

Exhibit No. __ T (BAE-1T)
Dockets UE-140188/UG-140189
Witness: Betty A. Erdahl

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

AVISTA CORPORATION,

Respondent.

**DOCKET UE-140188 and
DOCKET UG-140189
(Consolidated)**

TESTIMONY OF

BETTY A. ERDAHL

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Investor-Supplied Working Capital (Adjustment 1.03)

July 22, 2014

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LIST OF EXHIBITS

- Exhibit No. ____ (BAE-2), Combined Working Capital Summary
- Exhibit No. ____ (BAE-3), Combined Working Capital for the Twelve Month Period
Ended December 31, 2013 AMA
- Exhibit No. ____ (BAE-4), Combined Working Capital Calculation Allocated to
Operating and Non-Operating Business
- Exhibit No. ____ (BAE-5), Combined Working Capital Detail

1 I. INTRODUCTION

2

3 Q. Please state your name and business address.

4 A. My name is Betty A. Erdahl and my business address is the Richard Hemstad
5 Building, 1300 S. Evergreen Park Drive SW, Olympia, Washington 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 Energy Section of the Regulatory
10 Services Division.

11

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

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

14

15 Q. Please describe your education and relevant work experience.

16 A. I graduated from Washington State University in 1988 with a Bachelor of Arts
17 degree in Accounting. I have also completed relevant coursework such as the
18 “Basics of Regulation” offered by New Mexico State University, Rate Making
19 Process Technical Program, USTA class on Understanding Separations, Access
20 Charges, and Settlements, as well as Utility Ratemaking: The Fundamentals and the
21 Frontier. Before joining the Commission in June 1991, I worked for two years as an
22 accountant in the financial sector.

1 As a Regulatory Analyst, I am responsible for auditing the books and records
2 of regulated companies, analyzing cost of service studies, and examining affiliated
3 interest transactions. In addition, I participate in the development of Staff
4 recommendations concerning tariff filings by regulated companies for presentation to
5 the Commission at open public meetings and adjudications. I have also worked on
6 policy recommendations relating to spin-offs and mergers of regulated companies,
7 payphone deregulation, local calling areas, bundling of regulated and nonregulated
8 telecommunications services, implementation of N11 pursuant to the
9 Telecommunications Act of 1996, and numbering resources.

10
11 **Q. Have you testified before this Commission?**

12 A. Yes. I testified in Docket TG-920090, regarding affiliated interests of Waste
13 Management, Inc.; Docket UT-950200, regarding a general rate case of US WEST
14 Communications, Inc.; Docket UT-970066, regarding payphone access line rates of
15 Toledo Telephone Company; Docket UT-020406, a complaint by AT&T
16 Communications of the Pacific Northwest, Inc. against Verizon Northwest Inc.'s
17 access charge rates; Dockets UE-111048 and UG-111049, regarding a general rate
18 case of Puget Sound Energy, Inc.; and Docket UE-130043, regarding a general rate
19 case of Pacific Power & Light Company. I also prepared testimony in Docket UT-
20 040788, regarding a general rate case of Verizon Northwest Inc.; Docket UT-
21 051291, regarding affiliated interest contracts, overall earnings review, and provision
22 of a quality of service guarantee program in the Sprint spin-off of its local exchange
23 companies; and Docket UT-082119, regarding retention of pre-merger settlement

1 provisions, a requirement to offer a quality of service guarantee program, and
2 affiliated interest reporting in the CenturyTel/Embarq merger case.

3
4 **II. SCOPE AND SUMMARY OF TESTIMONY**

5
6 **Q. What is the purpose of your testimony in this proceeding?**

7 A. My testimony presents Staff's Investor Supplied Working Capital (ISWC)
8 adjustment in this case. The results of my analysis are incorporated into Staff's
9 attrition revenue requirement model presented in Staff witness Mr. McGuire's
10 Exhibit Nos. ___ (CRM-2) and ___ (CRM-3).¹

11 I respond to Avista's ISWC analysis sponsored by Avista witness Ms.
12 Elizabeth Andrews, which she describes in her direct testimony, Exhibit No. ___
13 (EMA-1T) at 37-40 (Electric) and at 67 (natural gas).

