Exh. JH-1T
Dockets UE-170485/UG-170486
Witness: Joanna Huang

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

TESTIMONY OF

JOANNA HUANG

STAFF OF
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Results of Operations and Revenue Requirements,
Conversion Factor,
Restating Incentive Expenses
Pro Forma Incentive Expenses
Restate Debt Interest
Pro Forma Director Fees Expense

October 27, 2017

TABLE OF CONTENTS

LIST OF EXHIBITS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Joanna Huang. My business address is the Richard Hemstad Building, 1300 South Evergreen Park Drive SW, 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" or "UTC") as a Regulatory Analyst in the Energy Section of the Regulatory Services Division.

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

A. I have been employed by the Commission since June 1996.

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

A. I received a Bachelor of Business Administration degree majoring in Accounting from National Chung-Hsing University, Taiwan, in 1987, and a Master of Accounting Degree from Washington State University in 1991. Prior to my employment at the Commission, I was employed by the Washington State Department of Revenue as an Excise Tax Examiner. I performed desk audits on Business and Occupation tax returns.

I began my employment with the Commission in June 1996. My work generally includes financial, accounting and other analyses for general rate case proceedings and other tariff filings by the electric and natural gas utilities regulated by the Commission. I attended the National Association of Regulated Utility Commissioners Annual Utility School in 1996 and 2001. In addition, I have attended numerous training seminars and conferences regarding utility regulations and operations.

Q. Have you testified previously before the Commission?

A. Yes. I testified in Puget Sound Energy general rate cases in Dockets UE-090704 and UG-090705, and Dockets UE-072300 and UG-07230; a PSE Power Cost Only Rate Case in Docket UE-130617; a Pacific Power general rate case in Dockets UE-152253, UE-130043 and UE-032065; Avista general rate cases in Dockets UE-160228 and UG-160229, Dockets UE-140188 and UG-140189, Dockets UE-120436 and UG-120437, Dockets UE-090134 and UG-090135, and Dockets UE-991606 and UG-991607; and a Northwest Natural filing in Docket UG-111233.

I have also participated in Staff's investigation in the following general rate cases and other matters: Docket UE-011595, Dockets UE-050482 and UG-050483, Dockets UE-070804 and UG-070805, Dockets UE-100467 and UG-100468, and Dockets UE-110876 and UG-110877 (all Avista); Docket UG-152286 and Docket UG-060256 (Cascade); Docket UG-080546 and Docket UG-031885 (Northwest Natural); and Dockets UE-070725 and UG-130137, UE-170033/UG-170034 (PSE).

II. SCOPE AND SUMMARY OF TESTIMONY

Q. Please explain the purpose of your testimony.

A. The purpose of my testimony is to present Staff's revenue requirement analysis. Staff conducted an independent, stand-alone analysis to determine if the revenues of Avista Corporation d/b/a Avista Utilities ("Avista" or "Company") are sufficient to allow the opportunity to achieve Staff's recommended rate of return. Staff used a modified historical test year study with known and measurable pro forma adjustments. This portion of my testimony responds to the Company's Traditional Pro Forma Study sponsored by Company witness Ms. Andrews, Exh. EMA-2 and Exh. EMA-6.

Q. In addition to the revenue requirement analysis, did you also analyze any specific adjustments in this proceeding?

A. Yes. I present Staff's recommendations on the following issues and adjustments:

- Conversion Factor and other affected adjustments
- Restating Incentives Expenses (Electric Adj. 2.15, Gas Adj. 2.14)
- Pro Forma Incentive Expenses (Electric Adj. 3.05, Gas Adj. 3.05)
- Restate Debt Interest (Electric Adj. 2.17, Gas Adj. 2.15)
- Pro Forma Director Fees Expense (Electric Adj. 3.12, Gas Adj. 3.12)

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

A. Yes. Exh. JH-2 and Exh. JH-3 present Staff's revenue requirement analysis using a modified historical test year Traditional Pro Forma Study for electric and natural gas operations, respectively. My Exh. JH-2 and Exh. JH-3 are Staff's responses to Avista witness Ms. Andrews's Exh. EMA-2 and Exh. EMA-6.

