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**VIA: UTC Web Portal**

August 2, 2019

Mark L. Johnson  
Executive Director and Secretary  
Washington Utilities & Transportation Commission  
621 Woodland Square Loop SE  
Lacey, Washington 98503

Re: Docket No. U-190531 – Comments of Avista Utilities

Dear Mr. Johnson,

Avista Corporation, dba Avista Utilities (Avista or Company), submits the following comments in accordance with the Washington Utilities and Transportation Commission’s (“Commission”) Notice of Opportunity to Submit Written Comments (“Notice”) issued in Docket U-190531 on July 5, 2019, regarding the Commission’s “Inquiry into Valuation of Public Service Company Property Used and Useful after Rate Effective Date.”

In its 2019 Regular Session, the Washington State Legislature passed E2SSB 5116, which included the Clean Energy Transformation Act, relating to the clean energy transition of electric utilities in Washington. Section 20 of **SB 5116** amends RCW 80.04.250, Valuation of public service property, and requires the Commission to “establish an appropriate process to identify, review, and approve public service company property that becomes used and useful for service in this state after the rate effective date.”

The Commission is conducting an inquiry into the appropriate process for identifying, reviewing, and approving public service company property that becomes used and useful for service in Washington State after the effective date of a proposed rate. The Commission seeks the perspective of public service companies and interested persons on this matter, and specifically requests feedback on the following questions:

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- 1. In order for property to be considered for inclusion in rates during the rate effective period, should such property specifically be identified in the general rate case giving rise to those rates, or can specific property be identified in a subsequent proceeding? If such property may be identified in a subsequent proceeding, what proceeding would that be and why?**

**Avista Response:** At the outset, Avista believes that it should have the opportunity to recover prudently incurred costs and investments that it makes in order to provide our customers with safe and reliable electric and natural gas service. Avista, for its part, has made, and will continue to make, substantial investments on behalf of our customers, but without being able to include more of those costs in rates in a timely fashion (i.e., reduce regulatory lag), it is ultimately the Company’s shareholders that absorb those costs through lower returns. In essence, the ability for the Company to earn close to the Commission-authorized rate of return is hampered starting day 1 after a general rate case. Therefore, Avista respectfully requests that the Commission and interested parties keep the overarching goal to “establish an appropriate process to identify, review, and approve public service company property that becomes used and useful for service in this state after the rate effective date” in mind as we work through this process.<sup>1</sup>

As to whether such property should be specifically identified in a general rate case, no, Avista does not believe that specifically identifiable projects should be required for inclusion during the rate effective period. Rather, a level of rate base should be supported by the Company for approval by the Commission, with a later proceeding or process to review actual property (specifically identified property) that has been placed in-service during the rate effective period.<sup>2</sup> This later prudence review serves not only as a vehicle to ensure utilities are investing in the right things at the right cost, but also serves to “check” the utilities to prevent what other parties may fear of the potential for unchecked capital

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<sup>1</sup> Rate base levels or specific projects included during the rate year should be included on an average-monthly-average (AMA) basis for the rate effective period, whereas any projects or level of rate base included prior to the rate effective date should be included on an end-of-period (EOP) basis, as they will be in service throughout the entire rate year.

<sup>2</sup> The Commission should arrive at an overall level of rate base that it deems to be “used and useful” for providing service to customers based on a cumulative level of investment. It does not now, nor should it going forward, otherwise make hundreds or thousands of individual rate base determinations in setting rates – that would be unworkable.

spending. If it is later determined, after review, that the level of prudently-incurred rate base expenditures is below that which is ultimately determined to be “used and useful,” adjustments or true-ups can be made at that time, along with the associated rate of return on that investment. (The process for this later determination is discussed below.)

If the Commission does not have the flexibility to approve a level of rate base, subject to later review, multi-year rate plans would not be feasible. The Commission now has the authority to determine that a level of plant will be “used and useful” during the rate-effective period, subject to later verification (and possible rate refund). Only in this way will multi-year rate plans become feasible.

