH-8.[2] Staff's proposed revenue requirements are based on a 9.5 percent return on equity and a 7.18 percent overall rate of return.[3]

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

A. Yes. I prepared Exhibits KMH-2 through KMH-13.

- Exh. KMH-2 is Staff's proposed revenue requirement increase (electric)
- Exh. KMH-3 is Staff's revenue requirement calculation (electric)
- Exh. KMH-4 is Staff's conversion factor calculation (electric)
- Exh. KMH-5 – is a list of uncontested adjustments (electric)

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[1] Hillstead, Exh. KMH-2, column g, line 1.
[2] Hillstead, Exh. KMH-8, column g, line 1.
[3] Parcell, Exh. DCP-3, P 1.

- Exh. KMH-6C – is Avista's confidential response to UTC Staff DR No. 46C
- Exh. KMH-7 – is Avista's response to Public Counsel DR No. 297 with Attachment B (electric) and Attachment C (natural gas)
- Exh. KMH-8 – is Staff's proposed revenue requirement increase (natural gas)
- Exh. KMH-9 – is Staff's revenue requirement calculation (natural gas)
- Exh. KMH-10 – is Staff's conversion factor calculation (natural gas)
- Exh. KMH-11 - is a list of uncontested adjustments (natural gas)
- Exh. KMH-12 - is Avista's response to UTC Staff Data Request No. 211 requesting the Company provide the cost components of its electric residential basic charge
- Exh. KMH-13 - is Avista's response to UTC Staff Data Request No. 212 requesting the Company provide the cost components of its natural gas residential basic charge

Q. Please identify other witnesses that sponsor testimony that have an impact on the revenue requirement.

A. Staff witness Parcell discusses modifications to the Company's cost of capital for this case, and Staff witness Wilson addresses power cost issues.

III. REVENUE REQUIREMENTS

Q. Briefly describe Avista's request for additional revenues.

A. On January 18, 2024, Avista made the filing at issue here to address what it describes as a revenue insufficiency. The filing consists of a two-year rate plan for both its electric and natural gas operations. For the first rate year, 2025 (RY1), Avista seeks a revenue increase of $77.1 million for its electric operations and $17.3 million for its gas operations. For the second rate year, 2026 (RY2), the requested increases total $78.1 million for electric and $4.6 million for gas.[4]

Underlying Avista's requests for incremental revenues are a proposed capital structure comprised of 51.5 percent debt and 48.5 percent equity. Avista proposes a return on equity (ROE) of 10.4 percent. With the Company's cost of debt, these components result in a rate of return (ROR) of 7.61 percent.

Q. Did the Company provide any adjustments in support of its revenue requirement request?

A. Yes. Avista provided extensive testimony, exhibits, and workpapers identifying its proposed adjustments that derive the electric and natural gas revenue requirement requests of $79.3 million[5] and $17.3 million, respectively, for rate year 2025.

Q. Did Staff build its proposed revenue requirement off the workbook the Company submitted with its January 18, 2024, filing?

A. No. Staff discovered errors with the workbook during its review and asked Avista to correct those through an answer to a data request, specifically UTC Staff Data Request (DR) No. 117. Avista did so, providing a revised electric revenue requirement model that corrected a calculation error related to the Company's pro

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[4] Although Avista filed a 2-year multi-year rate plan, Staff is recommending that the Commission only approve revenue increases for the 2025 rate year. See BAE-1T, Staff's policy witness.
[5] Updated from the Company's initial request of $77.1 million to $79.3 million per UTC Staff DR No. 117.

forma power supply adjustment 3.00P, specifically cell AE17.[6] The revised revenue requirement model corrected this calculation error and removed the duplication of pro forma transmission revenue, which was already in adjustment 3.00T. With these changes, the Company's revised revenue requirement request increased to $79.3 million from its original request of $77.1 million, an increase of $2.2 million.

Q. Please explain how the revenue requirement is calculated.

A. The revenue requirement is calculated by first taking the Company's adjusted rate base and multiplying it by the proposed rate of return to produce the net operating income *requirement*. Second, the adjusted net income, i.e. prudently incurred expenses, is subtracted from the *required* net operating income to calculate the net operating income deficiency or sufficiency. The final step is to convert the Company's net income deficiency or sufficiency into its incremental revenue requirement by dividing the defined deficiency or sufficiency by the Company's conversion factor.[7]

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[6] The update made by the Company did not incorporate the portfolio forecast error of $65.8 million (system) in which Staff filed a motion for partial summary determination on March 20, 2024.

