Exhibit No. ___ (DCG-1TC)
Docket UE-140188/UG-140189
Witness: David C. Gomez
REDACTED VERSION

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-140188 and UG-140189** ***(Consolidated)***

TESTIMONY OF

David C. Gomez

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Planned Capital Additions 2013-2015,
Pro Forma Cross Check to Attrition Validation and O&M Offsets

July 22, 2014

Confidential Per Protective Order
REDACTED VERSION

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is David C. Gomez. My business address is the Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., Olympia, Washington 98504.

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

A. I am employed by the Washington Utilities and Transportation Commission ("Commission") as the Assistant Power Supply Manager in the Energy Section of the Regulatory Services Division. I attained this position on July 1, 2012. Prior to my current position, I was the Deputy Assistant Director in the Solid Waste and Water Section of the Regulatory Services Division.

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

A. I have been employed by the Commission since May 2007.

Q. Please state your educational and professional background.

A. I hold a Bachelor of Arts degree in Business from Hamline University and a Masters of Business Administration degree from the University of Saint Thomas; both universities are located in Saint Paul, Minnesota.

Before joining the Commission, my relevant professional experience consisted of 25 years in a variety of fields, including management, contracting, supply chain, procurement, operations and engineering. I hold professional certifications from the Institute for Supply Management (ISM); APICS - The Association for Operations Management; Universal Public Procurement Council (UPPC); and QAI Global Institute (Software Testing).

While employed at the Commission, I have performed accounting and financial analysis of regulated utility and transportation companies, as well as legislative and policy analysis. I presented testimony on behalf of Commission Staff in Docket UE-121373, regarding the Coal Transition Power Purchase Agreement between Puget Sound Energy, Inc. and TransAlta Centralia Generation LLC, Docket UE- 130043, PacifiCorp's 2013 general rate case and Docket UE – 130617, Puget Sound Energy's 2013 Power Cost Only Rate Case (PCORC). I have also presented Staff recommendations to the Commission at numerous open meetings, and worked on various Commission rulemakings.

II. SCOPE AND SUMMARY OF TESTIMONY

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

A. First, I analyze the Company's "pro forma cross-check" (cross-check study) of its revenue requirement calculation. I focus on the rate base part of that study. I conclude that the Commission should not rely on the Company's cross-check study because the evidence shows the Company is not likely to actualize the amount of net plant the Company assumes in its study, and because the Company's study is based on the Company's recently updated capital budget, rendering results that are self-serving.

Second, I analyze the evidence the Company has presented to defend the [redacted] million increase in its budget for capital spending for the years 2014-2018. This substantial increase is the principal reason why the Company's cross-check rate base and revenue requirement so closely match the outcome of the Company's attrition study. I conclude the Company has not demonstrated that this increase is appropriate.

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

A. Yes, I prepared the following exhibits in support of my testimony:

- Exhibit No. __ (DCG-2), Avista's Construction Work in Process (CWIP) Balances.
- Exhibit No. __ (DCG-3), Avista's Capital Expenditures; Variances from 2012 GRC Estimates.
- Exhibit No. __ (DCG-4), Avista's Capital Additions; Variances from 2012 GRC Estimates.
- Exhibit No. __ (DCG-5), Avista's Annual Capital Expenditures, Additions and CWIP Balances, Company.
- Exhibit No. __ (DCG-6C), Company Response to Public Counsel Data Request (DR) No. 22, Confidential Attachment A.
- Exhibit No. __ (DCG-7), Avista Capital Addition Estimate Updates from Original Filing.

III. STAFF'S ANALYSIS OF AVISTA'S FORECAST OF PRO FORMA RATE BASE IN ITS CROSS-CHECK STUDY

Q. Where can the Commission find the Company's pro forma cross-check study in this case?

A. The Company's pro forma cross-check study is in Exhibit No. ___ (EMA-4), sponsored by Avista witness Ms. Andrews.

Q. How does Avista use its cross-check study in this case??

A. The Company uses the cross-check study, including the pro forma rate base contained in that study, to justify the results of the Company's attrition study.

Q. Where can Commission find Avista's capital expenditure and data showing the additions to rate base in this case and the relationship of these figures to the Company's cross-check results?

A. In his Exhibit No. __ (DBD-2), Mr. DeFelice summarizes annual capital expenditures for the years 2005 through 2018.[1] This exhibit shows the capital additions the Company is forecasting for the last half of 2013 and for all of 2014, 2015 and 2016. The capital additions are itemized by Attachment Number and Functional Group, which is how Avista categorizes and tracks individual capital projects for the years 2013-2016 in Exhibit No. __ (DBD-5).

