Exh. KBS-1T
Docket UE-170485/UG-170486
Witness: Kathi B. Scanlan

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

Kathi B. Scanlan

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Pro Forma Rate Base Adjustments, Modified Historical Test Year and Pro Forma Policy, Pro Forma O&M Offsets

October 27, 2017

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kathi Scanlan and my business address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, 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 a Regulatory Analyst in the Conservation and Energy Planning 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 2016.

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

A. I earned a Master of Engineering Management degree at Saint Martin's University in Lacey, Washington. I also obtained a Bachelor of Arts degree in Economics and Physics (Dual Major) from Claremont McKenna College in Claremont, California. Before joining the Commission, my professional experience includes over 10 years of regulatory analysis and rulemaking experience gained at the Washington Department of Ecology. While employed at the Commission, I completed the 58th Annual Regulatory Studies Program at the Institute of Public Utilities at Michigan State University in August of 2016. I also completed the Public Utilities Reports

Guide's "Principles of Public Utilities Operations and Management" in October of 2016.

Q. Have you previously testified before the Commission?

A. No.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. Please explain the purpose of your testimony.

A. My testimony provides an overview of the Commission's modified historical test year ratemaking practice, pro forma policy, and Staff's application of those Commission standards as applied to Avista's rate base adjustments in this case. I respond to Avista witness Ms. Schuh and address the treatment of pro forma 2017 major threshold capital additions and operations and maintenance (O&M) offsets. These capital adjustments are incorporated into the Company's three studies sponsored by Ms. Andrews: 1) Traditional Pro Forma Study, 2) EOP Rate Base Study, and 3) Rate Year Study. Avista witnesses Scott Kinney, Heather Rosentrater, and James Kensok, also provide direct testimony about system-forecasted capital additions from 2017 through 2021.

Q. Please summarize your recommendations.

A. First, Staff recommends allowing an EOP adjustment in this particular case, moving test year plant balances from an AMA to an EOP basis, for results ending December

31, 2016. Staff recommends the Commission include Staff's "Restate Plant from AMA to EOP" adjustments, totaling $69.7 million rate base for electric, and $14.2 million rate base for natural gas operations (Electric-2.19, Gas-2.16).

Second, Staff recommends pro forma rate base adjustments for actual transfers to plant through August 31, 2017, for the following three electric operation projects and programs: Substation Rebuilds, Information Technology Refresh Program, and Distribution Grid Modernization. Staff's proposed Electric Adjustment 3.10 results in an additional $8.7 million in rate base for 2017 major pro forma capital additions.

Third, for natural gas operations, Staff also recommends accepting five projects and programs actual transfers to plant through August 31, 2017: Aldyl-A Pipe Replacement, Information Technology Refresh Program, Information Technology Expansion Program, COF Long Term Restructuring Plan Phase 2, and Gas Distribution Non-Revenue Blanket. Staff proposed Natural Gas Adjustment 3.10 results in an additional $7.9 million in rate base for 2017 major pro forma capital additions.

Fourth, for both electric and natural gas operations, Staff has not included any O&M offsets because the programs or projects associated with those offsets do not qualify as major. Staff's recommendation on this portion of the Company's case has zero net effect on pro forma O&M expense.

Q. Please identify the specific pro forma capital and offset adjustments tied to your recommendations.

A. Staff contests pro forma capital additions (Adjustments 3.10) and O&M offsets adjustments (Adjustment 3.11) for electric and gas operations. Staff also provides a correct representation of an AMA to EOP test year adjustment for 2016 capital additions (Electric-2.19, Gas-2.16).

Q. How is your testimony organized?

A. My testimony has four components:

- **Commission Ratemaking Practice.** First, I discuss the Commission's ratemaking practice using a modified historical test year and address key concepts, including the accounting treatment of average monthly averages (AMA) and end of period (EOP) plant balances. I also address the risks associated with pro forma adjustments, consideration of offsetting factors, attestation timelines for the case, and the prudence of significant business asset acquisitions.
- **Staff Application of Commission Standards.** Second, I present Staff's 2016 AMA to EOP test year adjustment for 2016 capital additions (Electric-2.19, Gas-2.16). Further, I offer analysis related to Staff's recommended 2017 *limited* pro forma adjustments (Electric-3.10, Gas-3.10) and O&M offset adjustments (Electric-3.11, Gas-3.11).
- **Company's Direct Case for 2017 Capital Additions.** Third, I provide an overview of the company's direct case for pro forma 2017 capital additions, including forma 2017 capital addition threshold criteria for pro form adjustments (Electric-3.10, Gas-3.10). I also point out key

differences between the Company's definition of an "end of period" (EOP) adjustment relied on in its EOP Rate Base Study (Electric-3.15, Gas-3.14) and the standard definition of an EOP adjustment for capital additions.

- **Additional Concerns with Capital Projects.** I also address concerns with select capital additions presented by the Company, including Colstrip Units 3 & 4 upgrades, a purchase/upgrade to its current corporate jet, and construction of a new hangar for the jet.

Q. Please identify other members of Staff that have testimony related to pro forma capital additions and EOP accounting.

A. Staff witness Christopher Hancock directly responds to Avista's electric pro forma capital electric Adjustment 3.15 (in EMA-3) and natural gas Adjustment 3.14 (in EMA-7), included as part of Avista's EOP Rate Base Study. Mr. Hancock will also address extraordinary rate-making treatment, regulatory lag, revenue sufficiency, and a multi-year rate plan. Joanna Huang will present Staff's results of operations and revenue requirements analysis.