One point that should be remembered, and as discussed more in No. 4 below, is that typically the vast majority of the capital projects incurred by the utility for inclusion in rates are “programmatically” in nature. Typical programmatic investments undertaken by utilities include systematic pipe replacement, pole replacement, transformer upgrades, relocations due to road moves, customer connections, etc., and occur during the ordinary course of business and tend to be consistent over time. These “programs” have been typically reviewed by Staff and parties in general rate cases. The rationale for the investments are the same; the level of investment may slightly deviate.

Review and approval of specific property versus the level of rate base approved in a GRC could be reviewed through a separate review process to later follow on as a part of the same GRC docket, or in a subsequent GRC, or as a separate proceeding outside of a GRC, such as a capital tracker mechanism similar to the Washington Special Pipe Replacement Program Cost Recovery Mechanism (“CRM”).<sup>3</sup>

Under that mechanism, utilities are allowed a return of and return on specific eligible investments between rate cases. The CRM is in effect for a period of time (four years), after which a GRC filing is required. The cost recovery of CRM qualified plant, recovers the return on the prior year's plant investment and depreciation expense associated with a company's approved elevated-risk pipe replacement investment program plan. For example, for 2019, a company would be allowed to recover through the CRM:

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<sup>3</sup> CRM Commission Policy on “Accelerated Replacement of Pipeline Facilities with Elevated Risk” per Docket UG-120715.

- Approved replacement program costs incurred for the twelve month period November 1, 2018 to October 31, 2019. Recovery would be effective November 1, 2019, consistent with the company's annual purchased gas adjustment (PGA) filing and tariff. By looking retrospectively at a company's elevated risk replacement program, they ensure that improvements actually in service are included in rates, and that program investments are consistent with a company's replacement plans.
- On June 1 of each year a company that elects a CRM must file actual and projected investment for that program year. The June 1 filing includes investments incurred from November 1 of the previous year to April 30 of the current year and projected costs from May 1 through October 31 consistent with the approved replacement plan. The company then updates the projected costs with actual investment incurred during May through July and revised costs estimates for August through October with its annual Purchased Gas Adjustment tariff filing.
- Once actual project cost data are available, a company submits actual cost data through September and an updated estimate for October under the PGA docket for that year. This process should give reasonable recognition of the proposed tariff's effective date and the *used and useful* constraint.
- After the initial year, the CRM requires a separate revenue requirement calculation by program year considering changes to net rate base, depreciation, and operations and maintenance offsets. After the Commission has approved a CRM for a company, any general rate case filing must include all investment in base rates and reset the tariff to exclude any CRM recovery.

Generally, this mechanism could be broadened or serve as a template in order to allow for timely cost recovery of capital investment. In our view, the Commission has had the opportunity to become more comfortable with tracker mechanisms, and such a mechanism may serve as an alternative to what others may view as a shift towards becoming more of a future test year state.

2. **How should plant-in-service be valued (for the determination of rate base) for each year of a rate plan? Does this valuation depend on prospectively identifying specific plant investments across the rate plan during the general rate case giving rise to the rates? Why or why not?**

**Avista Response:** See also response to (1) above. The valuation or determination of the level of plant to be approved in a GRC for the rate effective period and beyond for a multi-year rate plan, may not adhere to a one-size-fits-all approach, but rather may need to be utility-specific. Options may include the use of historical trended levels of net plant, or forecasted levels of net plant, for example.<sup>4</sup> However, the valuation or determination of the level of rate base approved in any given GRC is as important as the process in place to review the projects, and the associated consequence of any differences between approved rate base levels and actual levels. As noted above, the review process could be a separate review process as part of the same GRC, a subsequent GRC, or as a separate proceeding outside of a GRC, such as a capital tracker mechanism. The consequence of differences may, for example, be adjustments to approved revenue increases prior to the rate effective date, or deferrals of differences tracked through a separate capital tracker (one-way or symmetrical balancing account), with refunds or surcharges through a separate tariff or future GRC adjustment. The important point is that the Commission will not have abdicated its responsibility to assure that rate base reflects actual plant in service that is used and useful.