[1] Mr. DeFelice's Exhibit No. __ (DBD-2) includes capital expenditure amounts associated with customer growth which the Company excluded in the capital expenditure amounts in the pro forma cross-check. See Company witness Andrew's Direct, Exhibit No. __ (EMA-1T), at 57, footnote 29. The amounts from 2014-2018 are Company forecasted amounts.

The Company's cross-check total rate base amount in Andrews Exhibit No. __ (EMA-4) is derived by adding the forecasted transfers to plant on a Washington basis for the last half of 2013; End-of-Period (EOP), all of 2014; EOP and 2015; Average of Monthly Averages (AMA).

Q. In his direct testimony,[2] Avista witness Mr. DeFelice refers to both capital additions and capital expenditures; are these terms synonymous?

A. No. "Capital additions" refers to capital projects which are placed in service and the associated investment is contained in the Company's plant accounts.

"Capital expenditures" refers not only to amounts invested in projects that are in service, but also to amounts invested in projects that are under construction and not yet booked to a plant account. While the project is under construction, Avista books these amounts to Construction Work in Progress ("CWIP").

This is an important distinction, which can be lost if these terms are used synonymously. This distinction is important in this case, because the validity of Avista's pro forma rate base contained in its cross-check study depends on whether the Company has a demonstrated ability to complete projects, and thus book capital expenditures to plant (*i.e.,* rate base) accounts.

Q. Is there an observable relationship between capital expenditures and capital additions for Avista?

A. Yes. In Figure 1 below, the Commission can see that from 2010-2013, Avista's sustained pace of increased capital expenditures was not matched one-for-one by

[2] DeFelice Direct, Exhibit No. __ (DBD-1T), at 8:5-21.

corresponding amounts of additions booked to plant accounts. The resulting gap between capital expenditures and additions (the lines in Figure 1) for those years represents growth in CWIP.

Staff's Exhibit No. __ (DCG-5) shows amounts for both capital additions and expenditures, along with beginning and ending CWIP balances. The accuracy of the Company's forecasts for capital expenditures and additions in Figure 1, which show the gap closing by 2014, are dependent on the Company's ability to complete both new, as well as, backlogged capital projects.

