Exh. BAE-1T
Dockets UE-170485/UG-170486
Witness: Betty A. Erdahl

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION,** **Respondent.**	**DOCKETS UE-170485 and UG-170486** ***(Consolidated)***

TESTIMONY OF

Betty A. Erdahl

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Investor Supplied Working Capital
Adjustments 1.03 E-WC and 1.03 G-WC

October 27, 2017

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Betty A. Erdahl and my business address is the Richard Hemstad Building, 1300 S Evergreen Park Drive SW, P.O. Box 47250, Olympia, Washington, 98504. My email address is berdahl@utc.wa.gov.

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

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as a Regulatory Analyst in the Energy 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 June 1991.

Q. Please describe your education and relevant work experience.

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

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

Q. Have you testified before this Commission?

A. Yes. I testified in Docket TG-920090, regarding affiliated interests of Waste Management, Inc.; Docket UT-950200, regarding a general rate case of US WEST Communications, Inc.; Docket UT-970066, regarding payphone access line rates of Toledo Telephone Company; Docket UT-020406, a complaint by AT&T Communications of the Pacific Northwest, Inc. against Verizon Northwest Inc.'s access charge rates; Dockets UE-111048/UG-111049, regarding a general rate case of Puget Sound Energy (PSE); and Docket UE-130043, regarding a general rate case of Pacific Power & Light Company (Pacific Power). I also prepared testimony in Dockets UE-170033/UG-170034, regarding investor supplied working capital in a general rate case of PSE; Dockets UE-140188/UG-140189, regarding a general rate case of Avista Corporation (Avista); Docket UT-040788, regarding a general rate case of Verizon Northwest Inc.; Docket UT-051291, regarding affiliated interest

contracts, overall earnings review, and provision of a quality of service guarantee program in the Sprint spin-off of its local exchange companies; Docket UT-082119, regarding retention of pre-merger settlement provisions, a requirement to offer a quality of service guarantee program, and affiliated interest reporting in the CenturyTel/Embarq merger case; and Docket UE-140762, et al., regarding a general rate case of Pacific Power, including an adjustment to investor supplied working capital (ISWC).

II. SCOPE AND SUMMARY OF TESTIMONY

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

A. I present Staff adjustments to the Company's investor supplied working capital ("ISWC"), which Avista includes as a line item in the per books rate base in the test year results of operations.[1] Staff's ISWC adjustments are identified as electric Adjustment 1.03 E-WC and gas Adjustment 1.03 G-WC. Staff's adjustments are intended to replace the ISWC adjustments proposed by the company.

Q. Please provide a brief overview of your recommendation.

A. I recommend re-categorizing four accounts, which in turn changes the overall ISWC amount. I also recommend that the Commission revise Avista's as-filed methodology for allocating ISWC between electric and gas operations. The recommended change in allocation method is a result of allocating ISWC to

Washington Electric and Gas operations based on investment rather than current asset and current liability accounts. Avista allocated ISWC based on its analysis of current asset and current liability accounts. Staff's recommended methodology results in slightly more working capital being allocated to electric operations and less working capital allocated to gas operations. Staff's recommended allocation method is also consistent with the Commission's accepted approach to ISWC for Pacific Power, Puget Sound Energy, and Cascade Natural Gas Corporation.

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

A. Yes, I have six supporting exhibits.

Exh. BAE-2 depicts Staff's recommended working capital amount for inclusion in rate base. Staff proposed an adjustment to Avista's working capital to arrive at its ISWC because the Company includes working capital in the per books results of operations. The results for electric and gas operations are presented in my exhibit on pages 2 and 3, respectively and incorporated into Staff witness Joanna Huang's Exh. JH-2 for electric operations and Exh. JH-3 for gas operations.

Exh. BAE-3 shows the detailed account-by-account analysis for calculating Staff's proposed ISWC. BAE-3 shows each balance sheet account, the associated dollar values, and categorization or re-categorization, as applicable.

Exhibits BAE-4 through BAE-6 are Avista responses to Staff data requests. In responding to Staff's requests, the Company discovered that many balance sheet accounts should be re-categorized and updated in the ISWC calculation. Avista's

[1] *See* Elizabeth M. Andrews, Exh. EMA-2 at 4-6, Row 48 and Andrews, Exh. EMA-6 at 4-5, Row 46

responses, which I am including as exhibits, support Staff's Adjustments 1.03 E-WC and 1.03 G-WC and show that Staff and Avista agree on at least several of the re-categorized accounts. Exh. BAE-4 is Avista's Response to Staff Data Request No. 245, Exh. BAE-5 is Avista's Response to Staff Data Request No. 246, and Exh. BAE-6 is Avista's response to Staff Data Request No. 241.

