**Exhibit No. \_\_\_T (MDF-1T)**

**Dockets UE-120436, et al.**

**Witness: Michael Foisy**

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,**  **Complainant,** **v.****AVISTA CORPORATION, d/b/a AVISTA UTILITIES,**  **Respondent.****WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,** **Complainant,****v.****AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.** | **DOCKETS UE-120436/UG-120437** **(*consolidated)*****DOCKETS UE-110876/UG-110877** ***(consolidated)*** |

**TESTIMONY OF**

**Michael Foisy**

**STAFF OF**

**WASHINGTON UTILITIES AND**

**TRANSPORTATION COMMISSION**

***Working Capital and Property Tax***

**September 19, 2012**

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**I. INTRODUCTION**

**Q. Please state your name and business address.**

A. I am Michael Foisy. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504.

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

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Analyst.

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

A. I have been employed by the Commission since February 2009.

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

A. I graduated from Regis University in Denver, Colorado with a Bachelor of Science degree in Technical Management in 1982. In 1985, I earned a Masters of Arts degree in Personnel Management from Central Michigan University.

 I began my employment at the Commission in February 2009. During my employment at the Commission, I have performed accounting, revenue requirement calculations and financial analyses.

 I attended the New Mexico State University, Center for Public Utilities, “Practical Regulatory Training for the Changing Electric, Natural Gas Industries” course in September 2009. I also attended the NARUC sponsored course, Innovative Regulatory Approaches to Accommodate Renewable Energy, Demand-Site Resources and Energy Efficiency Programs presented by New Mexico State University.

 I previously testified before the Commission in the 2010 PacifiCorp General Rate Case, Docket UE-100749 and the 2009 Puget Sound Energy, Inc. General Rate Case, Dockets UE-090704 and UG-090705.

**II. SCOPE AND SUMMARY OF TESTIMONY**

**Q. What issues do you address in your testimony?**

A. I present Staff’s adjustments on working capital and property taxes.

1. **Adjustment 1.03, Electric and Gas - Working Capital**

 **1. Introduction**

**Q. What is working capital?**

A. Working capital is the cash available for day-to-day operations of the organization. The accounting definition of working capital is the difference between current assets and current liabilities.

**Q. What is the goal of working capital in ratemaking?**

A. The goal of working capital in ratemaking is to determine if investors actually supply working capital, and if so, it is necessary to include the amount that investors supply in rate base and apply a return to that capital.

**Q. What method did Staff use to determine the amount of working capital investors supplied to Avista?**

A. Staff used the investor-supplied working capital (ISWC) method.

 **2. The Investor-Supplied Working Capital Method**

**Q. Please explain the basics of the investor-supplied working capital method.**

A. Investor-supplied working capital measures the difference between the amount capital invested in a business and the amount of investments of the business. More simply, ISWC is the amount of capital invested in the company by investors and available for use by the company. This investment is over and above the company’s own investment in plant and other facilities.

 If there is an excess of invested capital over investments, that amount is ISWC. ISWC is included in rate base and earns a return.

 The ISWC calculation requires a detailed analysis of the balance sheet to determine which accounts belong in Invested Capital and which accounts belong in Investments. In addition, some accounts are classified as non-utility or non-operating. Once the classifications are made, Investments are subtracted from Invested Capital, and the difference is the Company’s total investor-supplied working capital. This total is then allocated among the jurisdictions, the industry type (electric or gas), and non-utility operations to derive state-specific, industry-specific amounts.

 **3. Summary of Results**

**Q. Please state the working capital allowances Staff determined are appropriate for Avista’s electric and gas operations in this case, and compare those amounts to the allowances proposed by Avista.**

A. Using the investor-supplied working capital method or balance sheet approach, I calculate an ISWC allowance of $21,932,000 for Avista’s Washington electric operations and $3,568,000 for Avista’s Washington gas operations.[[1]](#footnote-1)

 The Company’s proposes an ISWC allowance of $31,877,000 for Washington electric operations and no ISWC allowance for Washington gas operations.[[2]](#footnote-2)

**Q. Please state the amounts of working capital Staff includes as adjustments for working capital, and how those amounts compare to the Company’s adjustments.**

A. As shown in Exhibit No. \_\_\_ (JH-2), Staff’s working capital adjustment for electric operations adds $3,744,000 to the “per books” rate base. As shown in Exhibit No. \_\_\_ (EJK-2), Staff’s working capital adjustment for gas operations adds $3,568,000 to rate base.

