**Exhibit No. \_\_\_ (CSH-1T)**

**Dockets UE-150204/UG-150205**

**Witness: Christopher S. Hancock**

**BEFORE THE WASHINGTON**

**STATE UTILITIES AND TRANSPORTATION COMMISSION**

|  |  |
| --- | --- |
| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,**  **Complainant,**  **v.**  **AVISTA CORPORATION dba**  **AVISTA UTILITIES,**  **Respondent.** | **DOCKETS UE-150204 and UG-150205**  ***(Consolidated)*** |

**TESTIMONY OF**

**Christopher S. Hancock**

**STAFF OF**

**WASHINGTON UTILITIES AND**

**TRANSPORTATION COMMISSION**

***Pro Forma Policy, Pro Forma Rate Base Adjustments, and Pro Forma Revenue***

**July 27, 2015**

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Exhibit No. \_\_\_(CSH-2), Electric Pro Forma Analysis

Exhibit No. \_\_\_(CSH-3), Natural Gas Pro Forma Analysis

Exhibit No. \_\_\_(CSH-4), Avista Revised Electric Pro Forma Cross Check Study

Exhibit No. \_\_\_(CSH-5), Avista Revised Natural Gas Pro Forma Cross Check Study

Exhibit No. \_\_\_(CSH-6), Major Electric ER Transfers as of June 30, 2015

Exhibit No. \_\_\_(CSH-7), Major Natural Gas ER Transfers as of June 30, 2015

Exhibit No. \_\_\_(CSH-8), Wood Pole Events Over Time

# Introduction

Q. Please state your name and business address.

A. My name is Christopher Scott Hancock. My business address is The Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., Olympia, WA 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 Energy Regulation 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 January 2015.

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

A. I graduated from New Mexico State University in 2013 with a Bachelor of Business Administration degree in Economics. In 2014, I graduated from New Mexico State University with a Master of Arts degree in Economics, specializing in Public Utility Policy & Regulation. Prior to my employment with the Commission, I interned at Southern California Edison’s regulatory affairs department, and served six years in the United States Air Force before being honorably discharged.

Q. Have you previously testified before the Commission?

A. No.

# Scope of Testimony

Q. Please explain the purpose of your testimony.

A. The primary purpose of my testimony is to provide an overview of Staff’s *pro forma* revenue requirement case in response to the Company’s Pro Forma Cross Check studiessponsored by Company witnesses Ms. Schuh and Ms. Smith. I present Staff’s recommendations on the: (1) definition of a “major” rate base adjustment; and (2) revenue requirement using a modified historical test year *pro forma* approach.

Staff’s *pro forma* revenue requirement analysis is intended to stand alone as an independent analysis to determine the revenues sufficient for the Company to have an opportunity to achieve its settled rate of return.

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

A. Yes. I prepared Exhibit No.\_\_\_ (CSH-2) and Exhibit No.\_\_\_ (CSH-3). These exhibits present my analysis of *pro forma* revenue requirements, for electric and natural gas operations, respectively. I present these exhibits using the same model and format that Avista uses in its direct case. My Exhibit Nos.\_\_\_ (CSH-2) and (CSH-3) correspond to Avista Exhibit Nos.\_\_\_ (JSS-2) and \_\_\_ (JSS-3), respectively.

Second, I sponsor Exhibit No.\_\_\_ (CSH-4) and Exhibit No.\_\_\_ (CSH-5) related to an important update Avista made to its Pro Forma Cross Check studies in Staff Data Request No. 131. These exhibits present the Company’s updated *pro forma* revenue requirement studies, for electric and natural gas operations, respectively.

Third, I sponsor Exhibit No.\_\_\_ (CSH-6) and Exhibit No.\_\_\_ (CSH-7). These exhibits show the actual transfer to plant balances as of June 30, 2015 in electric and natural gas operations, respectively, for a total of fourteen major projects. These exhibits are based on the Company’s response to Staff Data Request No. 143 on July 10, 2015.

Finally, I sponsor Exhibit No.\_\_\_ (CSH-8). This exhibit shows the trend of so-called “bad wood pole events” over time.

Q. Which other members of Staff have testimony on *pro forma* adjustments?

A. Mr. Jason L. Ball presents Staff’s recommendations regarding *pro forma* restating and expense adjustments. Mr. David C. Gomez presents Staff’s analysis of the prudence of certain plant additions.

Q. How is the remainder of your testimony organized?

A. In Section III, I discuss Staff’s calculations of the Company’s revenue requirements, using a modified historical test year with limited *pro forma* adjustments. I also take the opportunity to briefly compare Staff’s revenue requirement findings with those of the Company. In Section IV, I discuss Commission policy on *pro forma* adjustments, particularly the criteria these adjustments must meet to be accepted by the Commission during a general rate case. In Section V, I discuss capital additions made by the Company in the final three months of calendar year 2014. In Section VI, I discuss capital additions made by the Company in 2015. In Section VII, I discuss capital additions proposed by the Company for calendar year 2016. In Section VIII, I discuss other pro forma rate base adjustments. Finally, in Section IX, I discuss Staff’s treatment of the Company’s reconciliation adjustments filed in their original *pro forma* model.

# Summary of Revenue Requirements

## Staff’s Calculations

Q. What is Staff’s calculation for Avista’s revenue requirement for electric service?

A. Staff’s analysis demonstrates that, using a modified historical test period approach with limited *pro forma* adjustments, Avista has a total electric revenue requirement of $479,047,000. As shown in Exhibit No.\_\_ (CSH-2), page 2, line 7, this is a decrease of $20,935,000, or 4.2 percent, relative to 2015 base rate revenues.