[7] For utility rate making purposes, the conversion factor, when applied to the net operating income, produces the necessary revenue requirement. The conversion factor takes into account factors such as uncollectible accounts, Commission regulatory fees, federal income tax, and the public utility tax. The conversion factor is unique to each company and is different in each general rate case, as well as for each type of service. Avista's conversion factor for electric service is 0.75248. See Schultz, Exh. KJS-2-Elec RR Model AMA 2025-2026-Long, Tab CF, cell E24. Avista's conversion factor for natural gas service is 0.752649. See Schultz, Exh. KJS-3-Nat Gas RR Model AMA 2025-2026-Long, Tab CF, cell E27.

A. Electric Revenue Requirement and Adjustments

Q. Please describe Staff's proposed electric revenue requirement.

A. Staff's electric revenue requirement model begins with Exh. KMH-2,[8] which incorporates all the moving pieces that generates Staff's proposed electric revenue requirement. This exhibit is based on Company witness Schultz's electric revenue requirement model, Exh. KJS-2 Elec RR Model AMA 2025-2026 Long as revised as Attachment B to UTC Staff DR No. 117.

Staff's electric revenue requirement calculation starts with Exh. KMH-2[9] at Column *b:* Actual Per Results Report (Results of Operations) for year ending June 30, 2023, with restated adjustments in Column *c*. Column *d*, Restated Results Total, is the sum of Column *b* and Column *c*. Column *e* contains all of the Pro Forma Adjustments (including Staff's contested adjustments), and Column *f* is the total of Column *d* plus Column *e*. Column *h* is the result of all of the proposed changes, including Staff's proposed revenue requirement of $8.3 million.[10] Revenue related expenses are also in Column *g.*

[8] Avista's electric revenue requirement model was corrected by UTC Staff DR No. 117, Attachment B.

[9] Exh. KMH-2 is one of three exhibits within a much larger and extensive workbook. To preserve the integrity of the workbook's content and avoid circular and reference errors, all the tabs have been maintained. For ease in reviewing the information, Staff's exhibits are at the front of the workbook and any modified adjustment workpapers that flow into the revenue requirement calculation are identified with purple tabs. At the time of preparing testimony, workpapers related to labor increases are confidential, therefore tab E-3.05,5.02 PF NE Labor is marked with a C, and has a yellow tab.

[10] Hillstead, Exh. KMH-2 column *g*, line 1.

Q. Please discuss how Staff developed its electric revenue requirement recommendation.

A. Staff uses the Company's updated electric revenue requirement model in response to UTC Staff DR No. 117 for analyzing the adjustments and making its recommendation.

Staff's recommendation for the Company's electric revenue requirements is based on a modified historical test year approach, with adjustments for known and measurable changes to the test year's results of operations,[11] as well as pro forma expense adjustments for 2024 and 2025, and concluding with provisional plant additions for 2025.[12]

Q. Did you prepare an exhibit that shows Staff's electric revenue requirement calculation?

A. Yes. The derivation of Staff's electric revenue requirement is provided in Exh. KMH-3 at line 7. Staff accepts the Company's methodology for calculating the conversion factor for its electric operations, at line 6, and has provided this calculation in Exh. KMH-4.[13]

Q. What is Staff's recommended revenue requirement for Avista's electric operations?

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[11] The Company's test year ended June 30, 2023.

[12] Staff witness Erdahl addresses Staff's concerns with the Company's labeling of pro forma plant additions for 2023 and 2024 versus provisional plant additions.

[13] This exhibit also contains the calculations for the revenue related expenses (column H) that flow back to Exh. KMH-2, column *g*, lines 15-27.

A. Staff's analysis, based on a modified historical test period with restated, pro forma, and provisional adjustments, results in a recommended revenue requirement of $8.3 million for the rate year, a reduction of $71.1 million from the Company's revised request. Staff's revenue requirement calculation incorporates Staff witness Parcell's recommended capital structure of 1.92 percent short-term debt, 49.58 percent long term debt, a 48.50 percent equity component with a recommended ROE of 9.5 percent. This capital structure results in a 7.18 percent overall rate of return.

Q. Please identify the electric adjustments that are uncontested by Staff.

A. Staff has provided a list of the uncontested adjustments, see Exh. KMH-5.

Q. Please identify the electric adjustments that are contested by Staff.

A. Table 1, below, identifies the adjustments that are considered contested due to Staff's proposed change to the Company's capital structure, and thus impact the electric revenue requirement.