**Q. Please explain why Staff’s “adjustment” amount for gas equals your working capital “allowance” amount for gas operations, but Staff’s “adjustment” amount for electric operations does not equal your working capital “allowance” for electric operations.**

A. For electric operations, Avista includes $18,188,000 of working capital in its “per books” column, as shown in Ms. Andrews’ Exhibit No. \_\_\_ (EMA-2), page 1, column (b), line 47. Therefore, it is necessary for Staff’s working capital adjustment for electric operations to adjust from that $18,188,000 figure. To arrive at Staff’s working capital allowance of $21,932,000, my Adjustment 1.03 is a positive $3,744,000 ($21,932,000 less $18,188,000 = 3,744,000).

 The Company’s working capital adjustment for electric operations also adjusts from that $18,188,000 “per books” figure. To arrive at Avista’s proposed working capital allowance of $31,877,000, Avista’s Adjustment\_1.03 is $13,689,000 ($18,800,000 + $13,689,000 = $31,877,000).

 Because Avista did not include any working capital figure in its per books column for gas operations, my working capital allowance equals my adjustment.

**Q. Does Avista actually record working capital on its books of accounts?**

A. No. Avista states the balance “reflected in results of operations is the amount of ISWC approved in Docket No. UE-100467”[[3]](#footnote-3).

 **4. Explanation of Staff’s Working Capital Calculation**

**Q. Have you prepared an exhibit showing Staff’s working capital calculation?**

A. Yes. Pages 3 and 4 of my Exhibit No. \_\_\_ (MDF-2) contain Staff’s working capital calculation.

**Q. Please provide an overview of pages 3 and 4 of your Exhibit No. \_\_\_ (MDF-2).**

A. As I described earlier, the ISWC method calculates Investments and Invested Capital, and the difference is total company investor-supplied working capital. The resulting amount is split between operating and non-operating, and the operating portion is then allocated to the services within each jurisdiction.

 On page 3, line 55 of my Exhibit No. \_\_\_ (MDF-2), I show total company investor-supplied working capital of $43,819,307. This is the difference between the Invested Capital amount of $2,356,394,232 on line 9, and the Total Average Investments amount of $2,312,574,925 on line 53.

 I use the Investor Supplied Working Capital Ratio to determine how much ISWC is the responsibility of utility operations and how much is non-utility operations. The Investor Supplied Working Capital Ratio of 1.959 percent is determined by dividing the Total ISWC by the Total Investment, Net of CWIP and Preliminary Survey.[[4]](#footnote-4) The ISWC Ratio times the Total Average Operating Investment gives us the Total Operating Working Capital of $42,139,824.

 Similarly, Non-Operating investments times the ISWC Ratio assigns $1,679,484 of working capital to non-utility operations.

 The final step is to allocate the Total Operating Working Capital among the Company operations. This allocation is based on the investments in each state and each industry, gas or electric. The plant investments by state and industry are shown in lines 92 through 96 on page 4. The derivation of the percentage for each is shown just above with Washington – Electric Operations representing 52.0 percent of the Company’s total operations and Washington – Gas Operations at 8.5 percent of the total.

 The final resulting ISWC for Washington – Electric Operations is $21,932,177. The resulting ISWC for Washington – Gas Operations is $3,567,691.

 **5. Explaining Staff/Company Differences**

**Q**. **Does part of your Exhibit No. \_\_\_ (MDF-2) also portray how Staff’s working capital calculation differs from the Company’s calculation?**

A. Yes. My adjustments to the Company’s ISWC calculation are shown on Pages 5 and 6 of Exhibit No. \_\_\_ (MDF-2).

 The first column on Page 5, entitled “31-Dec-11 AMA Per Company”, is the Company’s calculation of total investor-supplied working capital.[[5]](#footnote-5) The ensuing columns of page 5 and 6 are Staff’s adjustments to that balance as discussed below. All numbers are total Company and are allocated as I discussed earlier in my testimony.