Q. What is Staff’s calculation for Avista’s revenue requirement for natural gas service?

A. Staff’s analysis also demonstrates that, using a modified historical test period approach with limited *pro forma* adjustments, Avista has a total natural gas revenue requirement of $174,519,000. As shown in Exhibit No.\_\_ (CSH-3), page 2, line 7, this is an increase of $3,605,000, or 2.1 percent, relative to 2015 base rate revenues.

## Avista’s Calculations

Q. What revenue requirements did Avista arrive at in their original *pro forma* analysis?

A. Avista calculated a $33,229,000 revenue requirement increase based on its electric Pro Forma Cross Check Study. For its natural gas operations, Avista calculated a revenue requirement increase of $12,021,000, based on its natural gas Pro Forma Cross Check Study.

Q. Has the Company updated its *pro forma* analysis?

A. Yes. As noted by Staff witness Mr. McGuire, the Company’s direct case contained significant errors which caused a dramatic overstatement of the rate year revenue requirement, especially for electric service.[[1]](#footnote-2)

After the Company corrected its errors and the Parties incorporated the terms of the proposed settlement into the model, the Company’s electric revenue requirement was reduced from $33.2 million to $10.9 million; Avista’s natural gas revenue requirement went from $12.0 million to $9.7 million. Therefore, the Pro Forma Cross Check studies provided in Avista’s direct case are obsolete and should not be relied upon to make rates. The Commission should consider only the updated, corrected Pro Forma Cross Check studies, as they represent what Avista should have provided in its direct case. Avista provided these updated studies in response to Staff Data Request No. 131, which I have attached as Exhibit Nos. \_\_\_ (CSH-4) and (CSH-5). A table displaying the Company’s proposed revenue requirement increases and the results of Staff’s review and analysis is shown below.

|  |  |  |  |
| --- | --- | --- | --- |
| ***Table 1: Proposed Revenue Requirement Increases*** | | | |
|  | **Initial Avista Study** | **Updated Avista Study** | **Staff's Analysis** |
| **Electric** | $33,229,000 | $10,922,000 | ($20,935,000) |
| **Natural Gas** | $12,021,000 | $9,713,000 | $3,605,000 |

Q. Please summarize the key differences between the Company’s direct case and its response to Staff Data Request No. 131.

A. The primary differences are explained in the Company’s response to Staff Data Request No. 131, in Attachment A:

…the Company revised its Pro Forma Electric and Natural Gas Studies to include known corrections or updates, to reflect the Multiparty Settlement agreement filed on May 1, 2015, and to reflect actual December 2014 depreciation and net plant impacts per actual 12.2014 results, as well as the impact of revising the Company’s Production/Transmission (P/T) ratio at 12.2014 on power supply costs and generation/transmission depreciation expenses and net plant.

Staff received this response on May 15, 2015.

Q. What is the purpose of Avista’s Pro Forma Cross Check studies?

A. Company witness Ms. Smith describes the purpose of Avista’s Pro Forma Cross Check studies as “a separate independent analysis of Avista’s need for a revenue increase in 2016 [emphasis added].”[[2]](#footnote-3) Thus, this analysis is theoretically capable of standing on its own.

However, the Company does not rely on a *pro forma* analysis in its direct case, and does not aim to set rates using such an approach. Avista instead bases its claims for a revenue increase on its attrition study alone. The Company’s *pro forma* case is only intended to support the “reasonableness of the electric and natural gas Attrition Study results.”[[3]](#footnote-4)

## Comparison Between Staff and Avista’s Calculations of Revenue Requirements

Q. Please briefly discuss some of the more sizeable contributing factors to the large difference between Avista’s initial Pro Forma Cross Check study results, and the *pro forma* revenue requirement analysis performed by Staff.

A. The table below illustrates the components of the major differences in the revenue requirement figures arrived at by Avista in their initial models, and the results of Staff’s review and analysis of the listed issues, including the financial impact of the Company’s power cost correction.

|  |  |  |  |
| --- | --- | --- | --- |
| ***Table 2 - Components of Major Differences in Revenue Requirement Figures*** | | | |
|  |  | **Electric** | **Natural Gas** |
| **1** | **Initial Avista revenue requirement** | $33,229,000 | $12,021,000 |
| **2** | *AURORA power cost error* | (17,196,774) | 0 |
| **3** | *Elimination of pro forma/attrition reconciliation* | (258,065) | (1,409,677) |
| **4** | *Meter retirements* | (6,862,903) | 0 |
| **5** | *2016 capital additions* | (3,969,355) | (1,551,613) |
| **6** | *2015 capital additions* | (15,096,774) | (2,561,290) |
| **7** | *2014, last three months, actual capital additions* | (6,404,839) | (906,452) |
| **8** | *Colstrip/CS2 O&M and Major Gen. Maint.* | (2,241,935) | 0 |
| **9** | **Net change:** | (52,030,645) | (6,429,032) |
| **10** | **Revenue requirement, after these effects** | **($18,801,645)** | **$5,591,968** |

Line 1 of the table states the revenue requirements claimed by the Company in their initial Pro Forma Cross Check study.[[4]](#footnote-5) Line 2 shows the effect of the AURORA power cost model coding error, acknowledged by the Company in their response to Staff Data Request No. 131, and discussed further in the Multiparty Settlement Stipulation.[[5]](#footnote-6) Line 3 shows the effect of eliminating the reconciliation mechanism discussed in Section IX of this testimony. Line 4 shows the effect of Staff’s analysis of the electromechanical meter retirements proposed by the Company, discussed further in Section VIII, subsection A of this testimony. Line 5 shows the effect of Staff’s disallowance of projected 2016 capital project additions to rate base, relative to the Company’s proposed treatment. Line 6 shows the effect of Staff’s audit of 2015 major capital additions. Line 7 shows the effect on revenue requirements between what the Company projected to be transferred to plant in the final three months of 2014 versus what was actually placed in service, and acknowledged by the Company in its response to Staff Data Request No. 131. Line 8 shows the effect of Mr. Ball’s analysis of major maintenance expenses planned for 2016. Line 9 shows the sum of Lines 2 through 8. Line 10 shows the effect that Lines 2 through 8 would have on the Company’s initial revenue requirement claims, if these were the only changes between Staff’s *pro forma* analysis and the Company’s initial Pro Forma Cross Check studies.