**3. What should be the review process for property included in rates that becomes used and useful after the rate effective date? Is this review process the same for plant placed in service both up to and during the rate-effective date?**

**Avista Response:** As noted above, the review process could be a separate review process as part of the same GRC (by supplementing the record), in a subsequent GRC, or as a separate capital tracker mechanism. As a part of any of those approaches, reporting requirements could be established requiring monthly, quarterly, semi-annual or annual reports. (The Company currently files monthly results of operations reports on a quarterly basis – these reports could be used as a form of review.) This subsequent reporting would provide opportunity for parties to review proof of subsequent rate base levels prior to rates

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<sup>4</sup> Historical trends used to value future rate base levels are predicated on historical actual information, and uses statistical trending of this information to capture the relationship of costs during the rate effective period. Whereas, forecasted levels of net plant may be based on a utility's forecast of expected capital levels, or trended historical data adjusted for known or expected forecasted information, to reflect the appropriate level of net plant during the rate effective period. Regardless the method, each method should review the need for adjustments necessary to assure that it does not overstate the level of plant or expense. Use of reporting to verify actual level of "used and useful" net plant will ensure the appropriate levels of net plant were approved. Other safeguards, such as an earnings test, may also be applied to protect rate payers of any overstatement of net plant approved.

going into effect in a multi-year rate plan, as well as during the rate effective period with summary rate base levels, as well as more detailed reports, and/or an opportunity for a more detailed audit of specific projects completed (prudence determination) in the Company's next GRC.

For example, in Avista's 2017 GRC (Dockets UE-170485 and UG-170486), to support its proposed level of rate base over the Company's multi-year rate plan, the Company had proposed to file capital reports annually by February 15th, prior to the May 1 effective date of rate years 1, 2 and 3 (2018 – 2020). The annual reports were to provide actual year-end (end of period) rate base balances as of December 31st of the recently completed year to allow Staff and other parties an opportunity to review, and provide assurance to the Commission, that levels approved in each of the rate years were based on plant that was used and useful, and serving customers prior to the effective date.

Lastly, through the Company's existing electric and natural gas Decoupling Mechanisms, Avista is subject to separate one-way earnings tests for each of its Washington electric and natural gas operations that will also act as a "check and balance" to ensure retail rates are set at appropriate levels. If Avista over-earns during any rate plan, Avista would share half of the overearnings, protecting customers. However, if Avista under-earns, there is no corresponding protection for the Company under these circumstances; Avista would absorb the shortfall.

If approved levels were adjusted, prior to rates going into effect<sup>5</sup>, or tracked and deferred for future purposes, any differences would be dealt with during the subsequent review process. Again, without this flexibility, multi-year plans would not be feasible.

Specifically, an audit should be performed for all plant, regardless of the time period, using sampling procedures similar to those described by the American Institute of Certified Public Accountants (AICPA). AICPA sampling guidelines are used by external auditors when testing controls or expense/revenue balances of a Company during annual financial

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<sup>5</sup> For example, in a multi-year rate plan, as a part of the review, if the reports show that actual net plant-in-service prior to rates going into effect were to be below what would support the approved revenue increases in the second year of the rate plan, and so on, the Commission would have an opportunity to make modifications prior to rates going into effect, and reduce the revenue requirement accordingly.

statement audits (Avista's external auditor is Deloitte). Avista's Internal Audit Department also uses these same guidelines when performing internal audits at Avista.<sup>6</sup> Different audit sampling methods<sup>7</sup> can be determined based on sample population (population size determines the number of items that are randomly selected), based on "risk of incorrect acceptance" (i.e., 5%, 10%, etc.) and "tolerable misstatement of errors rate" (i.e., 1%, 3%, etc.). After the risk assessments have been determined, a sampling table is used to determine the sample to select, based off total population.

The UTC could choose to audit all projects based on a specific determined sample size following this guidance, or choose the largest projects as one subset, and audit a sampling of the remaining projects following the AICPA guidance. Regardless of sampling methodology, the main point is a sample of all projects should be chosen from all annual capital projects for review, providing the Commission and other parties with support that the utility's specific capital additions meet the used and useful requirement.