**Q. Please explain the column entitled “ISWC Adjustment #1”.**

A. Adjustment 1 removes working gas inventory as a direct rate base investment. Avista included $10,772,781 in FERC account 164.1, Gas Stored-Current, a subset of the regulatory asset accounts. This amount represents Washington’s portion of the working gas inventory at Jackson Prairie. This is the inventory amount expected to turn-over at least once within a year’s time. As such, it should be considered a current asset similar to materials and supplies inventory. Therefore, it belongs in working capital.

**Q. Please explain why removing the gas inventory value from Investments places it in working capital?**

A. Recall the basic ISWC equation:

Invested Capital – Investments = Total ISWC.

An account such as the Working Gas normally will carry a debit, or in this instance, a “positive” balance. Adjustment 1 reduces the investment on line 23 and consequently increases the Total Investor Supplied Capital shown on line 53.

 In other words, reducing the “Investments” part of the equation makes “Total ISWC” larger, because the “Invested Capital” amount is unaffected by that change. A current asset such as working gas inventory could potentially be supported by investors as working capital.

 By the same token, increasing Investments will reduce the amount of ISWC. Figure 1 below may assist in visualizing the concept.

 **Figure 1.**

 Investor-supplied Working Capital

 Basic Concepts

Assets

Liabilities

and Owners

Equity

Assets

Liabilities

and Owners

Equity

Assets

Liabilities

and Owners

Equity

Debits

Credits

Debits

Credits

Debits

Credits

Current

Current

Current

Current

Current

Current

Assets

Liabilities

Assets

Liabilities

Assets

Liabilities

ISWC

ISWC

ISWC

increases

decreases

note 1

Investments

Capital

Investments

Capital

Investments

Capital

decrease

same as 1

same as 1

decreased

Note 1:

Note 2:

The reduction in investments,

increases ISWC.

An account, such as Low Income

Funds is taken out of capital.

This reduction in capital, decreases

ISWC

The Balance Sheet 1

The Balance Sheet 3

The Balance Sheet 2

An account, for instance storage gas,

is taken out of investments.

Balance Sheet 1 shows the normal account balance, either debit or credit. Balance Sheet 2 shows the effects of Staff’s Adjustment 1, crediting account 164100 and debiting Current Assets. Lastly, Balance Sheet 3 shows a liability, Low Income Funds, a credit in non-operating investments, being debited and Current Liabilities being credited. The increase to current liabilities relative to invested capital decreases ISWC.

**Q. Do any Staff Adjustments increase Average Operating Investments?**

A. Yes. My Adjustments 4, 8, 9, 10 and 11 each increase Investments, and thus reduce ISWC. Each of these adjustments relate to proper treatment of current liabilities in the ISWC analysis.

**Q. Please explain Adjustment 4 as an example of how to properly treat a current liability in the ISWC analysis.**

A. Adjustment 4 adds the Tariff Rider debit balance of $426,542 to the Other Regulatory Assets/Liabilities on line 23, in Average Operating Investment. A debit balance in the Tariff Rider Account indicates that the Company spent more in DSM measures than it collected from ratepayers. Under the terms of the Commission’s approval of the tariff rider as the recovery mechanism for DSM expenditures, the Company is not allowed to earn a return on a debit balance[[6]](#footnote-6).

 Adjustment 4 ensures that no return is allowed through the working capital calculation. This can easily be seen by evaluating the Company’s treatment of this item. As line 23 of the first column shows, the Company excluded this debit balance from its calculation. Therefore, the Company’s ISWC amount is higher by $426,542, and thus (after allocations, etc.), ratepayers would pay a return on this money. Staff’s Adjustment 4 precludes this from occurring.

**Q. Please explain Adjustments 8, 9, 10 and 11.**

A. Staff’s Adjustment 8 removes the balance of Account 235400, Transmission Service Deposits from line 21, Customer deposits and Advances. Removing this credit from an asset account and transferring it to current liabilities decreases working capital by $792,293.

 Staff’s Adjustment 9, removes Account 242375, Miscellaneous Liability – MT Lease Payments from line 23, Other Regulatory Assets/Liabilities. Removing this credit from investments and transferring it to a current liability decreases ISWC.