Table 1 – Contested Adjustments due to Proposed Change in Capital Structure

Adjustment Number	Adjustment Name
1.00	Results of Operations
1.01	Deferred FIT Rate Base
1.03	Working Capital
1.04	Remove Colstrip
2.15	Restate Capital 06.2023 EOP
3.04	Pro Forma AMI Amortization
3.15	Pro Forma Capital Additions to 12.31.2023 EOP
3.17	Pro Forma Capital Additions to 12.31.2024 EOP
4.01	Provisional Capital Additions to 12.31.2025 AMA

Table 2, below, identifies the adjustments that are contested by Staff, which will be discussed in detail later in my testimony.

Table 2 – Contested Adjustments

Adjustment Number	Adjustment Name
3.00P	Pro Forma Power Supply
3.05	Pro Forma Labor Non-Exec
3.08	Pro Forma Incentives
3.14	Pro Forma Misc O&M Exp
3.23	Pro Forma PPA Interest

Q. What is the impact of the contested adjustments identified in Table 2 on Avista's electric net operating income and revenue requirement?

A. Staff's proposed adjustments on the Company's electric operations, increase the Company's net operating income (NOI) by $43.5 million thus reducing its revenue requirement by $57.9 million as shown in Table 3 below.

Table 3 – Impact of Contested Adjustments on NOI and Revenue Requirement

Contested Adjustments				
Adjustment Number	**Company**	**Staff**	**Change to Net Operating Income**	**Revenue Requirement**
3.00P	($18,201,000)	$15,253,000	$33,454,000	($44,459,000)*
3.05	(5,210,000)	(3,815,000)	1,395,000	(1,854,000)
3.08	(919,000)	0	919,000	(1,222,000)
3.14	(7,012,000)	143,000	7,155,000	(9,508,000)
3.23	(1,706,000)	(1,096,000)	610,000	(810,000)
Total Impact of Adjustments			$43,533,000	($57,853,000)

*Rounding

Q. What was the Company's proposal regarding Pro Forma Power Supply, Adjustment 3.00P?

A. As part of the Company's pro forma power supply adjustment, Avista identified a $65.8 million (system) "portfolio forecast error." The Company seeks to incorporate this "error" into its pro forma power supply adjustment, and recover the Washington portion from ratepayers. See Commission Staff's Motion for Partial Summary determination, filed March 20, 2024.

Q. What is Staff's proposal regarding this adjustment?

A. Staff recommends that the Commission reject the $65.8 million (system) portfolio forecast error as discussed in Staff witness Wilson's testimony.[14]

[14] Wilson, Exh. JDW-1T at 4:15-10:6.

Q. What was the Company's proposal regarding Pro Forma Labor Non-Exec, Adjustment 3.05?

A. In Avista's initial filing, the Company annualized the impact of the actual wage increases effective in March of 2023 for union and non-union employees. The Company's adjustment also included the 2024 non-union wage increase approved by the board of directors, effective March 2024, as well as the expected increase for 2025.[15]

Q. Were the union wage increases fixed at the time the Company made its filing?

A. No. Union employees' increases are made in accordance with contract terms. At the time the Company filed the GRC, Avista was in negotiations for the 2024 and 2025 merit increases for union employees. The Company's pro forma adjustment included wage increase estimates for its union employees for 2024 and 2025, and were comparable to the increases for non-union employees.

Q. What issues do those estimated union pay raises create?

A. The union pay increases were pro forma adjustments. The Commission requires that pro forma adjustments be known and measurable.

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[15] For both non-union and union employees, the 2025 pro forma wage increase component was proportionate, from the expected effective date of the increase to December 31, 2025.

Q. What is Staff's proposal regarding this adjustment?

A. Staff has no concerns with the non-union workers' 2023 annualized portion of the adjustment. However, in response to UTC Staff DR No. 46C,[16] the Company's board meeting minutes approved a wage increase effective March 1, 2024, and a wage increase effective March 1, 2025. The wage increases are slightly different than what the Company had originally pro formed for this adjustment in its initial filing. Therefore, Staff is making a pro forma adjustment to reflect the actual approved wage increases for non-union workers for 2024 and 2025.[17]

Staff similarly has no concerns with the union workers' 2023 annualized portion of the adjustment. However, the union increases for 2024 and 2025 cannot be quantified at this time because the contract has not been ratified. The Company had anticipated that the union contract would be approved prior to response testimony being filed with the union wage increases being known and measurable, unfortunately that has not transpired. Therefore, Staff removed the pro formed union wage increases for 2024 and 2025 from the adjustment. However, Staff would support including the 2024 and 2025 union wage increases in the revenue requirement on rebuttal should those increases become known.