14
15 **Q. Please provide a brief overview of your testimony.**

16 A. Section III of my testimony provides a broad overview of the ISWC calculation and
17 its purpose in ratemaking. Section IV of my testimony presents Staff's ISWC
18 calculation as allocated to Washington ratepayers for both electric and natural gas
19 service. Lastly, Section V of my testimony discusses Staff's recommendation
20 regarding specific refinements to the portion of the ISWC calculation that includes
21 pension and post-retirement benefits.

22

¹ McGuire, Exhibit No. ___ (CRM-2) at 4-5, column [C], and Exhibit No. ___ (CRM-3) at 4-5, column [B].

1 **Q. Please summarize Staff's recommendation as it relates to Avista's proposed**
2 **ISWC adjustment.**

3 A. For electric operations, Staff's ISWC amount is \$33,264,334. For gas operations,
4 Staff's ISWC amount is \$10,550,154. These amounts are the same as Avista's most
5 recent update, because Staff confirmed Avista's analysis is correct. The Company
6 updated its case in Response to Staff Data Request 115-Revised Supplemental 2, and
7 Staff's ISWC calculations are the same as reflected in that Avista data request
8 response. This includes the treatment of pensions and other post-retirement benefits
9 and liabilities, including the associated regulatory assets and related tax impacts. As
10 I explained, I describe this treatment in detail in Section V.

11
12 **Q. Does Staff recommend the Commission attach conditions or direct Avista to**
13 **take additional action as a result of the treatment of pensions and post-**
14 **retirement benefits in ISWC?**

15 A. Yes. In order to ensure accounting consistency, Staff recommends the Commission
16 condition its acceptance of the ISWC adjustment as follows:

- 17 1) In future rate cases, Avista must calculate its ISWC in principally the
18 same manner, including the same underlying accounts and
19 methodologies.
20 2) Avista must include ISWC as a rate base item, whether ISWC is positive
21 or negative.

22

1 **Q. What effect does Staff's recommendation have on Avista's rate base?**

2 A. For electric operations, Staff's ISWC adjustment adds a total amount of ISWC of
3 \$33,264,334 to Avista's rate base. This amount is comprised of \$16,280,595
4 contained in column [A] of Staff witness Mr. McGuire's Exhibit No. ___ (CRM-2),
5 page 5, and \$16,983,739 contained in column [C] of that exhibit.

6 For natural gas, Staff's adjustment adds a total amount of \$10,550,154 to
7 Avista's rate base. This amount is comprised of \$5,694,987 contained in column [A]
8 of Staff witness Mr. McGuire's Exhibit No. ___ (CRM-3)), page 5, and \$4,855,167
9 contained in column [B] of that exhibit.

10

11 **Q. Are you sponsoring any exhibits in support of your testimony?**

12 A. Yes. My exhibits are as follows:

13 • Exhibit No. ___ (BAE-2), "Combined Working Capital Summary."

14 This exhibit summarizes the key figures and calculations in
15 determining an appropriate ISWC allocation to Washington
16 ratepayers.

17 • Exhibit No. ___ (BAE-3), "Combined Working Capital for the
18 Twelve Month Period Ended December 31, 2013 AMA." This
19 exhibit allocates company-wide ISWC to Non-regulated and
20 Regulated Operations, and then allocates ISWC for Regulated
21 Operations to Washington electric and gas operations.

22 • Exhibit No. ___ (BAE-4), "Combined Working Capital Calculation
23 Allocated to Operating and Non-Operating Business." This exhibit

1 provides the calculation of total ISWC and allocates between Non-
2 operating (Non-regulated) and Operating (Regulated) Working
3 Capital; and

- 4 • Exhibit No. ___ (BAE-5), “Combined Working Capital Detail.” This
5 exhibit shows the individual balance sheet accounts included in the
6 ISWC calculation. The individual accounts are combined and the
7 totals are provided in BAE-4.