I also sponsor Exh. JH-4 through Exh. JH-8. Exhibit JH-4 shows the revised conversion factors for electric and natural gas operations, respectively. Exhibit JH-5 illustrates Staff's calculation of the Restating Incentives Adjustment, and Exhibits JH-6 and JH-7 show further support for Staff's Restating Incentives adjustment. Exhibit JH-8 is Staff's Pro Forma Director Fees Expense Adjustment and supporting documents.

Q. Please identify the contested adjustments that Staff witnesses address in their testimonies.

A. The following table shows the adjustments that Staff contests and the Staff witness who addresses each adjustment.

Table 1

Line	Description	Elec. Adj.	Gas Adj.	Staff
	Working Capital	1.03	1.03	Erdahl
2	Restate Property Tax	2.02	2.02	White
3	Uncollectible Expense	2.03	2.03	White
4	Restating Incentive Expenses	2.15	2.14	Huang
5	Restate Debt Interest	2.17	2.15	Huang
6	Restate Plant From AMA to EOP	2.19	2.16	Scanlan
7	Pro Forma Incentive Expense	3.05	3.05	Huang
8	Pro Forma Property Tax	3.06	3.06	White
9	Pro Forma 2017 Threshold Capital Adds	3.10	3.10	Scanlan
10	Pro Forma O&M Offsets	3.11	3.11	Scanlan
11	Pro Forma Director Fees Expense	3.12	3.12	Huang
12	Power Supply & Transm Revs	4.00		Gomez
13	EOP 2017 Capital Net Rate Base (*)	3.15	3.14	Hancock

The EOP 2017 Capital Net Rate Base (*) adjustment is only shown in Avista witness Ms. Andrews's EOP Rate Base Study in Exhibits EMA-3 at page 10 and Exh. EMA-7 at page 8.

III. RESULTS OF OPERATIONS AND REVENUE REQUIREMENTS

A. Staff's Presentations of Revenue Requirements

Q. What is Staff's recommended revenue requirement for Avista's electric operations?

A. Staff's analysis, based on a modified historical test period with limited pro forma adjustments, results in a recommended increase of $10,034,000 additional annual revenue for Avista's electric operations, or an increase of 2.04 percent.[1] Staff's revenue requirement calculation is based on Staff witness Mr. Parcell's recommended 7.20 percent overall rate of return.

Q. What is Staff's recommended revenue requirement for Avista's natural gas operations?

A. Staff's analysis, based on a modified historical test period with limited pro forma adjustments, results in a recommended increase of $1,107,000 additional annual revenue for Avista's natural gas operations, or an increase of 1.25 percent.[2] Staff's

[1] Huang, Exh. JH-2, page 2, line 9.
[2] Huang, Exh. JH-3, page 2, line 9.

revenue requirement calculation is based on Staff witness Mr. David Parcell's recommended 7.20 percent overall rate of return.

Q. Does your revenue requirement, based on a modified historical test period with limited pro forma adjustments, reflect Avista's proposed rate plan?

A. No. My revenue requirement model and supporting exhibits recommend a single-year revenue requirement through the one-year rate period starting in May 2018. Staff witness Mr. Christopher Hancock addresses Avista's proposed rate plan and provides Staff's recommendation for a rate plan in 2019 and 2020.

B. Avista's Presentations of Revenue Requirements

Q. What revenue requirement did Avista present for its electric operations in Washington?

A. Avista proposes an increase of $61.356 million for 2018 rates and an additional two-year rate plan consisting of two additional revenue requirement increases of $13.983 million and $14.432 million for the rate periods beginning May 1, 2019, and May 1, 2020, respectively.[3] Avista's 2018 electric-side revenues increase of $61.356 is based on the Company's EOP Rate Base Study.