Q. What was the Company's proposal regarding Pro Forma Incentives, Adjustment 3.08?

[16] See Confidential Exh. KMH-6C.

[17] The pro forma adjustment reflects the full amount of the increase for 2024 and 10 months of 2025, March 1, 2025 to December 31, 2025.

A. The Company restated the level of test year incentives (Adjustment 2.13) using the traditional six-year average methodology[18] of actual incentive expense.[19] However, Company witness Schultz does not believe that the six-year average amounts are representative of the level of incentive expense the Company is forecasting to incur in 2025. Ms. Schultz also stated that it cannot leave a combined $1.6 million incentive expense that is reasonably likely to occur in the rate effective periods on the “cutting room floor.”[20] Therefore, the Company is pro forming a forecasted amount of $1.2 million above what the restating adjustment provides.

Q. Does Staff agree with the Company’s rationale for this adjustment?

A. No. The Company’s proposal to increase the incentive expense above the six-year average methodology does not meet the Commission’s standard of a pro forma adjustment. As I noted above, pro forma adjustments are to be based on known and measurable events. The dollar amount must be concrete and not “an estimate, a projection, the product of a budget forecast, or some similar exercise in judgment – even informed judgment – concerning future revenue, expense, or rate base.”[21] Ms. Schultz has provided no evidence that the incentive payout amounts meet that standard.

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[18] The six-year average methodology was proposed by Staff and accepted by the Company in Dockets UE-170485 and UG-170486 (2017 GRC).
[19] Schultz, Exh. KJS-1T at 65:7-8.
[20] Schultz, Exh. KJS-1T at 65:13-14.
[21] Avista, Dockets UE-090134 & UG-090135 & UG-060581 (consolidated); Order 10, at 21 ¶ 45.

Q. What is Staff's recommendation regarding this adjustment, and why?

A. Staff has recommended disallowing Avista's proposed pro forma incentive adjustments in the past, and does so again. Avista's adjustment assumes that the forecasted incentive pay is certain, that it *is* known and measurable. However, the purpose of incentive pay is to reward better performance, as such, incentive payouts can only be known and measurable in retrospect, they cannot be speculative.

In Avista's 2017 GRC, the Company proposed both restating and pro forma incentive adjustments. These adjustments reflected the Company's targeted incentive payout based on budgeted projections from the Company's Human Resources. At that time, Staff found the Company's proposal flawed, and thus recommended using a six-year average of actual incentive payouts as the methodology for the incentive adjustment. The Company accepted Staff's proposed methodology as the basis for calculating its restated incentive adjustment.

In this current proceeding, Staff analyzed the Company's workpapers for its pro forma incentive adjustment. Between 2017 and 2022 (the six years that comprise the six-year average) Staff identified large variations between the Company's targeted payouts and actual payouts. In 2017 the actual payout was 122 percent of the target; however, in 2019, 2020, and 2022 the actual payouts were below the target: 93 percent, 44 percent, and 80 percent, respectively.[22] Therefore, Staff's recommendation is to disallow the pro forma adjustment, and maintain the level of incentive payout at the six-year average, as restated in Adjustment 2.13.

[22] In addition, the payout for 2018 was 120 percent of the target, and for 2021 the payout was 114 percent of the target.

The Company may be correct in its speculation that the incentive payout will be significantly higher than the six-year average. If that is in fact the case, the Company will have the opportunity to include the actual payout amount as part of the six-year methodology in a future GRC.

Q. What is the Company's proposal for Pro Forma Miscellaneous O&M Expense, Adjustment 3.14?

A. In the Company's initial filing, the Company proposed to apply an escalation factor to increase certain operations and maintenance (O&M) and administrative and general (A&G) expenses for 2025. Specifically, Avista applied an escalation factor of 15.76 percent to certain O&M and A&G expenses from the end of the test year (June 30, 2023) through the rate year (December 31, 2025) that were not otherwise pro formed in other adjustments.

The Company calculated the 15.76 percent escalation factor by first averaging the changes in its O&M expenses between 2018 to 2022.[23] The average was 6.3 percent (identified by the Company in testimony as an annual escalation rate). The Company then multiplied the 6.3 escalation rate by 2.5, which represents the number years from the end of the test year to the end of the rate year.

The Company modified its pro forma O&M calculation and included the 2023 adjusted O&M expenses as part of the equation in response to Public Counsel's

[23] The Company identifies these amounts in its workpapers/exhibit as "CBR Adjusted O&M."