8 Together, these exhibits present the details and calculations supporting the ISWC
9 adjustment that is included in Staff witness Mr. McGuire’s Exhibit No. ___ (CRM-
10 2), page 5, column [C], line 48, and Exhibit No. ___ (CRM-3), page 5, column [B],
11 line 46.

12 III. ISWC OVERVIEW

13
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. Typically, a company incurs the costs of production and
20 sales prior to collecting the related revenues. Working capital represents the funds
21 needed by a company to pay its current obligations while waiting for payment from
22 its customers.

1 From the regulatory perspective, ISWC quantifies that portion of working
2 capital that has been provided by investors. This measured amount is then included
3 in rate base in order to provide a Commission-allowed rate of return on investor-
4 provided capital.

5
6 **Q. Please explain the ISWC method.**

7 A. The ISWC method is a comprehensive analysis based upon a full review of a
8 company's balance sheet. Broadly speaking, the ISWC method, or "balance sheet"
9 approach, measures the amount of invested capital provided by investors and
10 available for the Company's use, over and above the Company's investments in
11 operating plant, non-operating plant, and other specific items of investment. The
12 excess of invested capital over total investments represents ISWC.

13 Essentially, this is the inverse of the typical accounting formula for working
14 capital, which is equal to current assets minus current liabilities. However, the
15 ISWC method allows for a more precise recognition of the amount of working
16 capital that investors have supplied, because the calculation includes the remaining
17 balance sheet accounts, which are long-term assets, long-term liabilities, and owners'
18 equity.

19
20 **Q. How is ISWC calculated?**

21 A. Generally, the analyst reviews the balance sheet on a company-wide basis to
22 calculate company-total ISWC, which is then allocated across service territories and

1 lines of service. Lastly, those allocated-totals are then included as rate base items for
2 the appropriate territories and lines of service.

3 It is appropriate to use account balances on an Average of Monthly Averages
4 (“AMA”) basis, because this is consistent with the way other rate base elements are
5 calculated, and it correlates the balance sheet with the income statement. This
6 follows the matching principle of ratemaking, which traditionally attempts to
7 “match” the temporal relationship of revenues, rate base, and expenses for the
8 historic test period results of operations.

9
10 **IV. STAFF AND AVISTA ISWC CALCULATIONS**

11
12 **Q. Do both Staff and Avista use the ISWC method to calculate working capital in**
13 **this case?**

14 A. Yes.

15
16 **Q. Did Staff evaluate Avista’s proposed ISWC?**

17 A. Yes. Staff evaluated Avista’s ISWC calculation for both electric and natural gas
18 service. Staff reviewed the underlying balance sheet accounts and allocation
19 methodology and determined the Company’s calculation is correct as of the update
20 Avista provided on June 26, 2014, in response to Staff Data Request 115.

21 Accordingly, there are no substantive differences between Staff and Company on
22 this issue.

1 **Q. Please explain Staff's ISWC calculation.**

2 A. First, Staff reviewed the underlying balance sheet accounts included in Avista's
3 ISWC calculation, and determined the accounts are appropriate and properly
4 categorized as investments or current assets and current liabilities. My Exhibit No.
5 ___ (BAE-5) includes the various ISWC balance sheet accounts and amounts on a
6 company-wide basis. This exhibit lists each account included in the Company's total
7 company ISWC Summary. My Exhibit No. ___ (BAE-4) places these accounts into
8 more general categories. The company-total ISWC is \$76,113,783, as shown on my
9 Exhibit No. ___ (BAE-5) at 4:221.