Again, the Company’s initial Pro Forma Cross Check studies are obsolete, and its response to Staff Data Request No. 131 more accurately represents the case Staff would have expected from Avista. Some of the effects shown in the table above are present in the Company’s updated Pro Forma Cross Check studies included in Staff Data Request No. 131.

# Pro Forma Policy

## Criteria for Pro Forma Adjustments

Q. What criteria have historically been applied to *pro forma* adjustments?

A. The Commission historically applies four major standards for *pro forma* adjustments. These criteria ask the following questions of a given adjustment:

1. If the *pro forma* adjustment is to add new plant, is it “major?”
2. Are the costs associated with the adjustment known and measurable?
3. 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? [[6]](#footnote-7)
4. Have the costs related to the adjustment been prudently incurred?

To date there has been no clearly defined, consistently applied standard that takes into account the size of the utility in question.[[7]](#footnote-8) Avista’s filing in this case does not take into consideration whether the component projects of their *pro forma* capital additions are major in any sense, and instead seeks to “pro form” all capital additions expected to be made in 2014, 2015, and 2016. Staff presents, in subsection B, a reasonable level of “major” for *pro forma* plant additions.

Q. Why must a pro forma rate base addition be major?

A. The Commission stated in the recent Pacific Power & Light rate case that proposed plant additions need to meet “a reasonable definition of ‘major.’” [[8]](#footnote-9)

Q. What does it mean for an adjustment to be known and measurable?

A. WAC 480-07-510(3)(iii) requires that adjustments must “give effect for the test period to all known and measurable changes that are not offset by other factors.” Furthermore, the Commission has stated[[9]](#footnote-10):

The known and measurable concept requires that an event that causes a change in revenue, expense or rate base must be *known* to have occurred during or after the historical 12 months of actual results of operations. It must also be demonstrated (*i.e*., *known)* that the effect of the event will be in place during the 12-month period when rates will likely be in effect.[[10]](#footnote-11) The actual amount of the change must be *measurable.* This means the amount cannot be an estimate, a projection, the product of a budget forecast, or some similar exercise of judgment—even informed judgment—concerning future revenue, expense or rate base. Costs that are documented by actual expenditure, invoice, contract, or other specific obligation usually meet this test. Costs that are the product of forecasts, projections, or budgets generally will not qualify.

Q. What does it mean for a new plant addition to be used and useful to Washington ratepayers?

A. Section 80.04.250 of the Revised Code of Washington is a statutory requirement that property must be “used and useful for service in this state.” Furthermore, the Commission has stated[[11]](#footnote-12):

With very limited exceptions the plant must be in service by no later than the end of the rate proceeding if it is to be allowed in rate base. Typically, this means the plant will be in service before the suspension date, which generally marks the beginning of the “rate year.”

## Defining a Major Plant Addition

Q. What guidance does Staff rely on in developing its definition of a major rate base addition?

A. Staff relies heavily on the Commission’s guidance in Order 08 in Pacific Power & Light Company’s most recent rate case filing Docket UE-140762. The Commission noted that “there is no directly applicable legal standard for what is a ‘major’ project *except in WAC 480-140-040*…”[[12]](#footnote-13) (emphasis added); Staff’s position is anchored in this WAC.

Q. Please describe how WAC 480-140-040 guides Staff’s definition of a major rate base addition.

A. The relevant portion of WAC 480-140-040, Commission general—Budgets, 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.

This Commission rule makes defining major additions a relatively simple calculation. The appropriate cut-off amount is found by multiplying the Company’s 2014 Washington-allocated net utility plant in service for each industry (gas and electric) from the Company’s Commission Basis Report by 0.5 percent.

Staff arrives at the following figures for Avista using this method: $6,365,785 for Washington-allocated electric additions, and $1,251,285 for Washington-allocated gas additions. Informed by the guidance provided by WAC 480-140-040, Staff’s analysis treats the Company’s proposed *pro forma* plant adjustments in excess of these amounts as major.

Q. **Why is this a useful definition of a major rate base addition?**

A. This definition of a major rate base addition has the benefit of considering both whether a project is major in an overall sense (greater than “three million dollars on a total project basis”) and whether it is major relative to the size of the company’s operations in Washington (“greater than five-tenths of one percent of the company's latest year-end Washington-allocated net utility plant in service”). [[13]](#footnote-14)

Q. What should constitute a “project” with regard to a major rate base adjustment?

A. To be considered a major rate base addition, a “project” must be a discrete unit of utility plant-in-service. Avista’s Expenditure Requests (“ERs”) appropriately demark this threshold. Each Business Case presented by Avista’s management to the Capital Budget Planning Committee is composed of at least one ER. Occasionally, a Business Case presented to the Company’s Capital Budget Planning Committee will include multiple ERs.[[14]](#footnote-15) However, the project encapsulated by each ER is capable of being “used and useful”independent of the operation of other ERs within the same business case. [[15]](#footnote-16) This is a similar concept to a “retirement unit”, which is defined in Title 18 of the Code of Federal Regulations, Part 201.34, as “those items of gas plant which, when retired, with or without replacement, are accounted for by crediting the book cost thereof to the gas plant account in which included.” Therefore, each ER should be considered an independent project.