III. COMMISSION RATEMAKING POLICY AND STANDARDS

Q. What is the Commission's traditional ratemaking practice?

A. The Commission has said,

> "The Commission's long-established ratemaking practice requires companies filing for revised rates to start with an historical test year. There is a fundamental reason for this starting point: costs, revenues, loads and all other pertinent factors can be measured with a high degree of certainty because they have, in fact,

> occurred. The practical value of the historical test year is that the cost, revenue and plant data are available for audit, and the test year captures the complex relationships among the various aspects of utility costs, revenue, load, and other factors over a uniform period of time."[1]

To determine the appropriate revenue requirement for the rate-effective period, the Commission allows certain restating adjustments, the purpose of which is to "normalize" the test year, as well as pro forma adjustments to capture certain known and measureable changes that occurred subsequent to the conclusion of the test year. Historically, these pro forma adjustments have been limited to those that meet certain criteria, which I discuss below. Thus, the Commission's standard ratemaking practice is built around two basic components: 1) the modified historical test year, and 2) limited pro forma adjustments.

A. Modified Historical Test Year

Q. How does the Commission use a modified historical test year?

A. The modified historical test year starts with actual historical test year per book amounts. Certain restating adjustments then restate those per book amounts to reflect a typical operating year. The purpose of restating adjustments is to ensure that the test year reflects "normal" circumstances. For example, if test year winter weather was abnormally cold, we would not want to calculate rate year revenue and expenses using the corresponding abnormal winter sales volumes. To correct for abnormal weather conditions, we restate sales volumes to reflect "normal" weather. Revenue

[1] *Wash. Utils. & Transp. Comm'n. v. Avista Corp*., Dockets UE-160228 and UG-160228, Order 06, ¶ 80 (Dec. 15, 2016).

requirement is based on the assumption that circumstances in the rate year, including weather, will be normal.

Restating adjustments are also used to remove or smooth the effect of irregular events. The purpose of the full collection of restating adjustments is to ensure that the test year is a fair representation of the normal circumstances the business is expected to face in the rate-effective period. This restated, or "modified" historical test year is the basis upon which the Commission calculates a utility's revenue requirement.

Q. How are plant balances represented in the modified historical test year?

A. Plant balances are typically given on an "average of monthly averages" (AMA) basis. "Average of monthly average" rate base is calculated by determining the average net book value of each month of the test year and then averaging those 12 figures. The Commission has long used AMA plant balances for determining rate base because AMA balances maintain the matching principle.[2]

Q. What is the matching principle and why is it important to understand for AMA plant balances and rate base additions?

A. Representing plant balances on an AMA basis ensures that, for each month of the test year, revenues and expenses are matched to the plant balance for that month.[3] In other words, an AMA presentation attempts to match revenues and expenses

[2] *See Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, Dockets UE-090134, UG-090135 & UG-060518 (*consolidated*), Order 10, ¶ 55 (Dec. 22, 2009)
[3] Docket UE-160228, Order 06, ¶ 82.

incurred during the test period to the level of plant that produced those revenues and caused those expenses. AMA balances capture the accounting and economic reality that the level of plant in service evolves over the course of the test year.

Q. In addition to AMA, is there another approach to represent test year balances in the historical test year?

A. Yes. The primary alternative to an AMA plant balance is an end-of-period (EOP) plant balance. The Commission has in the past allowed for an EOP adjustment whereby plant balances are adjusted from AMA to reflect the plant balances on the company's books at the end of the test year.[4]

For this case, it is particularly important to understand that an EOP adjustment should only relate to *test year* plant balances. The EOP adjustment does not include items that were placed in service after the test year. Items placed in service after the test year are, in fact, pro forma adjustments and should in no way be included in the calculation of a test year EOP adjustment. Avista's testimony and adjustments to extend the EOP adjustment through the filing year are wholly beyond prior Commission practice.[5]

[4] *E.g., Wash. Utils & Transp. Comm'n. v. Puget Sound Energy, Inc.*, Dockets UE-130137 and UG-130138 (consolidated) *et al*., Order 07, ¶ 48 (June 25, 2017); *Wash. Utils. & Transp. Comm'n. v. Pacific Power & Light Co.*, Docket UE-130043, Order 05, ¶ 184 (Dec. 4, 2013).

[5] Schuh, Exh. KKS-1T at 5; (discussing End of Period (EOP) Rate Base Study as that, ". . .which also employs the use of an adjusted capital structure. This (EOP Rate Base) Study starts with the Traditional Pro Forma Study results and adjusts total rate base, including all 2017 remaining capital additions, to a December 31, 2017 EOP basis to determine the proposed revenue increase for Rate Year 1 beginning May 1, 2018.")

Q. Are there benefits to using a traditional EOP adjustment for ratemaking?

A. Yes. EOP plant balances are closer in time to the rate year than AMA balances. In that way, the EOP balances can be a more accurate estimate of the utility's plant balances in the rate year. Averaging methods, on the other hand, may bring a greater degree of precision to measuring the relationships between revenue, expenses, and rate base. What is important is that, although the EOP-AMA distinction may seem significant the first time it is used, it is actually only a six month advance in timing. Provided the Company is not allowed to switch back and forth between EOP and AMA for its own benefit, the results of either method will most likely be within the range of reasonable outcomes. Mr. Hancock elaborates further on the costs and benefits of AMA versus EOP ratemaking and explains Staff's recommendation to allow for an EOP adjustment in this case.

Q. Is one method, either EOP or AMA, always preferable?

A. No. Consistency is more important than choosing between the two methodologies. Both AMA and EOP have benefits and long histories. As noted above, AMA has been the standard practice at the Commission for a long time. EOP is also not an outlier. Many normal business practices, including financial reporting requirements, are done using EOP per generally accepted accounting principles (GAAP). EOP thus meets the definition of matching for virtually all business metrics.

It would be unfair to the Company and ratepayers to continuously move back and forth from AMA to EOP. If the Commission continues to accept the EOP

methodology for determining rate base values, then the Commission might want to consider whether it is fair to accept this method as an ongoing, persistent policy.

B. Limited Pro Forma Adjustments

Q. What is the purpose of limited pro forma plant adjustments?

A. Staff views a pro forma plant adjustment as an adjustment to the test year plant balances to capture the effect of significant investments that are put into service subsequent to the end of the test year but prior to the rate year. Post-test year capital additions, and the revenue and expense effects of those capital additions, by definition are not reflected in the test year. Therefore, it will not be captured in the ratemaking formula absent pro forma adjustments. Staff limits its acceptance of post-test year plant adjustments to major investments, as defined below.