10

11 **Q. How did Staff and Avista allocate total company ISWC to Washington, and**
12 **then to electric and gas service?**

13 A.. The first step is to allocate total ISWC between regulated and non-regulated
14 operations, using the ratio of working capital to assets. This is total ISWC divided
15 by total average investments.² This ratio is 3.155 percent, which is located in my
16 Exhibit No. ___ (BAE-4) at line 69.

17 Next, the ISWC ratio is multiplied by total average operating investment.³
18 Avista's total average operating investment is located in my Exhibit No. ___ (BAE-
19 4) at line 28. The product of the ISWC ratio and total average operating investment
20 is total operating working capital, which represents ISWC attributable to regulated
21 operations. The result is \$72,985,355 of total operating ISWC allocated to regulated
22 operations, as shown on line 73 of my Exhibit No. ___ (BAE-4).

² Total average investments is total investment less construction work in progress and less preliminary surveys.

³ Total average operating investment is used to denote the assets tied to regulated operations.

1 The next step is to allocate this \$72,985,355 of ISWC for regulated
2 operations to appropriate jurisdictions, using the allocation methodology Avista uses
3 for all of its common costs. Beginning at page 85 of her direct testimony, Exhibit
4 No. ____ (EMA-1T), Avista witness Ms. Andrews further describes the details of the
5 Company's allocation methodology. The Commission previously approved this
6 methodology.

7 My Exhibit No. ____ (BAE-3), line 39, columns J and K include the allocation
8 of ISWC to various service lines and territories. Columns ED-WA (J) and GD-WA
9 (K) illustrate the Washington results, which allocate \$33,264,334 to Washington
10 electric service and \$10,550,154 to Washington natural gas service.

11
12 **Q. Did Staff and Avista include any elements in its ISWC calculation compared to**
13 **previous Avista rate cases?**

14 A. Yes. Both Staff's and Avista's ISWC figures include amounts related to pension and
15 post retirement liabilities and the associated deferred federal income tax balances
16 ("post-retirement benefits"). I describe this next.

17
18 **V. TREATMENT OF POST-RETIREMENT BENEFITS**

19
20 **Q. Please explain what "post-retirement benefits" are, as you use that term in your**
21 **testimony.**

22 A. In the context of ISWC, the term "post-retirement benefits" refers to an employer's
23 contributions to its defined benefit retirement plans and post-retirement medical

1 benefits plans. The term also includes the deferred federal income tax balances
2 associated with an employer's contributions.

3
4 **Q. How do Staff and Company treat post-retirement benefits in the ISWC
5 calculation in this case, compared to prior cases?**

6 A. The Staff and Company ISWC calculations include the regulatory assets and
7 liabilities for post-retirement benefits, along with the associated accumulated
8 deferred federal income tax balances as current assets and current liabilities in the
9 ISWC calculation.

10 In past cases, post-retirement benefits either were not part of the ISWC
11 calculation at all, or were treated as non-operating investments. Either way, until
12 this case, post-retirement benefits did not affect the ISWC value.

13
14 **Q. What is the rationale for treating post-retirement benefits as current assets or
15 current liabilities within the ISWC calculation?**

16 A. Due to recent changes in the regulatory and economic environment surrounding
17 defined benefit pension plans, Avista and its shareholders have contributed capital to
18 the Company's pension plan far in excess of the amounts included in rates. Because
19 this is investor-supplied capital, it is appropriate for investors to earn a return on that
20 capital, to the extent it supports Washington-regulated operations.

21 Post-retirement benefits represent a legitimate expense and an ongoing
22 liability tied to employees' retirement benefits. The Commission should allow

1 Avista to recover the difference between Avista's actual contributions to the pension
2 and the amount the Company is currently collecting in rates.

3 Including post-retirement benefits as current assets or current liabilities
4 allows Avista to recover that portion of its contribution not included in rates as a rate
5 base item, thus, earning a return on that amount.