## Rate Base Accounting Methodologies

Q. Has the Commission stated a preferred rate base accounting methodology?

A. Yes. The Commission has asserted its preference for the average-of-monthly-averages (AMA) methodology. This methodology best maintains the matching principle.

Q. What is the matching principle?

A. The matching principle is an important accounting standard where expenses are recognized in the same period that the revenues occur.

The average-of-monthly-averages rate base accounting method best maintains the matching principle, because the accompanying revenue items in the test year are also reported as averages throughout the test year. Thus, they are “matched.”

Q. Is there another methodology that is occasionally used in a modified historical test year approach?

A. Yes. The end-of-period (EOP) rate base accounting method is occasionally used in the State of Washington, in limited circumstances.

Q. Has the Commission stated under what conditions year-end rate base accounting is an appropriate tool?

A. Yes. The Commission’s Order 08 in Dockets UE-140762, et al. references a 1981 case, *WUTC v. Washington Natural Gas*, in which the Commission drew the following conclusion:

(2) Year-end rate base is an appropriate regulatory tool under one or more of the following conditions:

(a) Abnormal growth in plant

(b) Inflation and/or attrition

(c) As a means to mitigate regulatory lag

(d) Failure of utility to earn its authorized rate of return over an historical period. *[[16]](#footnote-17)*

Q. What is attrition?

A. Staff witness Mr. McGuire defines attrition in his testimony as “the erosion of a company’s rate of return over time because the historical test period relationships in revenues, expenses and rate base does not hold during a future rate year.”[[17]](#footnote-18) Mr. McGuire discusses the phenomenon of attrition in great detail in his testimony.

Q. What rate base accounting methodology does Staff use in its pro forma revenue requirements analysis?

A. Staff uses the EOP method in its *pro forma* revenue requirement analysis.

Q. What is the reason for adopting end-of-period (EOP) balances rather than average-of-monthly-averages (AMA) balances?

A. Staff’s goal is to reflect rate base balances that are likely to exist during the rate year. Historically, the Commission has preferred AMA rate base calculation, adhering to the matching principle. However, as noted above, using an EOP approach has been identified as a tool for addressing regulatory lag and, more importantly, attrition. Mr. McGuire identifies the impact of attrition in Avista’s natural gas operations at current rates. Further, Mr. McGuire concludes that attrition may have an impact on the Company’s electric if the Commission adopts rates based on Staff’s *pro forma* revenue requirement. Exhausting a long-accepted tool, such as EOP, is appropriate prior to entertaining an even more extraordinary tool, such as an attrition allowance.

# Capital Additions in the Final Three Months of 2014

## Electric Adjustment 3.11

Q. Please describe the purpose of this adjustment.

A. This adjustment “pro forms” actual electric transfers to plant in the final three months of calendar year 2014.

Q. Did the Company have a similar adjustment in their initial and updated Pro Forma Cross Check studies?

A. Yes; this analogous adjustment was also referred to as electric Adjustment 3.11 in its Pro Forma Cross Check study. However, the Company did not have actual figures available at the time of the initial filing; instead, the Company used projected figures. The Company later updated these numbers through electric Adjustment 3.12U in its response to Staff Data Request No. 131.

For easier comparison to the Company’s original filing, Staff presents Adjustment 3.11 as the actual electric capital additions made in the final three months of 2014.

Q. How does Staff incorporate these actual capital addition figures in its *pro forma* revenue requirements analysis?

A. Staff “pro forms” capital additions between the end of the test year and December 31, 2014 on a *prima facie* basis, regardless of size. These capital additions were demonstrated to be used and useful to Washington ratepayers prior to the Company’s filing of this case, and were known and measurable shortly afterward.[[18]](#footnote-19)

Q. How does this compare to the Company’s initial Pro Forma Cross Check Study?

A. The Company dramatically overestimated the size of the capital additions that would be transferred into service the final three months of 2014. The Company then projected that the net effect of capital projects transferred to plant during this period would increase rate base by over $35.0 million. In fact, rate base shrank by over $4.3 million during this three month period. My adjustment reflects this reduction in rate base.

Q. What is the effect on net operating income due to this adjustment?

A. This adjustment reduces net operating income by $1,438,000 relative to the test year.

## Natural Gas Adjustment 3.07

Q. What is the purpose of this adjustment?

A. This adjustment “pro forms” actual natural gas transfers to plant in the final three months of calendar year 2014.

Q. Did the Company have a similar adjustment in their initial and updated Pro Forma Cross Check studies?

A. Yes; this similar adjustment was also referred to as natural gas Adjustment 3.07 in its Pro Forma Cross Check study. However, similar to Electric Adjustment 3.11, the Company did not have actual figures available to it at the time it made its initial filing. Instead, the Company used projected figures. The Company later updated these numbers through natural gas Adjustment 3.07U in its response to Staff Data Request No. 131.

For easier comparison to the Company’s original filing, Staff presents Adjustment 3.07 as the actual natural gas capital additions made in the final three months of 2014.

Q. How does Staff incorporate these actual capital addition figures in its *pro forma* revenue requirements analysis?

A. Staff “pro forms” capital additions between the end of the test year and December 31, 2014 on a *prima facie* basis, regardless of size. These capital additions were used and useful to Washington ratepayers prior to the Company’s filing of this case, and were known and measurable shortly afterward.