Q. What are the Commission's rules with respect to pro forma adjustments in rate case filings?

A. The Commission's rule defines pro forma adjustments to "give effect . . . to all known and measurable changes that are not offset by other factors."[6] The rule highlights two important concepts with regard to pro forma adjustments: 1) known and measurable and 2) offsetting factors.

[6] WAC 480-07-510(3)(e)(iii).

Q. What are the practical implications of the known and measurable standard?

A. The known and measurable standard requires that, in order to be allowed as a pro forma adjustment and included in rates, a capital addition must be known to have been placed in service, and the total final cost must be measurable. In general, the practical implication of the "known and measurable" standard is that forecasts generally do not qualify as pro forma adjustments.

Q. What is the importance of offsetting factors in pro forma adjustments?

A. The offsetting factors standard requires that, in order to be allowed as a pro forma adjustment and included in rates, a capital addition must not be offset by other factors, such as increases in company revenues or decreases in operating expense. The idea is that the increased revenue or decreased expense associated with the capital addition would offset the need for rate relief associated with the investment.

Q. How has the Commission interpreted offsetting factors?

A. Historically, the Commission has allowed pro forma adjustments as long as the ratemaking process adequately accounts for those offsetting factors and there is still a need for rate relief. In practical terms, the central question is the level of certainty with which a utility can show and document the costs and benefits of a plant addition.[7]

[7] Docket UE-090134, Order 10, ¶¶ 47. ("The less certainty with which actual utility costs and offsetting factors are known and measurable, the greater is the risk that an adjustment would disturb test year relationships and the less appropriate is the pro forma adjustment. The Commission must assess the certainty with which costs and offsetting factors are known when it balances the competing pressure to change test year values to reflect newer information with the objective of preserving the integrity of test year relationships.").

Q. Are there other limitations for pro forma adjustments?

A. Yes. The Commission historically has limited pro forma plant adjustments to major projects that are used and useful for ratepayers. The used and useful standard is based in statute,[8] and the Commission recently provided guidance that the new resource must be a benefit to ratepayers in Washington.[9]

Q. Why are pro forma plant adjustments limited to only those that are "major?"

A. Pro forma plant adjustments should be limited in number and scale because it is simply not feasible for a company to demonstrate, or for intervening parties to verify, with certainty and specificity every single capital transfer to plant and then to demonstrate, capture, and verify offsetting benefits for every single capital transfer to plant in separate pro forma adjustments.

Staff does not support extending pro forma treatment to include all minor programs because Staff could not feasibly verify and capture increased revenues or decreased expenses associated with these capital additions. From a risk standpoint, allowing more and more pro forma projects into the fold increases risks to ratepayer of unmatched revenues and costs.

Further, a Commission definition of major projects implies a materiality threshold. Aside from not being able to verify offsetting factors associated with a

[8] RCW 80.04.250.

[9] *Wash. Utils. & Transp. Comm'n. v. PacifiCorp, d/b/a Pacific Power & Light Co.*, Docket UE-050684, Order 04 ¶ 50 (April 17, 2006), . ("We interpret the phrase "used and useful in this state for service in this state" to mean benefits to ratepayers in Washington either directly (e.g., flow of power from a resource to customers) and/or indirectly (e.g., reduction of cost to Washington customers through exchange contracts or other tangible or intangible benefits))."

bevy of minor pro forma plant adjustments, minor plant transfers often have a largely immaterial effect on the overall revenue requirement calculation.

Q. In what way is the size of the program or project considered when evaluating *limited* pro forma plant adjustments?

A. In recent history, the Commission looked at the size of the project relative to the specific company's overall plant to determine a materiality threshold for major projects. In Pacific Power & Light Company's 2014 general rate case final order, the Commission limited pro forma plant adjustments to the one adjustment that could indisputably qualify as a major project.[10]

Further, in its final order for Avista's 2015 GRC, the Commission relied on WAC 480-140-040 as the basis for determining whether a project should be considered major. The relevant portion of the rule reads as follows:

> Major construction projects will be determined for water, gas, and electrical companies, as all projects where the Washington-allocated share of the total project is greater than five-tenths of one percent of the company's latest year-end Washington-allocated net utility plant in service, but does not include any project of less than three million dollars on a total project basis. This determination for companies providing combined industry services will be done on an industry-specific basis. [11]

[10] *Wash. Utils. & Transp. Comm'n. v. Pacific Power & Light Co.*, Docket UE-140762, Order 08, ¶ 152 (March 25, 2015) ("Among the 30 projects included in Pacific Power's filing in this case, only one, the Merwin Project, is indisputably a "major" plant addition.").
[11] *Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, Dockets UE-150204/UG-150205, Order 05, ¶ 40 (Jan. 6, 2016).