Q. What revenue requirements did Avista present for its natural gas operations in Washington?

[3] Andrews, Exh. EMA-1T, page 14, line 6.

A. Avista proposes a revenue increase of $8.269 million to its 2018 natural gas revenues and two additional revenue requirement increases of $4.22 million and $4.417 million for the rate periods beginning May 1, 2019, and May 1, 2020, respectively.[4]

Q. How did the Company present its 2018 revenue requirement calculation in this general rate case?

A. Avista's revenue requirement calculation is based solely on its EOP Rate Base Study in Ms. Andrews Exhibits EMA-3 and EMA-7. The Company first calculates its own modified historical test period results of operations with limited pro forma adjustments, shown on the final column of page 9 of Exh. EMA-2 and page 7 of Exh. EMA-6. For its EOP Rate Base Study, Avista then included 2017 end-of-period rate base in Adjustment 3.15 Electric and Adjustment 3.14 Gas. The Company also includes an adjusted capital structure to arrive at its intended revenue requirement.[5] The Company's present 2018 revenue requirement calculation is shown in the final column of page 10 of Ms. Andrews's Exh. EMA-3 and page 8 of Exh. EMA-7.

IV. CONTESTED ADJUSTMENTS

A. Conversion Factor

Q. What is a conversion factor?

A. A conversion factor converts the shortfall in net operating income (NOI) to the

[4] Andrews, Exh. EMA-1T, page 14, line 8.
[5] Andrews, Exh. EMA-1T, page 5, line 21.

revenue which will produce an NOI that achieves the targeted Rate of Return (ROR). It "grosses up" revenues to account for costs that will increase in proportion to revenues. These types of revenue-variable costs include state Business and Occupation taxes, regulatory fees, uncollectible debt expenses and Federal Income Tax (FIT).

Q. Does Staff use different conversion factors from the Company's case submitted on May 1, 2017?

A. Yes. The following table shows the differences between the Company's filed conversion factor and Staff's proposed conversion factor.

Table 2

Conversion Factor	Electric	Natural Gas
Avista	0.619413	0.620645
Staff	0.619659	0.619798

Q. Why does Staff use different conversion factors than the Company?

A. In response to a Staff data request in this case, Avista revised its uncollectible expenses. The Company revised the actual write offs for uncollectible expenses in the test period and changed the allocation between electric and natural gas operations. Avista's new Customer Care and Billing (CC&B) system cannot distinguish whether electric or natural gas uncollectible balance is being written off. Therefore, Avista reversed back to the same methodology the Company used in the years prior to the new CC&B system. Staff's conversion factor reflects these Company-acknowledged revisions provided in discovery.

Q. What is the method used prior to the new CC&B system and included in the Company's revised uncollectible expense adjustment?

A. Avista's revised adjustment combines total write-offs for electric and natural gas services and then uses the percentage of sales balances for electric and natural gas services to allocate the total write-offs to either electric or natural gas service.

Q. What is the impact of the revised conversion factor?

A. The impact of revising the conversion factor reduces the Company's filed electric and natural gas revenue requirements by $24,000 and $65,000, respectively.

Q. What are the adjustments that are impacted by the revised conversion factor for electric and natural gas operation?

A. The revised conversion factor impacts the following adjustments. In practice, the list below is for informational purposes only because the impact to these adjustments is immaterial in determining final rates.

Electric: Adjustment 2.10, Weather Normalization
Adjustment 2.11, Eliminate Adder Schedules
Adjustment 2.13, Eliminate WA Power Cost Deferred
Adjustment 3.08, Pro Forma Revenue Normalization

Natural Gas: Adjustment 2.10, Weather Normalization

Adjustment 2.11, Eliminate Adder Schedules

Adjustment 3.08, Pro Forma Revenue Normalization

B. Adjustment 2.15, Electric, and Adjustment 2.12, Gas - Restating Incentives

Q. What is the Restating Incentives adjustment?

A. This adjustment addresses incentive payments for Operating and Maintenance (O&M) costs. Avista pays these incentive amounts to non-officers, which can be union or non-union employees, and officers.