Q. How does this compare to the Company’s initial Pro Forma Cross Check Study?

A. The Company slightly underestimated the size of the capital additions that would be transferred into service the final three months of 2014. The Company projected that the net effect of capital projects transferred to plant during this period would increase rate base by over $3.0 million. In fact, rate base increased by $3.4 million during this three month period.

Q. What is the effect on net operating income due to this adjustment?

A. This adjustment reduces net operating income by $359,000 relative to the test year.

# 2015 Capital Additions

**Electric and Natural Gas Adjustments 4.01**

Q. Previously, you defined the standard for major capital additions. Which projects in 2015 meet this standard?

A. Avista has nine electric ERs, and seven natural gas ERs, that qualify as major by this approach. Two of these ERs apply to both industries. These ERs are listed in the table below, and are discussed in the testimony of Staff witness Mr. Gomez. Note that the values below represent the Washington-allocated share for each ER *as proposed by the Company* – not the figures Staff is supporting as 2015 transfers to plant.

**Table 3 – Major 2015 *Pro Forma* Transfers to Plant, as Proposed by Avista**

|  |  |  |  |
| --- | --- | --- | --- |
| **ER** | **ER Title** | **WA elec. share** | **WA gas share** |
| 5138 | CSS Replacement (Proj. Compass) | $ 45,886,848 | $ 13,608,584 |
| 5005 | Information Technology Refresh Program | $ 8,971,438 | $ 2,660,644 |
| 4140 | Nine Mile Redevelopment | $ 34,733,867 | $ - |
| 3008 | Aldyl -A Pipe Replacement | $ - | $ 8,072,366 |
| 4152 | Little Falls Powerhouse Redevelopment | $ 9,677,811 | $ - |
| 6103 | Clark Fork Implement PME Agreement | $ 9,398,989 | $ - |
| 4161 | CG HED U#1 Refurbishment | $ 7,715,178 | $ - |
| 4162 | PF S Channel Gate Replacement | $ 7,449,884 | $ - |
| 2060 | Wood Pole Mgmt | $ 7,219,301 | $ - |
| 2470 | Dist Grid Modernization | $ 7,122,008 | $ - |
| 7101 | COF HVAC Improvmt | $ - | $ 1,323,537 |
| 3005 | Gas Distribution Non-Revenue Blanket | $ - | $ 2,174,400 |
| 3306 | Goldendale HP | $ - | $ 3,504,911 |
| 3007 | Isolated Steel Replacement | $ - | $ 2,625,450 |
|  | **Company Total; Listed ERs** | **$138,175,324** | **$33,969,892** |

Q. What is Staff’s recommended 2015 pro forma capital additions?

A. For the 14 major capital additions, Staff’s recommended amount of *pro forma* transfers to plant is $56.7 million for electric service, and $16.2 million for natural gas service. These are, in total, $65.4 million less than the Company’s total of its revised amounts for the same listed ERs of $138.3 million. These figures are based upon the actual transfer-to-plant balances in the respective ERs, as of June 30, 2015, and modified by Mr. Gomez’s analysis. Mr. Gomez provides a detailed breakdown of Washington-allocated 2015 *pro forma* capital additions to rate base in Exhibit No. \_\_ (DCG-4). The table below summarizes Staff’s recommendation.

**Table 4 – Major 2015 Pro Forma Transfers to Plant, as Revised by Staff**

|  |  |  |  |
| --- | --- | --- | --- |
| **ER** | **ER Title** | **WA elec. share** | **WA gas share** |
| 5138 | CSS Replacement (Proj. Compass) | $ 36,864,000 | $ 10,933,000 |
| 5005 | Technology Refresh to Sustain Business Process | $ 2,654,000 | $ 735,000 |
| 4140 | Nine Mile Rehab | $ 3,092,000 | $ - |
| 3008 | Aldyl A Replacement | $ - | $ 2,387,000 |
| 4152 | Little Falls Plant Upgrade | $ 2,354,000 | $ - |
| 6103 | Clark Fork Settlement Agreement | $ 6,382,000 | $ - |
| 4161 | Cabinet Gorge Unit 1 Refurbishment | $ - | $ - |
| 4162 | Post Falls South Channel Replacement | $ - | $ - |
| 2060 | Distribution Wood Pole Management | $ 3,749,000 | $ - |
| 2470 | Distribution Grid Modernization | $ 1,608,000 | $ - |
| 7101 | HVAC Renovation Project | $ - | $ - |
| 3005 | Gas Non-Revenue Program | $ - | $ 1,648,000 |
| 3306 | Gas Goldendale HP Main Reinforcement Project | $ - | $ - |
| 3007 | Gas Isolated Steel Replacement Program | $ - | $ 464,000 |
|  | **Staff Total; Listed ERs** | **$56,703,000** | **$16,167,000** |

Q. Why did Staff concern itself with the June 30, 2015 actual balances for these projects?

A. Staff adopts an “in-service cutoff date” of June 30, 2015, for major plant additions; these items are used and useful for ratemaking purposes. These items were audited during a Staff visit to Avista’s headquarters in Spokane on July 8, 2015.

Staff considers all major plant in service as of June 30, 2015, to be appropriate for consideration as a standard, *pro forma* plant adjustment. This date was chosen to incorporate known and measurable transfers to plant that have occurred since the case was filed. Further, this date provided Staff enough time to verify the Company’s figures before the filing of testimony on July 27, 2015.[[19]](#footnote-20) The table below is included to help clarify matters. Mr. Gomez’s testimony addresses the proposed rate base additions that meet these standards.