Q. What is the Commission's used and useful standard?

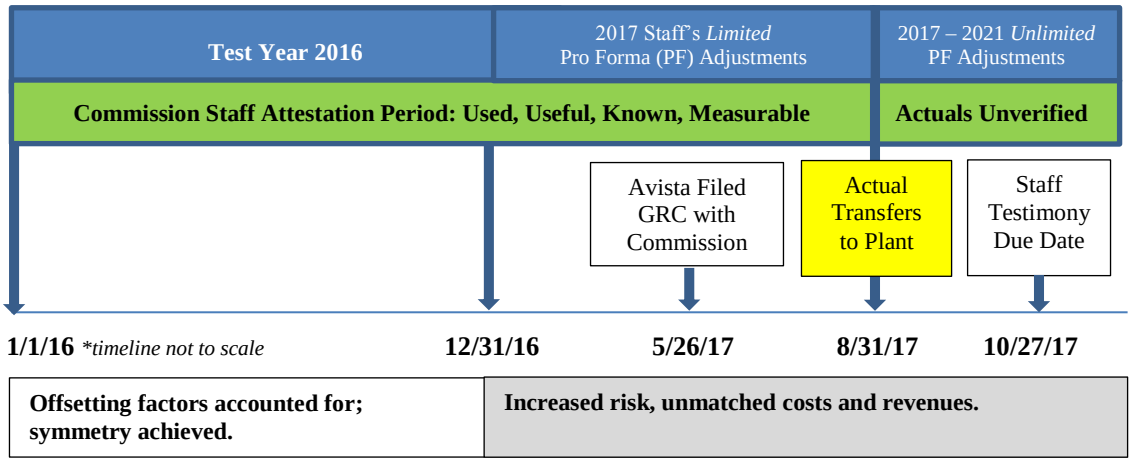
A. Typically, used and useful means the plant will be in service, or the Company has treated the asset as transferred to plant, before the suspension date of the case. The end of the suspension period generally marks the beginning of the rate year.

Q. How do Staff's recommendations for pro forma plant additions in this case relate to the Commission's used and useful standard?

A. If a project has yet to be placed in service at the time Staff completes its analysis and files responsive testimony, Staff cannot attest to the final project costs, the prudence of those final costs, offsetting factors, or whether the project will be used and useful to ratepayers in the rate year.

Figure 1 shows Staff's limitations to perform a continuous audit during the pendency of this proceeding and highlights actual transfers to plant data received from the Company through August 31, 2017.[12]

Figure 1: Staff's 2017 Attestation Period



[12] The time lag between when actual transfers are made for a given month and the reporting time as generally the 15th of the month following the transfers.

Q. Please summarize how Staff has applied the Commission's standards discussed above to assess the *pro forma* plant adjustments.

A. Staff considered five questions for reviewing *pro forma* adjustments in this case:

1. If the *pro forma* adjustment is to add new plant, is it "major", as the Commission has recently defined the term?
2. If the *pro forma* adjustment is to add new plant, has it been shown that the new plant will be used and useful to serve Washington customers? [13]
3. Are the costs associated with the adjustment known and measurable?
4. Are offsetting factors considered for the "major" plant additions?
5. Have the costs related to the adjustment been prudently incurred?

If the answer to all five of the above questions is "yes," then Staff would generally support including the limited pro forma adjustment in rates.

IV. STAFF'S APPLICATION OF COMMISSION STANDARDS

A. AMA to EOP Adjustment

Q. How does Staff propose to treat historical test year balances for plant?

A. Staff recommends adjusting Avista's test year plant balances to reflect end of period (EOP) plant balances as of December 31, 2016. When circumstances have warranted, the Commission has in the past based rates on EOP test year plant balances. As discussed by Staff witness Christopher Hancock, Staff recommends use

[13] Docket UE-050684, Order 04, ¶¶ 48-70 (providing a description of and applying the used and useful standard).

of an EOP adjustment as a mechanism to address the Company's concerns about regulatory lag.

It should also be noted that Staff's EOP adjustment reflects the standard definition of an EOP adjustment; that is, plant balances are presented on an end-of-period test year basis. Avista misleadingly labels its indiscriminate, unlimited *pro forma* presentation as an "EOP Study." Avista's "EOP Study" should not be confused with correct application of an EOP adjustment. Staff's presentation of a standard test year EOP adjustment is captured in Adjustment Electric-2.19 and Gas-2.16.

1. Adjustment 2.19-Electric and 2.16-Natural Gas

Q. Has Staff reviewed the test year EOP balances?

A. Yes. For 2016 plant in service, Staff analyzed the Company's presentation of an AMA and EOP delta difference for: 1) rate base plant in service; 2) accumulated depreciation/amortization; and 3) deferred taxes (net plant after DFIT).[14] Further, Staff reviewed the Company's 2016 electric and natural gas AMA and EOP balances, which are the basis of Staff's EOP Adjustments (Electric-2.19, Gas-2.16).

Q. Does Staff support including any expense adjustments as part of its 2016 AMA to EOP adjustment?

[14] Scanlan, Exh. KBS-8 and Exh. KBS-9.

A. No. An EOP adjustment is performed to reflect end-of-period plant balances, not to restate test year levels of expense. The benefit of using an historical test year is that revenues and expenses are observable and properly matched. If an EOP adjustment contains expense adjustments, the test year relationships will become further distorted.

Avista presents a case that distorts test year relationships by including expense adjustments as components of its "EOP 2017 Adjustment." This is inappropriate. For example, the Company includes depreciation expense adjustments in its EOP adjustment. Not only does this go beyond the standard application of an EOP adjustment, it twists the test year in a biased, unbalanced way. That is, the Company portrays increasing expense associated with higher plant balances but does not also capture offsetting revenues associated with transfers to plant that occurred in the test year.

Q. Please summarize the effect of Staff's "Restate Plant from AMA to EOP" Adjustments (Electric-2.19, Natural Gas-2.16)

A. Staff's adjustment for electric operations represents a $69.7 million net rate base increase. For natural gas operations, this adjustment represents a $14.2 million increase to net rate base. Staff witness Christopher Hancock addresses the associated increase in revenue requirement, and outlines Staff's argument in support of this adjustment.

B. Limited Pro Forma Standards

Q. How does Staff define the materiality threshold for Avista's *limited* pro forma rate base additions?

A. Staff defines a materiality threshold for major plant as greater than 0.5 percent of the Company's net utility plant, using the most recent Commission Basis Report (CBR).[15] Staff proposes *limited* pro forma rate base additions for those projects or programs that are above that threshold and in service as of August 31, 2017.