 Staff’s Adjustment 10, Accounts Payable – Jackson Prairie Storage also is a current liability in the investments, similar to Adjustment #9. Removing the $356,645 from investments and transferring it to a current liability decreases ISWC.

 Staff’s Adjustment 11 is the same situation as the prior two. Account 232681, Accounts Payable Lake CDA Current Fund, is a liability in the investment account. Removing the $183,333 from investments and transferring it to a current liability decreases ISWC.

**Q. Please explain Adjustment 3.**

A. Staff Adjustment 3 relates to Account 183000, Preliminary Survey and Investigations. The account balance of $4,058,188 is appropriately assigned in line 33, Preliminary Surveys as part of average investments, consistent with prior Commission’s decision on this issue in Docket U-77-25.[[7]](#footnote-7)

 Adjustment 3 removes this amount from working capital and reclassifies it as an investment to prevent the preliminary surveys expenditures from earning a return. As the Commission determined in its order in PacifiCorp Docket U-77-25[[8]](#footnote-8):

 Company proposed the inclusion of materials and supplies Accounts 151, 152, and 154) and miscellaneous electric surveys, investigation and research (Accounts 183, 186, and 187) as a part of the rate base. Commission Staff opposes such inclusions because the final determinations of the accounts have not yet been established – as in the future the Company will capitalize or expense the accounts. Commission Staff, following the investor supplied working capital approach, contends that no allowance for working capital is required. The Commission is of the opinion that the latter approach should be continued; such determination can be made from the record, and by analysis, no working capital is required. The Company position is rejected.

**Q. Your Adjustments 2, 12, 13 and 14 are adjustments to Non-utility/Non-operating Investments. Please explain these adjustments.**

A. Based on Staff’s detailed review of Avista’s balance sheet accounts, Avista does not include the following as investments:

Account 136000, Temporary Cash Investments - $5,837,560;

Account 134150, Other Special Deposits - Energy, $1,600,000;

Account 134120, Other Special Deposits - Newedge, $9,113,203; and

Account 165550, Prepayments - Wilmington Trust, $211,816.

 These accounts are properly classified as Investments because they are either already earning a return, or they are investments in Avista subsidiaries for which ratepayers should not be responsible to pay a return. Staff cures this with its Adjustment 2, Temporary Cash Investments; Adjustment 12, Other Special Deposits – Energy; Adjustment 13, Other Special Deposits – Newedge; and Adjustment 14, Prepayments-Wilmington Trust. In each instance, the debit to Non- Operating Regulatory Investments reduces ISWC.

**Q. Please explain Staff’s ISWC Adjustment 5, Notes Receivable.**

A. Avista includes Account 141150, Notes Receivable Miscellaneous as a current asset. While that may be true from a strict accounting view, this account earns interest. Therefore, it is appropriate to consider this account a Non-utility/Non-operating Investment to avoid allowing it to earn additional return through ISWC. This adjustment removes $287,381 from current assets and adds the same amount to Other Accounts and Notes Receivable. This increase to investments decreases ISWC.

**Q. Please explain Adjustment 6, Low Income Assistance, and Adjustment 7, Margin Call Deposit.**

A. These two ISWC entries are net liabilities within investment accounts. Account 242770, Low Income Funds represents a liability for monies collected for low-income assistance that has not yet been disbursed. It would be unfair for this reduction to investments to have the effect of allowing the Company to earn a return on this money. Staff transfers the credit balance of the account ($3,239,944) to current liabilities. This increases investments thereby reducing ISWC.

 Account 242050, Miscellaneous Liability – Margin Call Deposit carries a credit balance of $678,333. As a liability, it reduces the investment account. Staff Adjustment 7 removes this credit from investments and transfers it to current liabilities. This increases investments, thereby reducing ISWC.

**Q. Please explain Adjustment 15, Other Current Liabilities.**

A. The Company includes Other Current and Accrued Liabilities with a credit balance of $8,235,966 in non-utility investments, as shown on page 5, line 50 of my exhibit. Staff ISWC Adjustments 6 and 7 remove $3,918,277 of that from investments.