DR No. 297.[24] Avista's response revised the average annual escalation to 4.57 percent and when multiplied by an escalation rate of 2 (representing the number of years from December 31, 2023 through to December 31, 2025) results in a final O&M escalation rate of 9.13 percent.

Q. Does Staff agree with the Company's proposal for this adjustment?

A. No. Again, this adjustment does not meet the Commission's standard of a pro forma adjustment – the escalated increase is not known nor is it measurable. In addition, the changes in the adjusted O&M expenses had significant fluctuations between 2018 and 2023, as shown in Table 4 below.

Table 4 – Percentage of Change in O&M Expense

	2018	2019	2020	2021	2022	2023
O&M	146,848	155,757	162,760	169,899	187,348	182,876
Percentage Change		6.07%	4.50%	4.39%	10.27%	-2.39%

Q. What is Staff's recommendation for this adjustment?

A. Because the Company failed to provide evidence that the O&M expenses will escalate at the level proposed in the rate year, Staff recommends including only the incremental known and measurable 2023 O&M expenses not already included in the Company's test year, and to disallow any escalation component.

[24] Avista's response to Public Counsel DR No. 297, Attachment B for electric and Attachment C for natural gas, tab 2018-2023 Data, clarifies for Staff how the Company calculated the CBR Adjusted O&M amounts that were provided in its workpapers, see Exh. KMH-7.

Q. What is the Company's proposal for Pro Forma Power Purchase Agreement Interest, Adjustment 3.23?

A. Avista's proposal for Adjustment 3.23, pro forma power purchase agreement (PPA) interest, is to use an interest rate of 7.61 percent. This rate represents the Company's proposed ROR.

Q. Does Staff agree with the Company's methodology for calculating this adjustment?

A. No. Staff does not agree that the Company should use an ROR of 7.61 percent for calculating the interest in its PPA adjustment. The 7.61 percent is a computation based on the Company's proposed capital structure which includes an ROE of 10.4 percent. Using a rate of 7.61 percent results in an inflated interest expense and thus a higher revenue requirement.

Q. Why does Staff disagree with the Company's methodology?

A. Staff has a few concerns with the Company's methodology for this adjustment. Again, as stated earlier in my testimony, pro forma adjustments are to be known and measurable, not assumptions. A second issue Staff has with the Company's use of 7.61 percent for this adjustment is that this rate of return has not been authorized by the Commission, and is solely based on the Company's proposed capital structure.[25]

[25] Per the settlement stipulation approved in Avista's 2022 GRC, Dockets UE-220053, UG-220054, UE-210853 *(Consolidated),* the Company's authorized rate of return is 7.03 percent.

Q. Please explain.

A. RCW 80.28.410[26] provides a couple of options that can be used to calculate the appropriate interest on a PPA. Subsection (2) allows an electrical company to include for later consideration by the commission certain costs, including, but not limited to, the cost of capital. Such costs of capital include the company's authorized return on equity, or a rate of return of no less than the authorized cost of debt and no greater than the authorized rate of return.

Q. What is Staff's recommendation for this adjustment?

A. The use of 7.61 percent is not appropriate for this calculation. Based on the language provided for in RCW 80.28.410 and prior Staff recommendations,[27] Staff recommends that the interest rate for this adjustment be at Avista's cost of long-term debt, per Staff witness Parcell's capital structure recommendations, which is 4.93 percent.[28] This is the appropriate rate to use because PPAs are contracts, not capital investments. In Staff's view, the lower end of the range should be used absent adequate justification by the Company for the use of the upper end of the range. The Company made no such justification.

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[26] RCW 80.28.410: Clean energy action plan—Account for and defer costs. (wa.gov).

[27] In Docket UE-230810, Puget Sound Energy's petition for an Accounting Order, PSE sought authorization to defer certain PPA costs, including the return on the PPAs at the company's authorized rate of return. In Staff's memo for the March 28, 2024, Open Meeting, Staff recommended the Commission order PSE to calculate the return using the company's authorized cost of debt. The Commission has not ruled on this recommendation as Docket UE-230810 has been consolidated with PSE's current GRC, Dockets UE-240004 and UG-240005.

[28] Avista's authorized cost of debt is 4.97 percent, as identified in Table 6 of Final Order 10/04 Dockets UE-220053, UG-220054, UE-210854 *(Consolidated).*

Q. Please provide a visual overview of Staff's recommendations on the Company's electric revenue requirement.

A. Table 5 below illustrates the Company's electric revenue requirement request, combined with the changes to the Company's capital structure and contested adjustments, as recommended by Staff.