Q. Why did Staff use the 0.5 percent of net plant as the materiality threshold?

A. Staff's recommendation follows the specific language of the rule in WAC 480-140-040, which refers specifically to "net plant". Using net utility plant, rather than rate base, for this calculation is also consistent with the recommendations from Staff in the last two Avista rate cases.[16] I should note, however, that the Commission's order in Avista's 2015 general rate case referred to the 0.5 percent threshold as relative to the Company's rate base rather than specifying net utility plant.[17] Staff does not see the WAC and the prior Commission order as inconsistent, though. The 0.5 percent threshold as applied to net plant is still relative to the Company's rate base because net plant is a primary component of rate base.

Avista made clear to Staff in the discovery process for this case that the Company believes the materiality threshold should be defined in relation to rate base

[15] "Net utility plant" is defined as the original cost of utility property minus any accumulated depreciation.
[16] Dockets UE-150204/UG-150205 Direct Testimony of Christopher Hancock, Exhibit No. CSH-1T, at 12; Dockets UE-160228/UG-160229, Direct Testimony of Joanna Huang, Exhibit No. JH-1T, at 15.
[17] Docket UE-150204, Order 05, ¶ 40.

instead of net utility plant. Staff does not support the Company's use of rate base for this calculation, which is essentially net plant less deferred taxes (DFIT). Rate base also includes other elements such as working capital.

As explained above, Staff disagrees with using rate base because the specific language in WAC 480-140-040 uses net plant as the multiplier. Further, Staff supports the use of the investment portion of rate base as the multiplier for the threshold determination, which is net plant. In gauging whether or not a new investment qualifies as major relative to the Company's existing plant balances, it is reasonable to differentiate the value of actual plant in operation, or net plant, from the accounting effects of that plant, such as deferred taxes. Net plant in service is the best representation of the Company's existing plant balances and is the appropriate basis on which to determine whether a new investment is major.

Q. Which Commission Basis Report did Staff use to calculate Staff's threshold?

A. Staff obtained Avista's net utility plant in service figures from the Company's electric and natural gas CBRs filed in Dockets UE-170325 and UG-170326. The CBRs are based on a period of twelve months, ending December 31, 2016.

Q. What are the appropriate materiality thresholds for major capital additions in this proceeding?

A. Per the Company's most recent electric and natural gas CBRs, the major capital addition thresholds is $8,647,925 for Washington-allocated electric additions, and $1,685,555 for Washington-allocated gas additions. Avista applied a similar

methodology but calculated different thresholds because the Company multiplied 0.5 percent by rate base instead of net utility plant.

1. Adjustments 3.10: Threshold 2017 Capital Additions

Q. Which 2017 projects or programs meet Staff's threshold for major pro forma capital additions?

A. For Staff's Adjustments 3.10, three electric expenditure requests (ERs) and five natural gas ERs qualify as major projects or programs under Staff's approach to calculating *limited* pro forma capital additions. My Exhibits KBS-3 and KBS-4 show Avista's actual transfer to plant balances as of August 31, 2017, in electric and natural gas operations, respectively. The Information Technology Refresh Program, Expenditure Request (ER) 5005, applies to both industries. Note that the values below represent the Washington-allocated share for each ER.

Table 1: Electric Adjustment 3.10
Major 2017 Pro Forma Transfers to Plant, Avista vs. Staff Proposed
(through 8/31/17)

	ER	ER Title	Avista Proposed	Staff Proposed
1	2204	Substation Rebuilds	$ 10,413,641	$ 944,303
2	5005	Information Technology Refresh Program	$ 10,318,833	$ 3,144,403
3	2470	Distribution Grid Modernization	$ 9,835,159	$ 7,153,319
4	4152	Little Falls Powerhouse Redevelopment	$ 6,889,112	Excluded by Staff
5	2060	Wood Pole Management	$ 6,960,510	Excluded by Staff
		Total: Listed ERs	**$ 44,417,255**	**$ 11,242,025**

Table 2: Natural Gas Adjustment 3.10
Major 2017 Pro Forma Transfers to Plant, Avista vs. Staff Proposed
(through 8/31/17)

	ER	ER Title	Avista Proposed	Staff Proposed
1	3008	Aldyl-A Pipe Replacement	$ 11,257,792	$ 6,517,794
2	5005	Information Technology Refresh Program	$ 2,972,657	$ 941,107
3	5006	Information Technology Expansion Program	$ 1,955,695	$ 423,953
4	7131	COF Long Term Restructuring Plan Phase 2	$ 1,921,093	$ 204,713
5	3005	Gas Distribution Non-Revenue Blanket	$ 1,739,328	$ 1,819,892
6	3003	Gas Replacement for Street & Highway Projects	$ 1,513,362	Excluded by Staff
7	7139	New Downtown Network Building (Downtown Campus)	$ 1,411,346	Excluded by Avista[18]
		Total; Listed ERs	**$ 22,771,273**	**$ 9,907,459**

Q. Please summarize the 2017 pro forma plant additions included by Staff during its prudency review.

A. For electric operations, Staff recommends accepting three electric operation projects and programs: Substation Rebuilds, Information Technology Refresh Program, and Distribution Grid Modernization. For natural gas operations, Staff recommends accepting five projects and programs through August 31, 2017: Aldyl-A Pipe Replacement, Information Technology Refresh Program, Information Technology Expansion Program, COF Long Term Restructuring Plan Phase 2, and Gas Distribution Non-Revenue Blanket.

As shown in Tables 1 and 2, the figures Staff supports as 2017 transfers to plant are reflected in the amount that the Company actually transferred to plant. Staff visited Avista's headquarters on September 27, 2017 and reviewed these three

[18] Scanlan, Exh. KBS-2. Avista's Response to Staff Data Request No. 002 states, "This project should be removed from consideration as a natural gas related capital investment in 2017 because the Company inadvertently included it in the pro forma adjustment as being split between Washington Electric and Washington Natural Gas operations. This investment will support Avista's Washington electric operations only."

electric and five natural gas projects and programs. Using the Commission's prudence standard, Staff verified the projects are in service, used and useful, and known and measurable. Staff supports including these ERs in rates.