Exh. BAE-7 is also an Avista Response to a Staff data request that updates Avista's working capital adjustment to reflect the account-specific changes that Staff and the Company agree on and which Avista acknowledged in prior discovery responses.

III. INVESTOR SUPPLIED WORKING CAPITAL 101

Q. What is cash working capital?

A. Cash working capital refers to the funds necessary to sustain a company in its day-to-day operations. It is calculated by subtracting current liabilities from current assets.

Q. What is the ratemaking perspective on cash working capital?

A. In rate setting, the goal is to directly measure whether or not investors actually supply working capital. If they do, it is appropriate to allow a return on the amount of working capital the investors supply.

Q. What is the basic concept of the investor supplied working capital (ISWC) method?

A. Broadly speaking, the ISWC method, also known as the balance sheet method, measures the difference between the capital invested in a business and the investments in the business. In other words, ISWC is the amount of invested capital that was provided by investors and available for the company's use, over and above the company's investments in operating plant, non-operating plant, and other specific items of investment. If there is an excess of invested capital over investments, that amount is the working capital supplied by investors, or ISWC.

In summary, the ISWC method directly measures the amount of working capital that investors provide. If there is such an amount, it is included in rate base and earns a return and is allocated to operating and non-operating segments of the business based on the ratio of investments in each segment.

Q. Who provides working capital besides the investor?

A. Working capital may be provided by ratepayers or non-investors via various regulatory treatments such as deferred income taxes, unamortized investment tax credits, customer deposits, or trade creditors. The Company has use of those funds for a period of time.

Q. In general, how is ISWC allocated to the regulated portion of Avista's business?

A. Once the amount of investor supplied working capital is calculated, there are two basic assumptions applied:

1. ISWC is used for both operating and non-operating investments; and

2. The operating investments and non-operating investments share pro-ratably any excess investor-supplied funds.

Q. What has the Commission said about working capital in the recent past?

A. In the 2005 Pacific Power & Light general rate case, the Commission stated, "…the objective is to quantify the amount of working capital and current assets supported by capital on which investors are entitled to a return." The Commission also said: "We [the Commission] also expect Staff and other parties to provide full evidentiary support of any proposals and methods they may submit to substantiate adjustments to a company's figures."[2]

IV. STAFF ADJUSTMENTS 1.03 E-WC and 1.03 G-WC

A. Overview of the material differences between Staff's recommendation and the Company's proposal as filed.

Q. Please summarize Staff's recommendation to the Commission.

A. Staff recommends that the Commission adopt Staff's method of directly allocating the ISWC to the electric, gas, and non-operating segments based on investment rather than current asset and current liabilities accounts. Staff also recommends modifying the assignments of four balance sheet accounts within the ISWC to more appropriate categories. Staff's recommendation reduces Avista's per books ISWC amount for electric and gas operations by approximately $7 million and $4 million, respectively.

Q. How does Avista calculate the ISWC for Washington's electric and gas operations?

A. Avista does use the balance sheet approach, but it allocates the result by a mixture of methods. First, Avista allocates ISWC to its regulated and non-operating segments of the business using the percent of investment attributed to each of those categories. Second, Avista uses a new and different method to allocate ISWC between electric and gas. This new method allocates ISWC based on current asset and current liability accounts. My guess is that the Company uses current assets and current liabilities with the idea that it could determine the source of current and ongoing cash needs. However Avista did not provide support or a detailed explanation for its new method.

Q. Which exhibits document the differences between Staff's and the Company's ISWC proposals?

A. All of the exhibits are relevant and useful, but Exhibits BAE-2 and BAE-3 document the account-level differences between Staff and the Company and Staff's calculation methodology, respectively. I provide Exh. BAE-2, which is a summary of Staff's adjustments to Avista's ISWC. Exh. BAE-3 is a complete ISWC calculation, with all accounts listed, each account categorized, an allocation of ISWC to operating and

[2] *Wash. Util. & Transp. Comm'n v. Pacific Power and Light Company*, Docket UE-050684, Order 04 at ¶¶ 188-189 (April 17, 2006) ("2005 Pacific Order").

non-operating segments of the business, and an allocation of operating ISWC to the Washington electric and gas segments of the Company's business.

B. Details of Staff's Analysis

1. Specific calculation and Total dollar impact

Q. Please explain the foundations of Staff's analysis.

A. The starting point for my analysis is Avista's total company balance sheet as of December 31, 2016, on an average of monthly averages basis. The Company provided that document to Staff in discovery.