**Table 5 – Treatment of *pro forma* capital additions, by date**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **9/30/14 thru 12/31/14** | **1/1/15 thru 6/30/15** | **After 6/30/15** |
| **Major** | Accepted, *prima facie* | Audited | Fails known & meas. standard |
| **Other** | Accepted, *prima facie* | Excluded, *de minimis* | Excluded, *de minimis* |

Q. Is the use of a June 30, 2015 “in-service cut-off date” a punitive approach?

A. No. In Order 08, Dockets UE-140762 et al., footnote 57, the Commission noted that “it is even exceptional for the Commission to allow *pro forma* adjustments beyond a few months after the end of the test year.” Here, Staff allows adjustments nine months after the end of the test year.

Q. Does Staff’s use of an “in-service cutoff date” constitute a bright line cutoff?

A. Principally, no. Staff anticipates that it may be considered to *effectively* be a bright-line cutoff date, so it is necessary to address the distinction. Staff’s position is not based on whether a capital addition is used and useful as of June 30, 2015, as would be the case in the adoption of a bright-line cutoff date; the Commission has rejected use of a “bright line” approach in the last Pacific Power & Light’s general rate case.[[20]](#footnote-21) Additionally, Staff is not advocating for adoption of a bright-line cutoff date for future rate cases.

Instead, Staff’s position is founded on the known-and-measurable standard. The Commission has stated that “a more rigorous record and increasingly concrete support for *pro forma* adjustments” is required “the later in time plant additions are put in service and claimed to be used and useful.” [[21]](#footnote-22) Staff witness Mr. Gomez documents the Company’s inability to adhere to projected transfer-to-plant amounts and dates, while facing this higher standard.[[22]](#footnote-23) Staff’s approach in this proceeding reflects this policy, while also presenting the degree of support sought for items placed in service after the test year.

Furthermore, Staff’s approach is a practical one: Staff is constrained by the competing forces of the procedural schedules and the duty to verify that costs are sufficiently documented and appropriate to include in rates. Adoption of this date strikes a practical balance between these opposing interests.

Q. Does Staff’s approach help address the effects of regulatory lag?

A. Yes. The period of time between a rate filing and when new rates are placed into effect provides a great deal of uncertainty. “Regulatory lag” refers to the phenomenon where the changes in the relationships between a regulated public service company’s revenues, operating expenses, and rate base incurred during a rate proceeding are not fully reflected in the outcome of the rate proceeding.

In this case, the practice of allowing adjustments to the test year through the nine months after the test period (that is, through June 30, 2015), more accurately reflects the Company’s operations on a going forward basis. Further, Staff’s ability to examine the largest projects in this limited time period provides assurances that the projects are used and useful in the rate year. Updating rate base to reflect changes in the Company’s operations during the rate case works to mitigate the uncertainty in possible outcomes for the Company.

## Electric Adjustment 4.01

Q. What is the purpose of this adjustment?

A. This adjustment “pro forms” major electric 2015 capital additions, based on the respective project balances as of June 30, 2015 and Mr. Gomez’s subsequent analysis.

Q. What is the effect on net operating income due to this adjustment?

A. This adjustment reduces electric net operating income by $6,866,000 relative to the test year. This results in a revenue requirement increase of $11,075,000.

## Natural Gas Adjustment 4.01

Q. What is the purpose of this adjustment?

A. This adjustment “pro forms” major natural gas 2015 capital additions, based on the respective project balances as of June 30, 2015 and Mr. Gomez’s subsequent analysis.

Q. What is the effect on net operating income due to this adjustment?

A. This adjustment reduces natural gas net operating income by $1,917,000 relative to the test year. This results in a revenue requirement increase of $3,091,000.

# 2016 Capital Additions

**ELECTRIC AND NATURAL GAS ADJUSTMENTS 4.02**

Q. What is the purpose of these adjustments?

A. These proposed adjustments “pro form” speculative plant additions forecasted by the Company to occur in calendar year 2016.

Q. Do the proposed plant additions in this period meet the criteria used by the Commission in consideration of *pro forma* adjustments?

A. No. These proposed capital additions are not known and measurable, or used and useful. Consideration of these 2016 adjustments requires a future test year approach – one that heavily relies on the Company’s ability to forecast. Staff witness Mr. Gomez documents the Company’s questionable ability to forecast the timing and the size of their large transfers-to-plant. Further, the Commission recently reaffirmed that future test years are inconsistent with Washington ratemaking standards.[[23]](#footnote-24)

It is worth reiterating that the Commission has stated that “with very limited exceptions the plant must be in service by no later than the end of the rate proceeding if it is to be allowed in rate base.”[[24]](#footnote-25) The suspension date for this rate case has been set at January 11, 2016.

# Other Rate Base Additions

## Electric Adjustment 4.03 – Meter Retirement

Q. What is the purpose of this adjustment?

A. This adjustment, as originally proposed by the Company, accompanies the implementation of a “smart grid” meter deployment program by the Company, known as “Advanced Metering Infrastructure” (AMI). Avista seeks to transform the undepreciated balance of their in-service electromechanical meters, at the beginning of 2016, into a regulatory asset. This regulatory asset would be amortized over a 10-year period.

Q. What is Staff’s recommendation on this adjustment?

A. Staff recommends rejecting this proposed adjustment. This adjustment is tied directly to the Commission’s decision on Avista’s AMI program. Staff witness Mr. Nightingale recommends that the Commission reject the Company’s AMI proposal. Therefore, the undepreciated value of the meters should remain in rate base. Incidentally, this is accomplished by Staff’s dismissal of Avista’s 2016 adjustments, wherein the removal of meters from rate base is already reflected.[[25]](#footnote-26) By eliminating the Company’s proposed electric adjustments 4.02 (2016 Planned Capital Add) and 4.03 (Meter Retirement), Staff’s proposed treatment is accomplished. This treatment has no effect on net operating income compared to the test year.