Q. Why does Staff use an attestation period ending August 31, 2017?

A. Staff's primary objective is to preserve the integrity of test year relationships. Staff must assess the certainty with which costs and offsetting factors are known in order to properly reflect new information. That is, the farther a proposed *pro forma* adjustment is removed in time from the test year, and the less time that Staff has to ascertain supporting evidence, the greater the Company's burden to demonstrate that the requirements guiding the adjustment to the test year data have been met. The Company provided actual transfers to plant balances and supporting evidence for plant in service through August 31, 2017.

Q. What is the rate base impact of Staff's *pro forma* capital additions recommendations?

A. For Electric Adjustment 3.10, Staff includes three major threshold ERs, totaling $11.2 million plant in service. This results in rate base of $8.7 million for electric operations, where rate base is net plant minus deferred income tax. For Natural Gas Adjustment 3.10, Staff includes five major threshold ERs, totaling $9.9 million plant in service. This results in rate base of $7.9 million for natural gas operations.

Q. How does Staff treat Avista's forecasted capital additions beyond August 31, 2017?

A. Staff rejects the remainder of forecasted capital additions. The Company's forecasts are just that – forecasts, which have not occurred as transfers to plant. Staff cannot attest that the Company's forecasts accurately reflect actual project costs, the prudence of those final costs, offsetting factors, or whether the project will be used and useful to ratepayers in the rate year. In addition, the Company's forecasts for 2017 and previous general rate case plant transfers to plant have been substantially inaccurate, as explained later in my testimony.

2. Adjustment 3.11: O&M Offsets

Q. What is a "Pro Forma O&M Offset" adjustment?

A. This adjustment is to account for maintenance costs incurred in the test period that are reduced or eliminated as a result of placing specific plant in service in 2017.

Q. Please describe the Company's "Pro Forma O&M Offsets" (Adjustments 3.11 Electric, 3.11 Gas).

A. In the filing, Avista includes the following ERs for O&M offsets to electric operations: 2492, 2060, 2584. The Company acknowledged to Staff in discovery that the initial filing had inadvertently included the Autotransformers (ER 2492) offset in this adjustment for electric operations and that adjustment should be removed. Staff does not consider ERs 2060 and 2584 as major projects or programs

for electric operations because the associated costs are below the materiality threshold.

For natural gas operations, the Company includes figures for ERs 7126 and 7139 offsets. Avista also used discovery to correct the as-filed electric and gas service, state, and percentage share of Downtown Network New Warehouse/Ops Building (ER 7139) as zero percent, thus eliminating the gas operations offset share for this project. Staff excludes ER 7126 because it is not a major project.

Q. Does Staff include the Company's pro forma adjustments to O&M?

A. No. According to Staff's application of the Commission's materiality standard, none of the ERs associated with the O&M offsets presented by Avista qualify as major projects or programs for electric or gas operations. Therefore, Staff has not included any of Avista's proposed O&M offsets from the electric and natural gas operations.

Q. What is the effect of Staff's recommendations for pro forma O&M adjustments?

A. Staff eliminates Pro Forma O&M Offsets (Adjustments 3.11) for gas and electric operations. Therefore, the effect of this adjustment on Washington net operating income to the electric operation is zero. This results in a revenue requirement impact of zero. For natural gas operations, the net operating income effect is zero and also results in a revenue requirement impact of zero.

V. COMPANY'S DIRECT CASE FOR CAPITAL ADDITIONS

A. Avista Incorrectly Defines an EOP Adjustment

Q. How does Avista present plant in service?

A. Avista bases its revenue requirement request on what it titles an "EOP Rate Base Study" for electric and natural gas operations. However, the title of the study is highly misleading and suggests the study interprets an end-of-period adjustment, consistent with what has been accepted by this Commission in the past. It does not. In fact, Avista's "EOP Study" instead rolls an estimate of total net plant in service forward through December 2017, attempting to capture all potential transfers to plant, large and small, 12 months beyond the end of the historical test year. Together with associated accumulated depreciation and accumulated deferred federal income taxes, the Company includes all minor projects that are below the 0.5 percent threshold for 2017 (i.e., those not included in the Company's Traditional Pro Forma Studies) in its EOP Rate Base Studies for 2017.[19] Avista's "EOP Study" is more appropriately thought of as an indiscriminate pro forma study with unlimited pro forma adjustments through December 2017.

Q. What are the key differences between the Company's definition of an "EOP 2017 Capital Net Rate Base Adjustment" (Electric Adjustment 3.15, Natural Gas Adjustment 3.14) and Staff's definition of an EOP adjustment?

[19] *See* Andrews, Exh. EMA-2 and Exh. EMA-7.

A. The Company's "EOP" adjustment reflects indiscriminate pro forma adjustments for all plant additions, through December 31, 2017. Staff's definition of an EOP adjustment is limited to "walking balances forward" for plant in service from the beginning of the Company's historical test year to the end of that same test year, consistent with historical Commission practice.

Q. What has this Commission considered as a proper EOP adjustment?

A. As discussed above, an EOP adjustment only pertains to *test year* plant balances. EOP reflects plant balances at the end of the test year as an alternative to an AMA presentation —in this case balances ended December 31, 2016. Any plant adjustments beyond December 31, 2016 are pro forma adjustments for ratemaking purposes.