Q. Please explain the Company's Restating Incentives Adjustment 2.15, Electric, and Adjustment 2.12, Gas.

A. The Company restates this portion of incentive pay to reflect Avista's targeted incentive payout. That is, the Company's adjustment restates actuals to match Avista's own projections. The Company's calculation is a four-step process. First, the Company used its own Human Resource's (HR) projected and targeted 2016 incentive payout plus the payroll tax of 8 percent to arrive at a total targeted incentive 2016 payments for non-executives and executives. Second, Avista calculated the O&M-allocated portion of incentives for non-executives as 60.54 percent and for executives as 40 percent. Third, Avista multiplied that O&M-allocated portion of incentive payments by 1.09, which is the six-year average percentage of actual incentive payout relative to projected incentive payout, to calculate total incentives of $6,216,051 and $1,203,535 for non-executives and executives in 2016. Fourth, Avista compared its actual 2016 paid incentive with this projected and targeted 2016 incentive payout, adjusted by payroll tax, O&M percentage and the six-year average percentage, to arrive the restating incentive adjustment.

Q. What is Staff's response to Avista's Restating Incentive Adjustment?

A. Staff opposes the Company's adjustment. Avista's Restating Incentive Adjustment contradicts the definition of a restating adjustment. A restating adjustment adjusts the booked operating results for any defects that can distort test period earnings.[6] Avista's restating incentive adjustments replace test period incentive expenses with the HR Department's internal targeted 2016 O&M incentive expenses. Avista's proposed Restating Incentive is a pro forma adjustment, not a restating adjustment.

Q. Why is the Company's adjustment for O&M-related incentives flawed?

A. The primary flaw is that the Company's HR Department controls the targeted expense level, which potentially creates budget-based ratemaking. In this case, the Company uses its "2016 Target - at 100% per HR" and further applies it to the six year average percentage of incentive payout to arrive at a restated incentive expense. But, the "2016 Target - at 100% per HR" can be whatever amount the Company's HR Department wants it to be. Therefore, under the Company's proposal, Avista controls the amount of this restating incentive adjustment.

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

Q. Why not just treat the Company's restating adjustment as a pro forma adjustment?

A. The Company's adjustment also does not fit the definition of a pro forma adjustment.[7] Projected O&M 2016 labor expenses may or may not match with test period O&M incentive expenses, meaning those projections are not known and measurable. The Company's human resources projections are, by definition, budget-based estimates. A budget forecast, estimate, or Company-set target is not an appropriate basis for a pro forma adjustment.

Q. What then is Staff's recommendation for this adjustment?

A. Staff proposes to restate the test year actual incentive payout, in nominal dollar terms, to the six-year average of incentive payouts, in nominal dollar terms.

Q. How was the restating incentive adjustment calculated in the past?

A. Previously, Avista used the six year average, as Staff is recommending, for the incentive payout level for non-executives and officers to arrive at the restating incentive adjustment for the test period. After the general rate case filing in Dockets UE-120436 and UG-120437 in 2012, Avista has been applying its targeted expense level to the past six-year average percentage to arrive at the restating incentive adjustment for the test period.

Q. How does Staff's adjustment differ from the Company's adjustment?

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

A. Staff's methodology would disallow the Company's predetermined "2016 Target - at 100% per HR" as a basis. Staff's methodology also used a six-year average of dollar amounts instead of the average percentage.

Q. What is the impact of your recommended adjustment to Avista's incentive expenses?

A. Staff removed $580,000 and $167,000 from the Company's results of operation for electric and natural gas operations, respectively. The net operating impacts are $377,000 and $109,000 annual revenue increases to electric and natural gas operations, respectively.