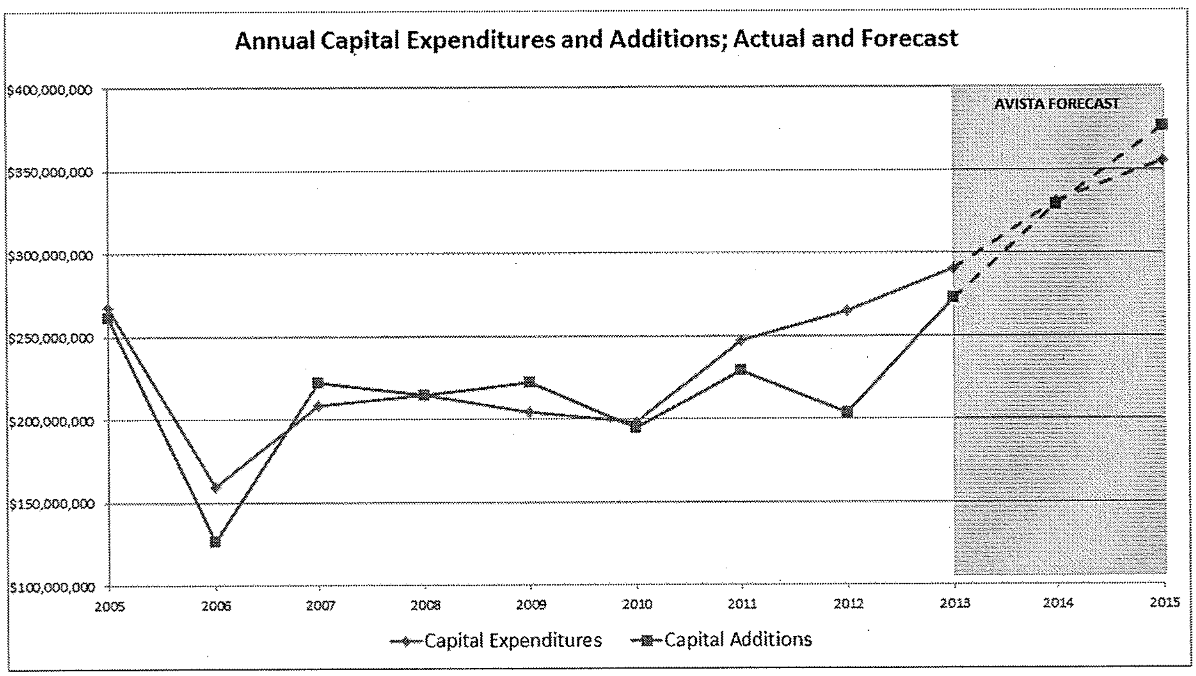

Figure 1; Annual Capital Expenditures and Additions; Actual and Forecast

Q. Has the Company claimed that its capital expenditure projections have been accurate?

A. Yes. Avista claims a high degree of accuracy in its estimates of future capital expenditures,[3] based on the eight year period shown in Table No. 3 of Mr. DeFelice's Exhibit No. ___ (DBD-1T). The Company's exhibit also shows a range of year-to-year differences between actual and planned capital expenditures of 20 percent.

Q. In Avista's 2012 rate case, what did the Company project for total *capital expenditures* for 2012 and 2013?

A. Avista projected $509 million of total capital expenditures for 2012 and 2013.[4]

Q. How close were actual capital expenditures to this estimate?

A. The Company's 2012-2013 projection was $38.9 million (7.6 percent) lower than what the Company actually expended.[5]

Q. In Avista's 2012 rate case, what did the Company project for total *capital additions* for 2012 and 2013?

A. In its 2012 rate case, Avista estimated $484.4 million[6] in capital additions.

Q. How close were actual capital additions to this projection?

[3] DeFelice Direct, Exhibit No. __ (DBD-1T), at 8:11-12.
[4] *Utilities and Transp. Comm'n v. Avista Corp.*, Cause Nos. UE-120436 and UG-120437 (consolidated), DeFelice Direct, Exhibit No. __ (DBD-1T), at 9:1.
[5] Exhibit No. __ (DCG-3).
[6] *Utilities and Transp. Comm'n v. Avista Corp.*, Cause Nos. UE-120436 and UG-120437 (consolidated), DeFelice Exhibit No. __ (DBD-4).

A. Actual capital additions for 2012 and 2013 were $475.7 million, or $8.7 million lower (3.3 percent) than what the Company estimated.[7]

Q. Does the relationship illustrated in Figure 1 above help confirm Mr. DeFelice's conclusion that there is a high level of confidence that the capital additions presented in this case will actually occur for the period July 2013 through December 31, 2015?

A. No. Mr. DeFelice asks the Commission to place its confidence in Avista's estimates of future capital additions based on an analysis of planned versus actual *capital expenditure* amounts for the years 2006-2013 (emphasis added). As we see in Figure 1, while capital additions and capital expenditures may correlate to some extent, they are not the same, and there are many variables that affect whether the expenditures result in additions to plant accounts.

Q. Are there factors that make it difficult to test the accuracy of Avista's projections of capital additions in this case?

A. Yes. To reliably test the accuracy of projections of plant additions from year to year, one cannot rely solely on the difference between planned and actual amounts of capital additions. One would also need to know the extent that any backlogged or delayed capital projects contributed to the actuals in a given year and properly account for those amounts to arrive at a true representation of the Company's performance to its capital project plans. The Company failed to analyze this.

[7] Exhibit No. __ (DCG-4).

By failing to provide such an analysis, Avista has not demonstrated the accuracy of its past and future capital addition projections. Another consequence is that the Company has not demonstrated the reliability of the pro forma rate base amount contained in Avista's cross-check study.[8]

Q. Are there other problems with the projections Avista uses in its cross-check analysis?

A. Yes. While Mr. DeFelice's Exhibit No. __ (DBD-5) does show projected transfers to plant amounts for the last half of 2013, and all of 2014, 2015 and 2016, many of the project documents in the exhibit lack specific milestones, timelines and schedules to backup these projections. This deficiency contradicts Mr. DeFelice's description as to the rigor behind Avista's capital budgeting process.[9]

Also, the cross-check study's projection of capital expenditures seems to be driven by Company's decision in the fourth quarter of 2013 to ramp up capital expenditures for 2014 and 2015 by almost $200 million. My concern is that such an analysis makes the projection self-serving; the type of "self-fulfilling prophecy" which the Commission has been concerned about in an earlier Avista rate case involving similar projections.[10]

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[8] *Utilities and Transp. Comm'n v. Avista Corp.*, Causes UE-120436 and UG-120437 (consolidated), Order 09 (December 26, 2012). The Commission had this same concern in Avista's last rate case. In its final order in the last case, the Commission approved a multi-party settlement stipulation which gave consideration in setting rates for 2013 and temporary rates in 2014, based on attrition "...caused substantially by Avista's ongoing capital expenditure program." In Order 09, at 4-5, ¶ 10, the Commission expressed its concern about Avista's ability to complete the capital projects described in its 2013 capital plan.