Q. Is Avista's "EOP Study" an appropriate reference point for the Commission in determining rates?

A. No. The Commission should ignore Avista's "EOP Rate Base Studies." [20] The appropriate starting point for calculating rates is a modified historical test year with limited pro forma adjustments.[21]

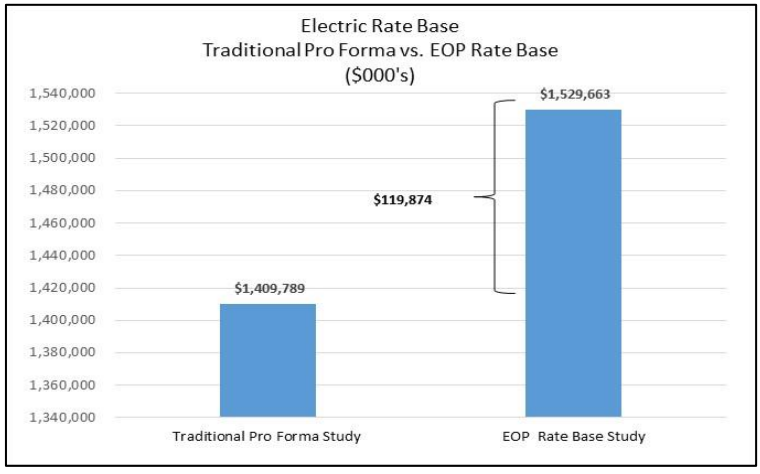
Avista contends that all major and minor electric and natural gas projects and programs forecasted will be in service by December 31, 2017. Accepting the EOP Rate Base Studies with indiscriminate capital adjustments would be beyond

[20] Andrews, Exh. EMA-3 (Electric EOP Rate Base Study) *and* Andrews, Exh. EMA-7 (Natural Gas EOP Rate Base Study).
[21] Dockets UE-160228 and UG-160229 (consolidated) Order 06, ¶ 79.

extraordinary ratemaking treatment and a clear divergence from the Commission's long-established ratemaking practice.

In Avista witness Karen Schuh's direct testimony, Ms. Schuh presents an adjustment titled "2017 EOP Adj" that reveals a delta of $119,874,000 between the Company's Traditional Pro Forma and EOP Rate Base Studies.[22] As shown in Figure 1 below, the Company significantly increases its rate base by presenting the EOP Rate Base Studies as including minor and major program and projects 12 months beyond the end of the historical test year. Avista's EOP Study appears to recommend that the Commission ignore the modified historical test year, which the Commission reaffirmed a mere five months before Avista filed the present case.[23]

Figure 1: EOP Electric Rate Base Study
(*<u>all</u> program and projects through 12.31.17*)



[22] Schuh, Exh. KKS-1T at 7.
[23] The Commission's Order 06 in Dockets UE-160228/UG-160229 was entered on December 15, 2016, while Avista filed its current general rate case on May 26, 2017.

Q. What is the appropriate starting point for considering Avista's request for additional revenues for electric and natural gas operations?

A. Staff contends the modified historical test year presentation in the Company's Traditional Pro Forma Study, sponsored by Avista witness Elizabeth Andrews in her Exhibit Nos. EMA-2 and EMA-6, is the appropriate starting point for considering Avista's request for additional revenues for electric and natural gas operations, respectively.

B. Avista's Modified Historical Test Year Study

Q. How does the Company define its threshold for major pro forma rate base additions (Electric-3.10, Gas-3.10)?

A. The Company defines a "major" plant addition as at least 0.5 percent of *rate base*. As noted above, Staff applies the 0.5 percent threshold to *net plant in service*.

Q. What effect does the Company's use of rate base have on the number of projects it defines as "major?"

A. As compared with Staff's proposal to use net utility plant, Avista's use of rate base yields a lower threshold and allows more projects to flow into rate base, further diluting the meaning of "major" projects or programs. Also, by the Company subtracting associated accumulated depreciation and deferred federal income taxes, and using rate base as the multiplier, Avista's proposal conflicts with the language set forth in WAC 480-140-040.

Q. How many projects did Avista propose as major additions for 2017 according to its threshold?

A. Avista proposes proposed including six electric projects and seven natural gas projects on a 2017 EOP basis.[24] Through Staff's data requests, the Company expressed that they inadvertently included certain projects.[25] According to the threshold that the Company calculated, the Company qualifies five electric and six natural gas program and projects, as listed as "Avista Proposed" projects and programs in Tables 1 and 2 of my testimony.

Q. How much does the Company propose in pro forma 2017 threshold capital adjustments for electric and gas operations?

A. The Company proposes an additional $44.4 million rate base plant in service for electric operations (Adjustment 3.10) and an additional $22.7 million for natural gas operations (Adjustment 3.10).

Q. What is the risk of accepting Avista's proposed major pro forma programs and projects through December 2017?

A. There are many risks to consider if the Commission entertains the Company's Pro Forma 2017 Threshold capital addition proposal, including: dilution, distortion, and deviation. First, by the Commission accepting the Company's presentation of major, and adding discrete project after discrete project, it may further dilute the meaning of major. Second, accepting more and more projects and programs distorts test year

[24] Schuh, Exh. KKS-1T at 9.
[25] Scanlan, Exh. KBS-2, Avista Response to Staff Data Request No. 002.

revenues and expenses, creating asymmetry and violating the matching principle. Third, although the Commission recognizes certain expenses that do not take place in the test year, the Company's proposal includes forecasted plant balances and puts the risk of error or delayed transfers to plant entirely on ratepayers. Many of those forecasts have historically been inaccurate.

Q. Please summarize Avista's forecast versus actual data for threshold pro forma transfers to plant January 1, 2017 through August 31, 2017.

A. Avista's forecasted 2017 transfers to plant have been inaccurate.[26] Through August 31, 2017, and for the three major electric projects (ERs 2470, 5005, and 2204), actual transfers to plant have been approximately $6 million lower than the Company had forecasted.[27] For the five major natural gas projects (ERs 3005, 3008, 5005, 5006, and 7131), actual transfers to plant have been approximately $3 million lower than Avista had forecasted. Although Staff recognizes that good faith forecasts will by nature be inaccurate because uncertainty increases with longer time horizons, this inherent inaccuracy serves as another reason to exclude those forecasted transfers to plant from rates.