As noted above, as a part of the approach to review capital projects, reporting requirements could be established, in addition to the results of operations reports currently filed on a quarterly basis. These subsequent reports provide opportunity for parties to review proof of rate base levels (preliminary reports), and later specific capital project reports, providing support for specific capital additions. For example, in Avista's 2012 GRC, Dockets UE-120436 and UG-120437, the Commission Ordered the Company to file reports as follows: (1) With regard to its planned capital expenditures for calendar year 2013 (rate-year 1 of its 2-year rate plan), Avista filed: (i) a progress report on its 2013 capital expenditures on or before September 30, 2013; and (ii) a comprehensive report on the final totals for 2013 capital expenditures on or before March 1, 2014. (2) As to the capital expenditures Avista planned to make in calendar year 2014 (year 2 of the 2-year rate plan), the Company filed: (i) its capital expenditure plan for 2014 on or before September 30, 2013; and (ii) updated changes in meeting its capital expenditure plan for 2014 and reports on progress in making

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<sup>6</sup> Audit sampling is the selection and evaluation of less than 100 percent of the population, with the expectation that the sample selected will be representative of the population and, thus, likely to provide a reasonable basis for conclusions about the population. In this context, representative means that evaluation of the sample will result in conclusions that, subject to the limitations of the sampling risk, are similar to those that would be drawn if the same procedures were applied to the entire population.

<sup>7</sup> Examples of sampling methods are statistical (random selection and use of appropriate statistical techniques to evaluate sample results) and non-statistical (judgmentally select a sample). Refer to Attachment A, including the AICPA "AU-C Section 530 Audit Sampling" guideline for additional information.

such capital improvements on June 1, September 1, and December 1, 2014, respectively, for the previous quarters. See Attachment B including Avista's Compliance Filing of its 2013 Expenditure Final Report and 2014 Capital Expenditure Plan Update.<sup>8</sup>

- 4. Should *pro forma* plant additions placed in service after the test year but before the rate effective date be considered using the same process that the Commission will use to identify, review, and approve property that becomes used and useful after the rate effective date? Or should these post-test year plant additions be considered under a separate process? What is the best way to incorporate the participation of all of the parties to the underlying rate proceeding in the process of reviewing the prudence of these post-test year plant additions?**

**Avista Response:** A similar process should be established that reviews plant placed in service during the historical test period, and *pro forma* projects placed in service during the GRC proceeding, and up to, and during the rate-effective period. It is entirely reasonable for parties to complete an "audit" of specific projects (as discussed in No. 3 above), rather than a review of all capital projects in a given year.

Furthermore, for a utility, many projects or programs are similar in nature from year to year. In those instances, a utility should provide detailed explanations of the various programmatic spending it is undertaking during the GRC and will undertake during the processing of the case as well as over the course of the rate year. Typically, much of a utilities capital investments that will go into service during any particular rate year are generally continuations of the programmatic spending undertaken in any given test year, and which are typically discussed in each case. These include capital projects such as ongoing replacement of major capital projects, failing and remediation on the worst performing feeders, circuits, etc., and other reliability work. These types of projects make up a significant portion of the plant that will go into service during the rate year. To the extent further review of the actual costs is needed, the Commission (Commission Staff and intervening parties) can undertake that review when the utility files its "capital reports", or in a subsequent rate case.

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<sup>8</sup> The Company did not include Attachment 2 in its entirety of the 2014 report (2014 Capital Expenditure Detail) representing over 300 pages of supporting Business Case information. This information is available through the WUTC Records Center under Dockets UE-120436 and UG-120437.



One missed opportunity under the current regulatory regime, is the use of periodic briefings with all parties between rate cases on planned capital investments. This would also serve to highlight certain areas requiring greater attention in the next GRC. While Avista had filed yearly capital budgets, it would appear that little use was made of them for general briefing purposes. No matter what further process eventuates from these discussions, this periodic briefing would prove useful.

- 5. If the rate base used to establish rates for a multi-year rate plan relies on a formula or plant-in-service projections (rather than a prospective identification of specific investments), what is the appropriate process for identifying, reviewing, and approving property that becomes used and useful for service after the initial rate-effective date? How should actual plant-in-service relate to the plant-in-service used to establish rates?**

**Avista Response:** Please see the Company's responses to parts (2) and (3) above.

Avista appreciates the opportunity to provide these comments and looks forward to participating in any future proceeding related to this issue. Please direct any questions regarding these comments to me at (509) 495-8601.

Sincerely,

*/s/Liz Andrews*

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