[9] DeFelice Direct, Exhibit No. __ (DBD-1T), at 7:8-12.

[10] *Utilities and Transp. Comm'n v. The Wash. Water Power Co.*, Cause Nos. U-81-15 and U-81-16, Second Supplemental Order, at 6 and 7.

In sum, the Company's cross-check rate base results are highly dependent on the Company's ability to complete its projects and transfer them to plant accounts. This is problematic, not only for the new capital expenditures the Company authorized late in 2013, but also a growing amount of CWIP that has built up over the last two years as a result of previous capital spending.[11]

There is, therefore, no real assurance that the budgeted increase in utility plant investment for the years 2014 and 2015 will be transferred to plant accounts and thereby be part of rate base in 2015.

Q. **Can you provide some concrete examples substantiating this concern?**

A. Yes. In 2013, the actual amount the Company transferred to its plant accounts was materially different than the amount it estimated in the Company's direct case. The original estimate was $23.1 million higher than actual.[12] Also, as part of its supplemental response to Staff's Data Request 91, the Company updated its predictions for capital additions in 2014 and reduced its original estimate by $7.7 million from the amounts originally shown in Exhibit Nos. __ (EMA-4) and (EMA-5) of Avista's direct case.

Staff has prepared Exhibit No. __ (DCG-7), which summarizes these amounts and changes through 2015.

The majority of the change in the Company's estimate of capital additions for 2014 and 2015 is the result of Avista's decision in June of 2014 to delay the implementation of its Customer Service and Work and Asset Management software

[11] See Exhibit No. __ (DCG-2) which shows an over a 100 percent increase in CWIP from 2011 to 2013.
[12] Avista response to Staff Data Request 91 Supplemental, Workpaper Attachments.

system (Project Compass) until the first quarter of 2015.[13] In addition to the delay and push out of the planned $67.3 million in Project Compass, the Company is increasing its 2014 capital spending for that project by almost $20 million. The added expenditure for Project Compass is above and beyond the $75 million expenditure increase for 2014 already approved by Avista's Capital Planning Group and Board of Directors late in 2013.

Staff's Exhibit No. __ (DCG-7) shows the reduction in Project Compass capital additions, partially offset by an increase of $24.9 million in forecasted capital additions in the categories of Electric Production, Transmission, Distribution and General. Avista does not provide an explanation as to how it plans to accomplish an almost 25 percent increase in capital additions this year in these categories, with 2014 now more than half over.

Compounding Staff's concern about the viability of Company estimates for capital additions are the data in Avista's workpapers[14] showing almost half of the annual amount of forecasted transfers for 2014 scheduled to move into rate base in the fourth quarter of 2014. For 2015, the fourth quarter amount is 70 percent of the annual amount. Without an understanding of Avista's past performance in meeting capital project due dates, there exists a very real possibility that material differences between forecasted and actual capital additions will occur, which adds more problems to the already unreliable results of the Company's cross-check results.

[13] Avista supplemental response to Public Counsel's Data Request 181, Attachment A, Avista's Project Compass – Revised Timeline and Budget Forecast.
[14] Avista workpapers - WA CapX Additions 12.31.14.xlsx, 2014 Plant Transfers 10-16-13 and WA CapX Additions 12.31.15.xlsx, Tab 2015 Adds.

Delays and cost overruns, compounded by a decision by the Company to significantly increase its capital spending, and rising CWIP levels, are all causes for concern. Despite assurances from the Company that it can complete its capital projects on time and on budget, Staff's analysis casts doubt on Avista's ability to meet the capital project projections it has presented in this case. The bottom line is that the Company has not demonstrated that the rate base amount contained in its cross-check study is a reliable figure.

III. STAFF'S ANALYSIS OF AVISTA'S DECISION TO INCREASE CAPITAL SPENDING

Q. What is the background behind Avista's increase in planned capital spending?

A. Since 2006, Avista's capital expenditures have grown by a total of almost 90 percent.[15] The Company is planning to spend almost $700 million[16] in 2014 and 2015 for capital projects in: enterprise technology, generation, transmission and distribution, environmental remediation, gas distribution and customer growth.