Table 5 – Snapshot of Proposed Electric Revenue Requirement

Avista's revised revenue requirement (UTC Staff DR No. 117)	$79,342,000
Staff's contested adjustments' impact (Table 3)	(57,853,000)
Change from Avista's ROR of 7.61% to Staff's ROR of 7.18%	(13,199,000)
Staff's proposed revenue requirement	$8,290,000

B. Natural Gas Revenue Requirement and Adjustments

Q. Please describe Staff's proposed natural gas revenue requirement.

A. Staff's natural gas revenue requirement model begins with Exh. KMH-8, which incorporates all the moving pieces that generate Staff's proposed natural gas revenue requirement. As with the electric revenue requirement model, the natural gas model is based on Company witness Schultz's natural gas revenue requirement model, Exh. KJS-3 Nat Gas RR Model AMA 2025-2026 Long.[29]

[29] Avista's response to UTC Staff DR No. 117 made a correction that only impacted the electric revenue requirement model, it was not necessary for Avista to revise its natural gas revenue requirement model.

Staff's natural gas revenue requirement recommendation starts with Exh. KMH-8[30] at Column *b* and goes through the same process as Staff's electric revenue requirement calculation, ending with Column *h.* Column *g* of this exhibit contains Staff's proposed revenue requirement of $11.3 million[31] as well as the revenue related expenses.

Q. Did you prepare an exhibit that shows Staff's natural gas revenue requirement calculation?

A. Yes. The derivation of Staff's revenue requirement is provided in Exh. KMH-9 at line 7. Staff also accepts the Company's methodology for calculating its conversion factor for its natural gas operations and has provided this calculation in Exh. KMH-10,[32] noting again that the conversion factor is identical to what Avista filed in its initial case.

Q. What is Staff's recommended revenue requirement for Avista's natural gas operations?

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[30] As with the Exh. KMH-2, Exh. KMH-8 is one of three exhibits within a much larger and extensive workbook. To preserve the integrity of the workbook's content and avoid circular and reference errors, all the tabs have been maintained. For ease in reviewing the information, Staff's exhibits are at the front of the workbook and any modified adjustment workpapers that flow into the revenue requirement calculation are identified with purple tabs. At the time of preparing testimony, workpapers related to labor increases are confidential, therefore tab G-3.05, 5.02 PF NE Labors is marked with a C, and has a yellow tab.

[31] Hillstead, Exh. KMH-8 column g, line 1.

[32] This exhibit contains the calculations for the revenue related expenses (column I) that flow back to Exh. KMH-8, column g, lines 15-27.

A. As with Avista's electric operations, Staff's analysis of the Company's natural gas operations is based on a modified historical test period with restated, pro forma, and provisional adjustments for 2024 and 2025, and results in a recommended revenue requirement of $11.3[33] million for rate year 2025, a reduction of $6.0 million from the Company's initial request. Staff's natural gas revenue requirement calculation is again based on Staff Witness Parcell's recommended capital structure and a 7.18 percent overall rate of return.

Q. Please identify the natural gas adjustments that are uncontested by Staff.

A. Staff has provided a list of the uncontested adjustments, see Exh. KMH-11.

Q. Please identify the natural gas adjustments that are contested by Staff.

A. Table 6 below identifies the adjustments that are considered contested by Staff due to Staff's proposed change to Avista's capital structure, and thus have an impact on the natural gas revenue requirement.

Table 6 – Contested Adjustments due to Proposed Change in Capital Structure

Adjustment Number	Adjustment Name
1.00	Results of Operations
1.01	Deferred FIT Rate Base
1.03	Working Capital
2.15	Restate Capital 06.2023 EOP
3.04	Pro Forma AMI Amortization
3.15	Pro Forma Capital Additions to 12.31.2023 EOP
3.17	Pro Forma Capital Additions to 12.31.2024 EOP
4.01	Provisional Capital Additions to 12.31.2025 EOP

[33] Hillstead, Exh. KMH-8, column *g*, line 1.

Table 7, below, identifies the adjustments that are contested by Staff.

Table 7 – Contested Adjustments

Adjustment Number	Adjustment Name
3.05	Pro Forma Labor Non-Exec
3.08	Pro Forma Incentives
3.14	Pro Forma Misc. O&M Exp

Q. What is the impact of Staff's contested adjustments identified in Table 7 on Avista's natural gas net operating income and revenue requirement?

A. Staff's proposed adjustments on Avista's natural gas operations increase the Company's net operating income by $2.0 million thus reducing its revenue requirement by $2.6 million as shown in Table 8 below.