## Natural Gas Adjustment 4.03 – Project Compass Deferral (Regulatory Amortization)

Q. Please describe this adjustment.

A. The Commission has allowed Avista to defer, for recovery in a future proceeding, the natural gas revenue requirement amount associated with Project Compass for the calendar year 2015.[[26]](#footnote-27) Specifically, the Settlement Stipulation in Docket UG-140189 states that:

The Parties agree the natural gas revenue requirement associated with the Project Compass Customer Information System for the calendar year 2015 will be deferred for recovery in a future proceeding, based on the actual costs of the Project at the time the Project goes into service.

The Company’s filed case uses an estimated amount.[[27]](#footnote-28)

Q. Does Staff support this adjustment?

A. Yes, with some changes. Staff witness Mr. Gomez addresses cost overruns on Project Compass in his testimony, and recommends disallowance of $18.702 million of final costs of this program. As discussed by Mr. Gomez, this recommendation is motivated largely by concerns over conflicts-of-interest and prudency issues related to the System Integrator contracted under this project.[[28]](#footnote-29) Adopting Staff’s recommendation results in a reducing in net operating income in natural gas operations of $614,000. This necessitates a marginal increase in revenue requirements of $990,000.

## Electric and Natural Gas Adjustments 4.04 – O&M Offsets

Q. Please describe these adjustments.

A. This adjustment accounts for expenses and savings to operations and maintenance (O&M) costs for capital investments.

Q. What is Staff’s recommendation for this adjustment?

A. For electric service, Staff’s recommendation results in an increase in net operating income of $309,000. For natural gas service, Staff’s recommendation results in an increase in net operating income of $18,000. These net operating income figures differ from those in the Company’s original filing, which were an increase of $127,000 and an increase of $51,000, respectively.

Q. How does Staff’s stated treatment of 2016 *pro forma* items affect this adjustment?

A. To be consistent with Staff’s approach above, the 2016 items included in this adjustment have been removed.

Q. What other changes does Staff advocate for this adjustment?

A. In order to reflect the recommendations of Staff witness Mr. Nightingale, Staff removed the offsets Avista claimed for 2016 due to implementation their AMI program.

Staff also updates this adjustment to reflect the comments in Exhibit \_\_\_\_ (KSS-5), which note that the Company’s workpapers for this adjustment are not fully reflective of the information the Company had at filing.

Finally, Staff updates this adjustment to reflect the Company’s response in Staff Data Request No. 182, regarding “bad wood pole events.” Staff’s analysis incorporates the Company’s response, and is shown in Exhibit No. \_\_\_ (CSH-8).

Q. Can you provide some examples of how the Company’s workpapers for this adjustment are not fully reflective of the information the Company had at filing?

A. Yes. In Company Exhibit \_\_\_ (KSS-5), Attachment No.\_\_ ETD-11, it is noted that “After Revenue requirements was determined that the following additional offsets exist.” A very similar example exists in the following attachments in Exhibit KSS-5: Attachment No.\_\_ GP-11; GP-17; and, G-10.

Q. Please discuss “bad wood poles” and Avista’s response to Staff Data Request 182.

A. A “bad wood pole” event is an unplanned event which causes a wood pole to become unusable for service. Examples of such events are vehicle collisions, lightning strikes, rotting of the mast or cross-arm, wind damage, fires, and felled trees. These are things the Company has little to no control over.

Staff Data Request No. 182 asked the Company to explain their prediction of a reduction of 110 “bad wood pole” events, as stated in its initial filing. In its response, the Company acknowledged a methodological flaw, incorporated actual figures through calendar year 2014, and provided documentation to support a new Company expectation of a reduction of 209 bad wood pole events to take place in 2016.

Q. Did Staff review the Company’s updated information on “bad wood pole” events?

A. Yes. Staff reviewed the support documentation included in the Company’s response, and found a clear trend in reduced bad wood pole events over time. The relationship between bad wood pole events and time lends itself to a linear regression, particularly because the Company has little to no control over these events. Bad wood pole events are highly, and negatively, correlated with time. However, the Company’s claim of a reduction of 209 bad wood pole events in this response was a predicted incremental number for 2016. Staff is hesitant to project so far into the future, and errs on the side of caution by merely estimating the reduction in 2015 bad wood pole events. Staff’s recommendation for this adjustment includes this treatment.

Q. Please describe what is shown in Exhibit No. \_\_\_ (CSH-8).

A. This exhibit shows the trend in bad wood pole events over time. There is a strong relationship present here, as evidenced by the relatively high coefficient of determination of 0.703.[[29]](#footnote-30) This suggests that future bad wood pole events in the short term can be estimated based on past trends. The line of best fit for this data, represented by the equation displayed on the chart, can be used to reasonably estimate the number of future bad wood pole events in the short term.

Q. What does this line of best fit suggest the number of bad wood pole events will be in the year 2015?

A. Based on this line of best fit, Staff expects Avista to record 727 bad wood pole events in 2015. This represents a reduction of 123 bad wood pole events, relative to the observed total in 2014 of 850.

# Reconcile Pro Forma to Attrition

**Electric Adjustment 4.05 and Natural Gas Adjustment 4.06**

Q. Please describe the purpose of these adjustments.

A. The purpose of these adjustments, as originally proposed by the Company and explained by Ms. Smith, is to “establish revenue, expenses and rate base numbers that can be used as inputs to the Company’s cost of service studies prepared by Company witnesses Ms. Knox… and Mr. Miller.”[[30]](#footnote-31)

In the Company’s Pro Forma Cross Check study, this adjustment forces the *pro forma* revenue requirement model to produce the same revenue requirement result as the Company’s attrition study. This is a necessary step in the Company’s original filing, but services no purpose for Staff’s analysis.