Q. How did Staff calculate the total ISWC?

A. Staff reviewed the underlying balance sheet accounts, as shown in my Exh. BAE-3. The amounts of each account (Col. a) are put into one of four categories. Next, the "Total Investments" is categorized into Investments-Rate Base or Non-Operating Investments category. Staff then independently calculated ISWC by subtracting the total investments (Line 769, Col. e) from the total invested capital (Line 769, Col. d). The resulting ISWC is $131,204,725. In other words, investors are supplying capital to the tune of about $131 million for Avista's cash flow needs. I provide a detailed, column-by-column explanation of my Exh. BAE-3 later in my testimony.

Q. How did Staff allocate the $131,204,725 in ISWC?

A. As noted above, Staff allocated the $131 million of ISWC to two categories: operating investment and non-operating investment: 86.87 percent is operating and 13.13 percent for non-operating based on investments. Therefore, investors supply the utility with about $114 million of the $131 total ISWC for utility operations. Non-operating investments receive the balance of $17 million of working capital as calculated on Lines 788-790, Col. a.

Then an allocation of the operating ISWC of $113,979,205 (Exh. BAE-3 at Line789, Col. a) is allocated to Washington electric and gas operations based on investment. The average investment and allocation factors from Avista's quarterly reports are shown on Exh. BAE-3 at Lines 772 – 783, Col. e. The calculated allocation factors are shown on Line 774 (Col. e) for electric and Line 778 (Col. e) for gas of my exhibit BAE-3 as 51.06 percent for electric and 10.07 percent for gas. As my exhibit BAE-2 shows, approximately $58 million (Line 18, Col. d) is allocated to electric operations and more than $11 million (Line 21, Col. d) is allocated to gas operations.

2. Rationale for allocating ISWC on the basis of investment rather than current assets and current liabilities.

Q. Why does Staff allocate investor supplied working capital using investment?

A. The balance sheet approach to calculating ISWC is based on the idea that total capital supports all investments in all segments of the business. That is, capital is financing the asset side of the balance sheet and, as a result, it is reasonable to allocate that capital based on the assets of each business operating segment.

Staff also values consistency of ISWC methods between the utilities in Washington. The ratio-of-investments method of allocating investor supplied working capital is similarly used by Puget Sound Energy, Pacific Power and Light, and Cascade Natural Gas Corporation to allocate working capital to each segment of the business.

Apportioning ISWC as above provides the regulated utility a fair opportunity to earn a return on the working capital in proportion to each segment of its regulated business in Washington.

Q. Is the Company's working capital allocation fair and reasonable?

A. No. As noted above, Avista's allocation of ISWC is not used by any other utility in Washington State to calculate working capital for electric or gas segments of the business. Avista's allocation is also confusing because while the Company allocates ISWC to the non-operating segment of the business using investment/rate base, it uses a different method to allocate ISWC between electric and gas segments of the business.

As far as Staff can tell, the Company's proposed allocation of "operating" ISWC based on current asset and current liability accounts has not been fully explained by Avista or specifically approved by the Commission in this case or a prior case. My Exh. BAE-6, Avista's response to UTC Staff Data Request No. 241, states that the new method of allocating working capital was not used in the 2010, 2011, or 2012 rate cases and those three cases were settled and silent to the allocation of ISWC. Avista's response also asserts that the company used and

supported this new method of allocating ISWC in the 2014 general rate case, Docket Nos. UE-140188 and UG-140189. However, Ms. Andrew's Exhibit EMA-1T, Page 37 at Lines 26-28 states: "This methodology is consistent with the ISWC the methodology utilized in the past three general rate cases, Docket Nos UE-100467, UE-110876 and UE-120436." and failed to explain this new method of allocating ISWC, therefore full evidentiary support of this new method has never been offered to Staff's knowledge.

3. Rationale for re-categorizing accounts to non-operating, and thus removing them from the ISWC for utility operations.

Q. What types of accounts did Staff assign to the non-operating category?

A. The following types of accounts were put into the non-operating category by Staff: accounts earning or accruing interest on behalf of Avista or the rate payer (e.g., bank accounts, escrow accounts, and Purchase Gas Adjustment accounts), accounts that are not allowed for rate making purposes (e.g., charity and donations), and accounts that are related to non-utility operations. These accounts not allowed to earn a return for rate making purposes to assure that rate payers are not required to pay a return on those accounts because it is not fair, just or reasonable. Hedging is considered non-operating because it is simply a result of market changes, it is more of an accounting "artifact" and does not represent a real investment by the company. As for charity and donations, these have always been disallowed for rate making purposes because they are not related to providing electric or gas service to customers.