Table 8 – Impact of Contested Adjustments on NOI and Revenue Requirement

Contested Adjustments				
Adjustment Number	**Company**	**Staff**	**Change to Net Operating Income**	**Revenue Requirement**
3.05	(1,442,000)	(1,030,000)	412,000	(547,000)
3.08	(291,000)	0	291,000	(387,000)
3.14	(1,291,000)	(1,000)	1,290,000	(1,714,000)
	Total Impact of Adjustments		$1,993,000	($2,648,000)

Q. What is the Company's proposal regarding Adjustment 3.05 and Adjustment 3.08?

A. Avista's proposals for these adjustments are comparable to what the Company proposed for Adjustments 3.05 and Adjustment 3.08 on the electric side, which I discussed above in Section III A. of my testimony.

Q. What is Staff's recommendation for these adjustments?

A. To avoid being repetitive, Staff has the same recommendations for Adjustment 3.05 and Adjustment 3.08 as those discussed earlier in my testimony under Section III., and based on the same rationales.

Q. What is the Company's proposal regarding Adjustment 3.14?

A. Again, Avista's proposal for the natural gas O&M adjustment is the same as the electric adjustment, which is to escalate the 2018 – 2023 average expense.

Q. Please provide a table showing the changes in the natural gas O&M expenses between 2018 and 2023.

A. Table 9 below illustrates the fluctuations in the natural gas O&M expenses between 2018 and 2023.

Table 9 - Percentage of Change in Natural Gas O&M Expenses

	2018	2019	2020	2021	2022	2023
O&M	37,298	39,437	42,735	40,856	43,529	45,777
Percentage Change		5.73%	8.36%	-4.40%	6.54%	5.16%

Q. What is Staff's recommendation for this adjustment?

A. Staff's recommendation is to include only the incremental known and measurable O&M expenses from the end of the test year, June 30, 2023, to December 31, 2023.

There is a slight nuance between the Company's electric and natural gas pro forma O&M adjustments worthy of discussion. Unlike Adjustment 3.05 (pro forma labor) in which the Company uses the same non-union wage increase percentages between electric and natural gas, and the same union wage increase percentages between both industries, or Adjustment 3.08 (pro forma incentives) in which the Company allocated the total amount of the proposed pro forma incentive payouts between electric and natural gas based on specific allocation factors.

In Adjustment 3.14, the Company proposed a different escalation factor for the natural gas adjustment due to the differences in the annual O&M expenses between the two utilities, although the Company's process for computing the escalation factor was otherwise the same. Based on the Company's initial filing's workpapers, the average annual escalation rate for natural gas was identified as 4.57 percent. With the same 2.5 multiplier as electric, this equaled an O&M escalation factor of 11.44 percent (vs. the 15.76 percent on the electric side). As noted earlier in my testimony, the escalation rates were modified in response to Public Counsel DR No. 297. As a result, the Company changed the O&M escalation rate for natural gas from 11.44 to 8.56 percent based on a revised average annual escalation rate of 4.28 percent and a new multiplier of 2. Having said that, Staff's recommendation for this adjustment is to still allow only the incremental known and measurable 2023 O&M expenses not already included in the Company's test year and to disallow any escalation component.

Q. Please provide a visual overview of Staff's recommendations on the Company's natural gas revenue requirement.

A. Table 10 below illustrates the Company's natural gas revenue requirement request, combined with the Staff's recommendation to the Company's capital structure, and impact of contested adjustments, as recommended by Staff.

Table 10 – Snapshot of Proposed Natural Gas Revenue Requirement

Avista's revenue requirement request	$17,293,000
Staff's contested adjustments' impact (Table 8)	(2,648,000)
Change from AVA's ROR of 7.61% to Staff's ROR of 7.18%	(3,348,000)
Staff's proposed revenue requirement	$11,297,000

IV. BASIC CHARGES – ELECTRIC AND NATURAL GAS

Q. Please explain what a basic charge is and its purpose.

A. A basic charge is the flat fee applied to a customer's bill each month regardless of the amount of kilowatts or therms used. The purpose of the basic charge is to recover customer-related fixed costs associated with metering, billing, customer service, and payment processing.[34]

Q. Please describe Avista's proposal regarding its basic charges.

A. The Company is proposing to increase the basic charge for all its electric and natural gas customers, as discussed in Company witness Miller's testimony, JDM-1T.