C. Adjustment 2.15, Electric and Adjustment 2.12, Gas – Pro Forma Incentives

Q. Please explain Avista's proposed pro forma incentive adjustment, Adjustment 3.05, Electric, and Adjustment 2.12, Gas.

A. In addition to Avista's restating adjustment discussed above, Avista included a wage increase of 6.486 percent to arrive at a 2018 projected level of incentive expenses. Avista's proposal effectively assumes that the pro forma level of incentive expenses will precisely match the percentage growth in base wages over the same time period. Avista's proposal also assumes that pro forma incentive pay can only increase year-over-year, with no potential decrease in incentive payouts in the near future.

Q. Please explain how Avista calculated its proposed pro forma incentive adjustment.

A. Avista applied a pro rata share of the 2016 wage increase for January 1, 2016 through March 26, 2016. That pro rata percentage is 0.486 percent. In addition, Avista also added a three percent wage increase for each of 2017 and 2018, for a total of six percent. The sum total is an increase of 6.486 percent incentive pay.

Q. What is Staff's recommendation for the Company's pro forma incentive adjustment?

A. The Commission should reject the Company's pro forma incentive adjustment because the incentive amount is based on nothing more than projections and goes against the basic definition of incentive pay.

Q. Please explain how the Company's pro forma incentive adjustment is based on projections.

A. Avista's calculation starts with its own HR Department's targeted 2016 incentive expenses. Avista's use of its "2016 Target - at 100% per HR" is an HR projection and, therefore, is not known and measurable. Under Avista's proposal, that targeted level of incentive expense goes into rates as if it were a certainty, while the employees' future performances are undetermined until after that performance is complete. Incentive pay is to reward performance and, therefore, the amount of the payment can only be known and measurable in retrospect.

Further, the Human Resource predetermined targeted 2016 incentive level can be manipulated to achieve any desired expense level. Annual Company incentive plan payouts can vary year-to-year with employee and overall company performance. Avista's 2016 Target - at 100% per HR as basis for incentive payments are not known and measurable until after two years. Avista's basis for 2016 incentive payments thus does not reflect a fair and reasonable level of revenue or expense that should be included in customers' rates.

Q. Why is Avista's treatment of incentive pay inappropriate?

A. The second reason that I disagree with Avista's methodology is the definition of an incentive. Incentive pay and base wages are distinct. Incentive pay is variable and depends on employee and company performance. If, however, the Commission allows companies to simply escalate incentive pay on a pro forma basis at the same rate as wages, then incentive pay effectively becomes guaranteed and can only increase annually. Under such a proposal, incentive pay can never decrease, which removes any actual incentives associated with that portion of pay. By definition, incentive is to reward better performance, and performance varies annually. By its nature, incentive pay has to be variable and uncertain rather than known and measurable. Therefore, Avista's method is contradictory to the definition of incentive and the Commission should reject the Company's pro forma incentive adjustment.

Q. How has the Commission treated pro forma incentive pay in the past?

A. Avista has not proposed pro forma incentive adjustments in ten of its recent filings.[8] Avista did propose a pro forma incentive adjustment in Docket UE-090134. In that case, the Commission ruled to leave the Company's incentive program costs for electric and natural gas operations at the test year level. In the past eleven general rate cases, Avista only once attempted to make a pro forma incentive adjustment. The Commission disallowed this one attempt by Avista.[9]

Q. Have you prepared an exhibit that shows your pro forma incentives adjustment?

A. Yes. My Exh. JH-4 shows Staff's recommendation to completely eliminate the **"**Pro Forma Incentive Expenses," Adjustment 3.05, Electric and Adjustment 2.12, Gas.

D. Adjustment 2.17, Electric Adjustment 2.15, Gas - Restate Debt Interest

Q. Please describe Staff proposed Adjustment 2.17, Electric Adjustment 2.15, Gas, - Restate Debt Interest.

A. Staff's proposed Restate Debt Interest calculates the tax effect on interest using Staff witness Mr. David Parcell's recommended weighted average cost of debt as applied to Staff's recommended level of rate base. The only difference between the

---

[8] *See generally* Dockets UE-160228/UG-160229, UE-150204/UG-150205, UE-140188/UG-140189, UE-120436/UG-120437, UE-110876/UG-110877and UE-100467/UG-100468, UE-080416/UG-080417, UE-070804/UG-070805, and UE-050482/UG-050483.