From 2010-2013, Avista's capital expenditures averaged $253 million per year. However, at the end of 2013, the Company decided to significantly increase capital expenditures for 2014-2018, raising the annual average by almost $100 million, compared to the annual average for the prior three-years; 2010-2013.[17]

[15] DeFelice Direct, Exhibit No. __ (DBD-2).
[16] 2014's approved level of capital expenditures is $331 million and for 2015, $355 million.
[17] For 2014, [redacted] million increase and for 2015, [redacted] million increase from originally planned amounts.

Q. What does Avista cite as the primary drivers for its decision to significantly increase capital spending for the years 2014-2018?

A. The Company cites the primary drivers for increasing capital expenditures as: 1) the business need to fund a greater portion of the departmental requests for new capital investments that in the past have not been funded; 2) the need to capture investment opportunities and benefits identified by our asset management capabilities, and 3) a continued focus on controlling the increase in operation and maintenance (O&M) spending through prudent capital investment.[18]

The Company also states that the timing for increasing its capital spending is appropriate because of low capital costs funding projects now will result in lower long-term costs to customers.[19]

Q. How much of the increase in capital spending for the years 2014-2018 does Avista plan for the years 2014 and 2015?

A For 2014 and 2015, the Company has decided to increase its capital spending by [redacted] million.

Q. In what specific areas of its operations does Avista plan to use the incremental [redacted] million in increased capital spending for the years 2014 and 2015?

A. For 2014 and 2015, the Company has decided to increase its Functional Group capital spending by the following amounts:[20]

- Electric Transmission and Distribution - [redacted] million.

[18] Thies Direct, Exhibit No. __ (MTT-1T), at 6:16-21.
[19] Morris Direct, Exhibit No. ___ (SLM-1T) at 10:12-13.
[20] Public Counsel Data Request 022C, Confidential Attachment A, at 49.

- Generation - [redacted] million.
- Gas - [redacted] million.
- Enterprise Technology - [redacted] million.
- Growth - [redacted] million.
- Other - [redacted] million.
- Environmental - [redacted] million.

Q. Have you prepared an exhibit that provides a more detailed breakdown?

A. Yes. In my Confidential Exhibit No. __ (DCG-6C), pages 34, 35 and 36, I provide information from Avista's September 30, 2013, meeting of its officers regarding the Company's five-year capital plan. The proposed five-year plan divided incremental spending amounts into three categories, which comprise almost 75 percent of the Company's [redacted] million increase for 2014 and 2015. They are:

- Revised estimate to complete – An additional [redacted] million for projects already in process and which require more funding to complete than what was originally planned.[21]
- Improved funding of base projects - [redacted] million added to blanket capital projects like Wood Pole Management, Road Moves, Substation Capital Spares and Transformer Change Outs. These blanket capital projects are of an on-going nature.
- New Business Cases –Added [redacted] million in new projects.

[21] Does not include the Company's recent addition of another almost $20 million in spending for Project Compass.

The remaining [redacted] million of the [redacted] million increase is spread across a number of other capital projects with over half the amount going to accelerate completion of already planned programs in the Gas and Electric Transmission and Distribution Functional Groups.

Q. Has the Company justified the need for the [redacted] million in increased capital spending approved late in 2013?

A. No. Avista witnesses[22] have not identified in their testimony the specific "business needs" and "investment opportunities and benefits," cited in Company witness Mr. Thies' testimony as justification for an increase of [redacted] million in capital spending. In addition, the Company claims that one of the benefits resulting from the significant increase in capital spending for 2014 and 2015 is that it contributes toward controlling increases in Avista's O&M spending. Nowhere in its testimony has the Company made the connection between the increase in O&M spending for 2014 and 2015 resulting from Avista's increase in capital spending and controlling O&M cost increases.[23]

For example, the Company's justification for an additional [redacted] million in capital spending in electric transmission and distribution capital projects in this case is presented in the testimony of Ms. Rosentrater. However, her testimony provides only generalized statements of efficiency gains, savings and offsets stemming from transmission projects planned for 2013-2015. She says nothing about how the incremental increase in capital spending adds a corresponding incremental value to

[22] Mr. Scott Kinney for generation, Mr. Jim Kensok for enterprise technology and Ms. Heather Rosentrater for electric transmission and distribution.
[23] Exhibit No. __ (DCG-6C), at 39.

rate payers. I note also that her testimony is almost word-for-word the same as Mr. Kinney's testimony on the same subject in the 2012 rate case.[24]

Q. Does Avista claim it needs to ramp up its capital expenditures to fulfill its obligation to serve?

A. Yes. Mr. Morris cites the Company's legal obligation to provide safe and reliable service to every customer as reasons for Avista's significant increase in capital spending.