Q. Does Staff’s recommended case require this adjustment?

A. No. This adjustment has been eliminated from Staff’s pro forma analysis, and therefore has no impact on revenues or income.

Q. Does this conclude your testimony?

A. Yes.

1. Testimony of Chris McGuire, Exhibit No. \_\_\_ (CRM-1T), page 47, Section VI, subsection A. [↑](#footnote-ref-2)
2. Testimony of Jennifer S. Smith, Exhibit No. \_\_\_ (JSS-1T), page 3, lines 11-14. [↑](#footnote-ref-3)
3. *Id*. at page 3, lines 15-16. [↑](#footnote-ref-4)
4. This figure was based on an assumed rate of return higher than the one settled by the Parties in this case. Subsequent lines in this table show the effects after incorporating the settled rate of return of 7.29 percent. [↑](#footnote-ref-5)
5. Multiparty Settlement Stipulation, page 3, paragraph 5b. [↑](#footnote-ref-6)
6. *Wash. Utils & Transp. Comm’n v. Pacific Power & Light Co.* Docket UE-050684, Order 04 (Apr. 17, 2006), 19-28 (providing a description of the used-and-useful standard). [↑](#footnote-ref-7)
7. *Wash. Utils & Transp. Comm’n v. Pacific Power & Light Company*, Docket UE-140762, Order 08 (March 21, 2015), ¶ 152 (noting that Pacific Power has used $10,000,000, and then $250,000, in successive rate cases as a threshold for what constitutes a major capital project). This provides a recent and representative example of how the standard for a major capital addition changes from rate case to rate case. [↑](#footnote-ref-8)
8. *Id.* at ¶ 170 [↑](#footnote-ref-9)
9. *Wash. Utils & Transp. Comm’n v. Avista Corp.*, Docket UE-090134, Order 10 (Dec. 22, 2009), ¶ 45. [↑](#footnote-ref-10)
10. This is also known as the “rate year.” [↑](#footnote-ref-11)
11. Docket UE-090134, Order 10 at ¶48. [↑](#footnote-ref-12)
12. Docket UE-140762, Order 08, Footnote 222. [↑](#footnote-ref-13)
13. Note that it is possible for a plant addition to exceed 0.5% of a company’s Washington-allocated net plant in service, while remaining under $3.0 million on a total project basis. This scenario is more likely to occur with smaller companies, although it is less likely to occur as time goes by and net plant in service increases in value. In this scenario, WAC 480-140-040 would guide against considering such an addition to be a major plant addition. Put differently, a rate base addition must first be greater than $3.0 million on a total project basis, and then be greater than 0.5% of the Washington-allocated net plant in service for the given company in a given industry. Nonetheless, this first hurdle (greater than $3.0 million on a total project basis) does not play a part in this case, due to Avista’s relatively large size in Washington. [↑](#footnote-ref-14)
14. Testimony of Karen Schuh Direct, Exhibit No. \_\_\_\_ (KSS-5). [↑](#footnote-ref-15)
15. That an ER is independently used and useful was confirmed by the Company during an in-person meeting with Staff on May 7, 2015. [↑](#footnote-ref-16)
16. Docket UE-140762, Order 08 at ¶145 (citing *Petition of Puget Sound Energy and NWEC for Decoupling Authority*, Dockets UE-12167 and UG-121705 (consolidated) and *WUTC v. Puget Sound Energy*, Dockets UE-130137 and UG-130138 (consolidated), Order 07, (June 25, 2013) ¶ 45 (citing *WUTC v. Wash. Nat. Gas Co.,* 44 P.U.R. 4th 435, 438 (Sept. 24, 1981))). [↑](#footnote-ref-17)
17. McGuire, Exhibit \_\_\_ (CRM-1T), page 29, Section V, Subsection B. [↑](#footnote-ref-18)
18. The Company filed this rate case on January 11, 2015. [↑](#footnote-ref-19)
19. Dockets UE-090134 & UG-090135, Order 10 at ¶78. [↑](#footnote-ref-20)
20. Docket UE-140762, Order 08 at ¶169. [↑](#footnote-ref-21)
21. *Id.* [↑](#footnote-ref-22)
22. *See* Testimony of David C. Gomez, Exhibit No. \_\_\_ (DCG-1TC). [↑](#footnote-ref-23)
23. Docket UE-140762, Order 08 at ¶8. [↑](#footnote-ref-24)
24. Docket UE-090134, Order No. 10 at ¶48. [↑](#footnote-ref-25)
25. *See* *supra* Section VII at pp. 26-27. [↑](#footnote-ref-26)
26. Docket UE-140188, Full Settlement Stipulation, (Aug. 18, 2014), 4-5, ¶ 7. [↑](#footnote-ref-27)
27. *See* Smith Direct, Exhibit No. \_\_\_ (JSS-1T), page 50, footnote 26. [↑](#footnote-ref-28)
28. Gomez, Exhibit No. \_\_\_ (DCG-1T), pages 44-48. [↑](#footnote-ref-29)
29. The independent variable in this linear regression, time (as represented by the year), has a p-value of 0.002. This statistical indicator gives Staff confidence in the short-term predictive power of this line of best fit. [↑](#footnote-ref-30)
30. Smith Direct, Exhibit No. \_\_\_ (JSS-1T), page 3, lines 17-21. [↑](#footnote-ref-31)