 ISWC Adjustment 15 addresses three other accounts:

Account 242775, Miscellaneous Liability – Enron Settlement, a debit of $1,076;

Account 242790, Miscellaneous Liability – Mobius, a credit of ($197,917); and

Account 243000, Obligation Under Capital Lease, a credit of ($209,891). Staff considers these accounts as current liabilities, not investments, and transfers the net credit balance of ($406,732) out of investments and into current liabilities. This transfer reduces ISWC.

**Q. How do these figures translate to Staff’s revenue requirements presentation?**

A. As I explained, Avista includes $18,188,000 of working capital in its electric per books amounts, but no amount of working capital for gas. Therefore, to reflect my $21,932, 000 amount of working capital working for electric operations; I increase the Company’s per books electric working capital figure by $3,744,000. This amount is shown in Ms. Huang’s Exhibit No. \_\_\_ (JH-2), page 2, column e (electric)

 For gas, I simply add $3,568,000 in working capital to rate base. This amount is shown in Mr. Keating’s Exhibit No. \_\_\_ (EJK-2), page 2, column g (gas).

1. **Adjustment 3.06, Electric and Adjustment 3.04, Gas – Property Tax**

**Q. Please explain Staff’s Property Tax Adjustments.**

A. Staff’s Property Tax Adjustments 3.06 electric, and 3.04, gas reflect the Company’s property tax expense using the most current levy rates, and the assessed value as of June 30, 2012, which is the most recent assessed value. This adjustment meets the definition of a pro forma adjustment because it is known and measureable. The Company supplied these Property Tax calculations in its response to Staff Data Request 333. I use the response to Staff Date Request 333 as my Exhibit No. \_\_\_(MDF-3C).

 Although June 30, 2012, is beyond the test period, Staff recognizes that Washington’s method of calculating property tax contributes to the Company’s ability to match the tax expense to the appropriate tax year. In a compromise to the Company’s forecast of using future plant additions that are not known and measurable, Staff recommends using the last known and measurable property tax calculation.

**Q. What is the effect of Staff’s Property Tax Adjustments 3.06 and3.04?**

A. Staff’s Property Tax Adjustments decrease electric net operating income by $29,000.

 Gas net operating income decreases by $40,000.

**Q. Please describe the Company’s Property Tax Adjustments 3.06 and 3.04.**

A. The Company’s Property Tax Adjustments 3.06 (electric) and 3.04 (gas) are based on a forecast of property tax expense for the rate year, as explained in Ms. Andrews’s direct testimony, Exhibit No. \_\_\_ (EMA-1T), page 54. Ms. Andrews states: “the property on which the tax is calculated is the property value as of December 31, 2012.”

**Q. Should the Commission accept the Company’s adjustments?**

A. No. The Company’s adjustments are not known and measureable because they use forecasts of assessed values that may or may not exist in the future. As such, they are not known and measureable and therefore they fail the Commission’s definition of a proper pro forma adjustment in WAC 480-07-510.

 Because the Company’s property tax adjustments are forecasts based on judgment rather than known and measureable data, they fail the “known and measurable” standard the Commission should reject them.

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

A. Yes.

1. Exhibit No. \_\_\_ (MDF-2), at 2, lines 26 and 28, respectively. [↑](#footnote-ref-1)
2. Exhibit No. \_\_\_ (EMA-1T), at 19, line 3 [↑](#footnote-ref-2)
3. Exhibit No. \_\_\_ (EMA-1T), at 19, lines 1-2 [↑](#footnote-ref-3)
4. As shown on Exhibit No. \_\_\_ (MDF-2), at 4, line 66 divided by line 64 (or $43,819,307 ÷ $2,237,202,209 = 1.959%) [↑](#footnote-ref-4)
5. From Ms. Andrews’ workpapers, at 1-03-3. [↑](#footnote-ref-5)
6. *Utilities and Transp. Comm’n v. Avista Corp.,* Docket UE-991606, Third Supplemental Order (September 29, 2000), at 112 [↑](#footnote-ref-6)
7. *Utilities and Transp. Comm’n v. Pacific Power & Light Co.,* Docket U-77-25, Second Supplemental Order (January 19, 1978), at 5 and 6. [↑](#footnote-ref-7)
8. Id. [↑](#footnote-ref-8)