Q. Has Avista demonstrated that its ramp up in capital expenditures is necessary to fulfill its obligation to serve?

A. No. Avista has not provided sufficient evidence to demonstrate that the increase in its capital budget is necessary to meet its obligation to serve. In RCW 80.28.010(2) it states that the utility; "shall furnish and supply such service, instrumentalities and facilities as shall be safe, adequate and efficient, and in all respects just and reasonable." Avista needed to show how its decision to increase capital spending is just and reasonable and results in facilities that are both efficient and adequate.[25]

For example, the Company did not provide sufficient evidence to show or quantify how test period capital expenditures are in response to specific safety and reliability obligations, nor is there any direct evidence presented by the Company to show that its increase in capital expenditures for 2014 and 2015 are appropriate to

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[24] Comparison of Rosentrater Direct, Exhibit No. __ (HLR-1T), pages 17 (at 19-23) through 20 and *Utilities and Transp. Comm'n v. Avista Corp.*, Cause Nos. UE-120436 and UG-120437 (consolidated), Kinney Direct, Exhibit No. ___ (SJK-1T), pages 17-19.

[25] RCW 80.28.010(2).

meet specific performance and reliability requirements. In particular, Avista offers no explanation why an increase in capital spending is the preferred option when compared to other alternatives such as delaying projects or re-prioritizing funding, like Avista has done in the past.[26]

In the past, the Company chose to delay funding for certain capital projects when it believed the amount of risk associated with the delay was reasonable and prudent.[27]

Q. Does Avista's direct testimony discuss how shareholder interests weighed into the Company's decision to increase its capital spending?

A. No. In Mr. Thies' testimony, he lists several factors Avista considers when setting its overall level of capital investment each year.[28] He did not list shareholder interests. Yet, shareholder interests appear to be a key factor Avista considered. For a utility with low revenue growth such as Avista, the only ways to improve earnings is to cut costs and/or increase rate base. From the materials presented in my Exhibit No. __ (DCG-6C), I am concerned that one of the considerations for increasing capital spending is the preservation of shareholder value in the form of targeted Earnings per Share (EPS).

Q. What do you conclude and recommend?

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[26] *E.g., Utilities & Transp. Comm'n v Avista Corp.*, Dockets UE-120436 & UG-120437, Exhibit No. __ (SLM-1T), Page 21, ¶¶ 16-23; *Utilities & Transp. Comm'n v Avista Corp.*, Dockets UE-110876 & UG-110877, Morris Direct, Exhibit No. __ (SLM-1T), at 18, ¶¶ 21-26; and *Utilities & Transp. Comm'n v Avista Corp.*, Dockets UE-100467 & UG-100468, Morris Direct, Exhibit No. __ (SLM-1T), at 34, ¶¶ 6-11.
[27] *Id.,* and in this docket, Morris Direct, Exhibit No. __ (SLM-1T), at 10:2-4.
[28] Thies Direct, Exhibit No. __ (MTT-1T) at 6:1-8.

A. I conclude the Company has not shown that its significant ramp-up in capital expenditures is reasonable. As I noted earlier in my testimony, the Commission had expressed its concern in the last rate case regarding the Avista's ability to complete the capital projects described in its capital plan.[29] Staff believes that the Commission's concern is well placed.

Earlier in my testimony, I explained the importance of distinguishing between capital expenditures and additions. For this reason, Staff recommends the Commission expand its requirements of the Company's reporting on its capital spending from the last case to include actual versus planned transfers to plant along with planned versus actual CWIP balances. In addition, the information regarding capital expenditures, transfers to plant and CWIP should be broken out by Functional Group.

While Staff found the Company's Capital Investment Business Cases in Exhibits No. __ (DBD-5) helpful, Staff recommends Avista provide greater detail around the calculation of Assessment Scores for each business case, particularly how it arrived at the financial assessment score which represents the customer's internal rate of return.[30] Furthermore, each business case should contain an accurate timeline with information regarding milestones and completion dates that correspond with expected and actual transfers to capital reported elsewhere.

Q. Does this conclude your testimony?

A. Yes.

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[29] *Supra* n15.
[30] Avista's response to ICNU Data Request 1.8.