[9] *Wash. Utils.& Transp. Comm'n v. Avista Corp.*, Dockets UE-090134 & UG-090135, Order 10, page 54, ¶ 129.

Company's and Staff's adjustments is due to differences in weighted average cost of debt and the level of rate base.

The federal income tax effect of the restated level of interest for the test period increases Washington net operating incomes by $19,000 and $4,000 in total. My Exh. JH-2, pages 11 and 19 show the calculation.

E. Pro Forma Director Fee Expense (Adjustment 3.12)

Q. What is the Pro Forma Director Fee Expense (Adjustment 3.12)?

A. The director fee is exactly what it sounds like – the expense item for compensation paid to the Company's directors. In this case, Avista also adds a pro forma adjustment to re-apportion the vast majority of those director fees to regulated ratepayers.

Q. Why is this adjustment at issue?

A. Avista is proposing to change the director fee expense based on an annual survey of its Board of Directors. The claimed purpose of the survey is to account for how directors split time between utility and non-utility operations. However, the substance of the survey results show that the directors just claimed a blanket allocation of 97 percent to the regulated utility and only 3 percent for the non-utility operations.

Q. Do you agree with Avista's pro forma adjustment on director fee expense?

A. No. Staff recommends that the Commission disallow the proposed pro forma director fee expense adjustment. Staff proposes that the Commission follow recent practice and leave the director fee allocation of 50 percent utility / 50 percent non-utility.

Q. How was this adjustment done in the past?

A. Avista has usually made a restating adjustment to the director fees that splits those fees 50/50 between utility and non-utility operations. Avista has traditionally not made any further pro forma adjustments to director fees.

Q. Is there a Commission order for applying the 50/50 split between utility/non-utility?

A. Yes. Avista applied a 50/50 split between utility and non-utility operations in accordance with the Commission's Order 05 in Docket UE-090134. The Commission determined that Directors' Fees and Meetings costs should be shared equally between shareholders and ratepayers. [10]

Q. Does Avista have any substantive reason for allocating 97% of director fees to regulated ratepayers?

A. No. The 97 percent utility and 3 percent non-utility allocation is a predetermined figure from all the directors' time sheets.[11] The fact that every director had the exact same allocation suggests the timesheets are not credible and not reliable for re-assigning director costs through Avista's proposed pro forma director fee expense.

[10] Dockets UE-090134/UG-090135 (*consolidated*), Order 10, ¶ 142.
[11] Huang, Exh. JH-8, page 3.

Q. Why is the current 50/50 split the more reasonable allocation?

A. First, and as noted above, the Commission order for a 50/50 split is less than ten years old. Second, Avista has announced a merger with Hydro One, a utility based in Toronto, Ontario, Canada. The Company's proposal to change director fee allocations for the rate year when the Company is in the process of a merger that will take place in that rate year does not make sense. Restructuring Avista's ownership could very plausibly lead to corporate restructuring and re-allocation of executive and director-level expenses because directors are, at least theoretically, representatives of the owners. Changing an allocation of director time and expense in the midst of those ownership changes based on unreliable, backward looking timesheets is not reasonable. Maintaining the consistently-used 50/50 split is a much more reasonable default estimate of director fees than the predetermined 97 percent utility / 3 percent non-utility from timesheets.

Q. Did Avista propose any similar pro form director fees adjustment in the last two years in the UE-160228/UG-160229 and UE-150224/UG-150225 general rate case filings?

A. Avista did not make any proposed pro forma director fees adjustments in at least its last two general rate case filings.[12]

Q. Does this conclude your testimony?

A. Yes.

---

[12] *See generally Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, Docket UE-160228/UG-160229 and Docket UE-150204/UG-150205.