Q. What is Staff's criteria for assigning these accounts to the non-operating category vs current asset or current liability category?

A. If an investment account that earns interest is put into the electric or gas category it would result in the opportunity for Avista to benefit from a second return from the rate payers in addition to the interest the Company is already earning. Staff re-categorized Accounts 131400 and 136000 to non-operating because these accounts earn interest and thus should not generate a second return for investors through working capital treatment. These accounts are also categorized as non-operating for the other regulated utilities in Washington State because these accounts earn interest.

The other two accounts that Staff categorized differently than Avista are related to Idaho earnings test liability. The Company categorizes similar accounts for Washington operations as current liabilities because interest may not accrue until such time that the earning test has been completed. In other words the account represents a current liability and is a source of working capital because it does not earn interest. Staff re-categorized the two Idaho accounts to be consistent with Washington ratemaking treatment. Idaho does not require interest be accrued for those accounts in the Idaho sector of its business.

Q. What about those accounts that Avista corrected or revised in response to Staff's data requests in this case?

A. As I noted above, Avista identified many accounts the Company categorized incorrectly in the initial filing. The Company re-categorized those accounts in an updated ISWC calculation provided in Exh. BAE-7, response to UTC Staff Data

Request No. 244. Staff and the Company agree that those accounts should be re-categorized for various reasons: interest rate hedging accounts were re-categorize from non-operating to invested capital, workers compensation is a current liability re-categorized from non-operating, the rate accrual earnings test represents a liability that is not eligible to accrue interest on the amount and moved from non-operating to the liability category, and post-retirement benefits not allowed for ratemaking were re-categorized to non-operating. My exhibits include the Company's revisions and corrections and my account-by-account analysis in BAE-3 also reflects the Company's acknowledged changes.

C. Explanation of Exhibits

Q. Please walk through your Exh. BAE-2.

A. The starting point for my analysis is Avista's total company balance sheet as of December 31, 2016, on an average of monthly averages basis, shown in Exh. BAE-7, as provided by the Company in its response to UTC Staff Data Request No 244.

Exh. BAE-2 shows the total average invested capital on Line 2 less total average investments on Line 5 equals total investor supplied working capital of $131 million on Line 7, Col. d. The ISWC is then allocated between operating of $114 million and non-operating of $17 million which are shown on Lines 11 and 15, respectively. Operating investments are 86.87 percent on Line 10 and non-operating investments are 13.13 percent of the total on Line 14.

Operating ISWC on Line 11 is then allocated to electric of $58 million and gas of $11.5 million, which is calculated by multiplying the total operating ISWC (Line 11) by the electric percentage of 51.06 and gas percentage of 10.07. The percentage allocated based on investment is derived in the quarterly report allocating operating investment to each state (Washington, Oregon, and Idaho) and service (electric and gas).

Q. Please explain how Exh. BAE-3 calculates ISWC.

A. Column a shows Avista's total company balance sheet as of December 31, 2016, average of monthly average balances. These amounts go into the following categories and columns:

- Current Assets (Col. b);
- Current Liabilities (Col. c);
- Average Invested Capital (Col. d); and
- Total Investments (Col. e).

Next, my exhibit BAE-3 documents the "Total Investments" as sub-categorized into operating (Col. f) or non-operating (Col. g).

Once all accounts are categorized appropriately, total investments are subtracted from average invested capital to determine whether or not the investors have provided working capital to meet the day-to-day needs of the business. Staff's ISWC calculation of $131,204,725 (shown on Line 770, Col. e) is the amount being provided by investors. This working capital amount is then allocated based on operating and non-operating investment divided by the total average investments to

get each component's prorated share of working capital. The calculated allocation factors are shown on Line 771, Col.s f and g as 86.87 percent for operating and 13.13 percent for non-operating.

The percentage for each of these two categories is then multiplied by Staff's proposed working capital amount on Line 770, Col. e to determine the amount of working capital that should be allocated to each category on Lines 789, Col a and 790, Col a.

Finally, the ISWC allocated to the operating segment of Avista's business is allocated to electric on Line 774, Col. d and gas operations on Line 778, Col. d.

V. CONCLUSIONS

Q. What are your conclusions regarding the working capital adjustment?

A. For the reasons I have stated, the Commission should accept Staff's method for calculating working capital:

- Categorize each account as shown in Exh. BAE-3; and
- Allocate ISWC based on percentage of total average investment as shown in BAE-2.

Q. Does this conclude your testimony?

A. Yes.