It is worth noting here that Avista has over-estimated projected transfers to plant in the pro forma period of past general rate cases, too. Staff also identified chronic over-forecasting of transfers to plant in Avista's 2016 and 2015 general rate case proceedings.[28]

[26] Scanlan, Exh. KBS-5 Avista Response to Staff Data Request No. 265.
[27] Scanlan, Exh. KBS-6 Major Pro Forma Transfers Variance (January – August 2017).
[28] Dockets UE-150204/UG-150205 Direct Testimony of Christopher Hancock, Exhibit No. CSH-1T, at Pages 17-21. Dockets UE-160228/UG-160229, Direct Testimony of Joanna Huang, Exhibit No. JH-1T, at Page 18.

Q. What do Avista's incorrect forecasts mean for the Company's revenue requirement request in this proceeding?

A. Staff contends that Avista's as-filed limited pro forma studies have generally proven to be wrong. In particular, the transfer to plant forecasts have been wrong throughout the pendency of this proceeding. Not only do Avista's "limited" pro forma studies contain non-major plant, and not only do Avista's transfers to plant through December 2017 contain currently unverifiable forecasts, but the transfers to plant that are known and measurable as of August 31, 2017, are substantially lower than what Avista forecasted when it filed its case.

The Commission should not rely on Avista's revenue requirement request, even in its limited pro forma studies, as those requests contain rate base amounts that are inflated and substantially incorrect.

VI. ADDITIONAL CONCERNS WITH CAPITAL PROJECTS

Q. Why is Staff documenting additional concerns with two of Avista's proposed capital expenditures?

A. I want to be clear that Staff's case excludes 2017 minor capital expenditures and projected costs for 2018, including Colstrip 3&4 upgrades and the Company's proposal to upgrade its corporate jet and build a new hangar. As I explain above, Staff's case uses an EOP adjustment through the end of 2016 and then allows a handful of major capital projects that went in service by August 31, 2017. On a

Washington-allocated basis in 2017, capital investments for Colstrip 3&4, the aircraft upgrade, and hangar construction do not meet Staff's criteria, so Staff excluded them in calculating 2018 rates. However, Staff is documenting concerns over those future investments because Avista has proposed a rate plan that runs through April 30, 2021.

A. Colstrip Units 3 & 4

Q. Are there lingering concerns with any other capital additions?

A. Yes. Due to their relatively small size on a Washington-allocated basis, Staff did not elect to expend significant resources to further investigate Avista's Colstrip Units 3 and 4 minor capital additions.[29] But through Staff's data requests and research, it appears that neither Montana law nor federal law required capital investment in Smart Burn technology environmental controls.[30] Avista informed Staff in discovery that the capital investments were the result of how the Company anticipated Colstrip Units 3 & 4 Selective Catalytic Reduction (SCR) requirements during the 2017 review period. Without regulatory certainty, the owners decided to move ahead with installing Smart Burn technology controls in 2016 and 2017, respectively.[31] These new controls are expected to improve removal of nitrous oxides (NOx).

[29] Avista is 15 percent owner of Colstrip Units 3 and 4.
[30] State of Montana Regional Haze 5-Year Progress Report (Draft), at Section 2.1.6, Pages 2-7 and 2-8, (July 2017). Colstrip 3 & 4 were not identified in Montana FIP analysis and did not result in emission limits.
[31] Scanlan, Exh. KBS-10 Colstrip Units 3 & 4 Smart Burn Technology Capital Addition; Exh. KBS-11C, Avista Response to Staff Data Request 278C.

Q. Why did the Company support these capital additions?

A. It is unclear. If there are no applicable federal or state requirements for emission limits for Colstrip Units 3 and 4, any party to a general rate case should question an investment in environmental controls categorized by the Company under "Mandatory and Compliance."

Q. In this proceeding, were the Company's Colstrip 3 and 4 adjustments adequately supported?

A. No. The information provided in direct testimony by Avista representatives discussing Colstrip 3 & 4 thermal capital additions is sparse, vague and lacking sufficient detail. One explanatory paragraph was provided by Avista witness Scott Kinney (Exh SJK-4, Page 100). The only actionable information provided by Mr. Kinney is that Avista's review capability for individual Colstrip 3 & 4 projects with the owner group every September does not appear to give Avista any line item veto capability for individual projects. Mr. Kinney also indicated some projects are reclassified to O&M if the work does not conform to Avista's capitalization policy.

This overview-as-justification is another problem with including minor capital additions and projections into the future. The Company does not, and often cannot, include sufficient information about potential benefits to ratepayers. Therefore, Staff and the intervening parties have very little information to respond to or even to review. This effectively places the evidentiary burden on Staff and the intervening parties, rather than the Company.

Q. Should the Commission approve Avista's Smart Burn technology environmental controls investments for Colstrip Units 3 & 4?

A. Due to Staff's limited investigative timeline in this case, I cannot provide the Commission with a thoroughly developed argument and well-positioned presentation of facts and evidence for the prudency of minor capital additions. The Commission has generally approved adjustments when they were adequately supported. But in this case, it is questionable, at least to Staff, as to whether or not the Company has fully supported installed or to be installed Colstrip 3 & 4 capital additions and related expenses.

Given that both Staff's and Avista's limited pro forma studies exclude this project, then this project should be excluded from this rate case. Recovery can be considered in a future rate case when the project in question is embedded in the test year results of operations.

B. Corporate Jet and Hangar

Q. Does Staff have concerns about other *pro forma* capital additions in 2018 and beyond?

A. Yes. Avista witness Heather Rosentrater discusses two other capital additions set for 2018 that Staff would like to flag for further Commission deliberation:

- Avista corporate jet (Company Aircraft Capital, Exh. HLR-6, Page 327)
- Avista hangar construction for jet (Airport Hanger, Exh. HLR-6, Page 356).

Staff has concerns about Avista's business cases for a new private plane and whether or not adequate documentation was presented for these two pro forma capital

additions. Again, the Company did not present a detailed discussion of offsetting factors. As discussed previously in my testimony, these projects did not meet Staff's criteria for major limited pro forma adjustments. Staff flags the merits of including these two pro forma 2018 capital additions in rate base, which can also be discussed as part of the next rate case.

Q. Does this conclude your testimony?

A. Yes.