6
7 **Q. Please describe the changes in the regulatory and economic environment**
8 **regarding post-retirement benefits to which you refer.**

9 A. Accounting Standards Codification 715 – Compensation – Retirement Benefits
10 (“ASC 715”) provides standards for employers’ accounting for pensions and other
11 benefits, including an employer’s contributions to its pension fund. The general
12 purpose of ASC 715 is to allow an employer to annually expense the present value of
13 post-retirement benefits its employees earned over the course of a fiscal year.

14 On the other hand, the federal Pension Protection Act (“PPA”), which was
15 enacted in 2006, largely mandates the amounts an employer must actually contribute
16 to its pension fund.

17 While the PPA and ASC 715 share similar policy goals, the calculations are
18 different and the results may not match. Therefore, the amount a company is
19 required to actually contribute to its pension fund under the PPA may differ
20 substantially from the amount that same company is permitted to expense on its
21 financial statements under ASC 715.

22

1 **Q. How does this difference between the PPA and ASC 715 translate to the ISWC**
2 **calculation?**

3 A. For purposes of the ISWC calculation, a post-retirement benefits current asset or
4 current liability is the difference between actual contributions required under the
5 PPA, and the amount ASC 715 allows as an expense. If the company's ASC 715
6 expense is greater than the PPA actual contribution, the Company records a current
7 liability, which reduces ISWC. Conversely, if the company's actual contributions to
8 pensions are larger than the ASC 715 expense, the Company records a current asset,
9 which increases ISWC.

10 As I previously described, Avista's actual pension contributions under the
11 PPA have been significantly larger than its expense under ASC 715. Consequently,
12 Avista has recorded a current asset in the amount of the difference. Staff determined
13 that the Company's actual contributions in excess of its ASC 715 expenses are
14 appropriate and accurately reflect Avista's legitimate obligations toward post-
15 retirement benefits. Therefore, Staff recommends the Commission include the
16 resulting current asset in the ISWC calculation.

17
18 **Q. Has the Commission previously allowed treatment of post-retirement benefits as**
19 **regulatory assets and liabilities within the context of ISWC?**

20 A. Yes, in two prior cases. In Docket UT-950200, a rate case involving U S WEST
21 Communications, Inc., the Commission included in rate base a \$70 million Pension

1 Asset.⁴ More recently, in its Final Order in Docket UE-130043, the Commission
2 accepted PacifiCorp's ISWC adjustment, which included pensions and other post-
3 retirement benefits in the current asset and liabilities columns of PacifiCorp's ISWC
4 calculation.⁵ This increased Washington ISWC by \$7.5 million.⁶

5
6 **Q. Does Staff have any concerns regarding its recommended treatment of post-
7 retirement benefits in ISWC?**

8 A. Yes. Staff's concern is consistency, because it is very possible, or even likely, that
9 the relationship between the PPA-mandated pension contribution levels and ASC
10 715 expenses will "invert" at some point in the future. If this occurs, it would reduce
11 ISWC, perhaps substantially.

12 Accordingly, to assure consistency within the entire ISWC calculation, the
13 Commission should direct Avista to account for all ISWC components in principally
14 the same manner in future cases as it has done in this case, and require the Company
15 to include ISWC as a rate base item, whether the ISWC amount is positive or
16 negative.

17
18 **Q. Does this conclude your testimony?**

19 A. Yes.

⁴ *Utilities & Transp. Comm'n v. US WEST Commc'ns, Inc.*, Docket UT-950200, Fifteenth Supplemental Order at 70 (April 11, 1996). In effect, this \$70 million increase to rate base was offset by a \$38 million decrease in rate base as a result of a negative ISWC calculation.

⁵ *Utilities & Transp. Comm'n v. PacifiCorp*, Docket UE-130043, Final Order at 91-93 (December 4, 2013).

⁶ *Utilities & Transp. Comm'n v. PacifiCorp*, Docket UE-130043, Zawislak Direct, Exhibit No. ____ (TWZ-1T) at 7:13-14.