[34] *See* WAC 480-85-060(3) (Table 2: Electric Cost of Service Approved Classification and Allocation Methodologies and Table 4: Natural Gas Cost of Service Approved Classification and Allocation Methodologies); *see also, Wash. Utils. & Trans. Comm'n v. Pac. Power & Light Co.* Dockets UE-140762, UE-140617 & UE-131384, Order 08, 91, ¶ 216 (March 25, 2015) (2014 PacifiCorp GRC Order) ("The Commission is not prepared to move away from the long-accepted principle that basic charges should reflect only "direct customer costs" such as meter reading and billing.")

Specifically for residential customers, the Company is proposing a $15 basic charge for electric service, an increase of $6 from the current $9 basic charge; Avista is also proposing a $15 basic charge for natural gas service, an increase of $5.50 from the current $9.50 basic charge. These proposed changes equate to increases of 67 percent and 58 percent, respectively.

Q. What are the cost components of Avista's basic charges?

A. The Company's claim of "need" for the significant increases to the basic charges as discussed in Company witness Miller's testimony[35] was not clearly apparent to Staff, and Avista did not clarify matters in response to discovery requests. Staff posed two data requests to Avista requesting that the Company provide the individual monthly cost components that support the proposed increases to the electric and natural gas residential basic charges. Unfortunately, Avista's responses to those data request directed Staff back to the Company's initial cost of service exhibits, the exhibits that Staff found insufficient to support the Company's proposed increases.[36]

Q. Does Staff support Avista's proposed residential basic charge increases?

A. No, Staff does not support the substantial increases to the residential basic charges as proposed by the Company. However, Staff could support a modest increase to the

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[35] Miller, Exh. JDM-1T at 32:7-23 for residential electric service and Exh. JDM-1T at 34:5-8 for residential natural gas service.

[36] Exh. KMH-12, Avista's response to UTC Staff DR No. 211 and Exh. KMH-13, Avista's response to UTC Staff DR No. 212.

residential basic charge for both electric and natural gas – a similar approach taken by Staff in PacifiCorp's recent GRC.[37]

Q. What is Staff's recommendation regarding Avista's residential basic charges, and why?

A. The Company claims that the fixed costs for residential electric service is $26.55 and $37.43 for natural gas service; therefore, substantial increases to the basic charges are warranted. Staff reviewed the Company's cost of service workpapers for both electric and natural gas and was able to confirm a portion of the basic charges' composition, identified as average unit cost in the workpapers: $10.93 for electric[38] and $18.60[39] for natural gas. What was not discernible to Staff was the additional amounts the Company is including in the basic charge calculation as justification for the increases to its basic charges.

Staff recommends an increase of $1.00 to the residential basic charges under Schedule 1 for electric service and Schedule 101 for natural gas. These increases would bring the residential basic charge for electric service up to $10 and up to $10.50 for natural gas service. Staff acknowledges that these basic charges may still be below the Company's alleged overall cost of providing service; however, an

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[37] *Wash. Utils. & Trans. Comm'n v. PacifiCorp* Dockets UE-230172 & UE-210852 (Consolidated), Staff recommended a $0.50 increase to PacifiCorp's residential basic charge versus the company's proposed increase of $2.25. The Commission ultimately approved a $0.75 increase for single-family customers, and a decrease of $1.00 for multi-family customers.

[38] Garbarino, 240006-07-AVA-MJG-UE-24 Base Case Electric COS Model, tab "E2 Summary of Avg Cust Unit" at cell E40.

[39] Anderson, 240006-07-AVA-JCA-Natural Gas Cost of Service Workpapers, tab "Avg Cust Unit Costs" at cell D35.

incremental increase is consistent with prior Commission guidance and policies regarding gradualism.

Large increases in the basic charge are more likely to have real impacts on customers, regardless of energy usage. Staff is taking a moderate approach to increasing the basic charge. Increasing the basic charges helps lessen the volumetric increases in the energy charges Avista's customers would pay per kilowatt hour or therm. When fixed customer-related expenses are not included in the basic charge, they will be recovered through the volumetric energy charges. Taking this more gradual approach to increasing the basic charge will prevent rate shock to low usage customers.

Q. Please summarize Staff's observations and recommendations regarding basic charges.

A. Again, basic charges are intended to recover specific customer-related fixed costs. The Company's current basic charges fall short of covering these costs. Should the Commission decide to allow an increase, Staff recommends limiting the residential basic charge increases to $1.00 for both electric and natural gas service in an effort to correct these deficiencies while maintaining the Commission's long-standing policy on gradualism.

Q. Does this conclude your testimony?

A. Yes.