

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

1. My name is Ken Hua. My business address is 1300 S Evergreen Park Drive SW, Olympia, Washington, 98504-7250.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

- A. I am employed by the Washington Utilities and Transportation Commission (Commission) as a Revenue Requirements Specialist.

Q. WHAT ARE YOUR EDUCATION AND PROFESSIONAL QUALIFICATIONS?

- A. I graduated from the University of Washington with a Bachelor of Arts in Accounting in August 1987. My post graduate work includes completion of the University of Utah Communications Program. I earned my Certified Public Accountant Certificate from the State of Washington in 1990. I have approximately 12 years of experience in the private and public sectors, including more than four years as a comptroller and accountant and more than seven years as a Revenue Requirements Specialist at the Commission. I have worked on the U S WEST Communications, Inc. rate case in Docket No. UT-950200, the Puget Sound Energy merger in Docket No. UE-960195, Puget Sound Power and Light's PRAM proceeding in Docket No. UE-951270, and Avista Utilities' rate case in Docket Nos. UG-991607 and UE-991606. I have also testified before this Commission in Docket No. UT-950200.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to present, as a member of the Staff accounting team, the results of my review of certain issues related to the Company's proposed revenue requirement and rate base. My recommendations are incorporated into Mr. Russell's results of operations in Exhibit ____ (JMR-2).

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. I propose the following recommendations and adjustments:

- (1) Adjustment B, Payroll - to disallow the increase in payroll expense;
- (2) Adjustment G, Year 2000 - to disallow the dollars spent for Year 2000 (Y2K) issues under Regulatory Assets;
- (3) Adjustment N, CIS Rate Base - to disallow certain Customer Information System (CIS) dollars in the rate base; and
- (4) Adjustment Q, Claims - to disallow the adjustment for Operating and Maintenance (O&M) relating to test period claims.

I also recommend no changes to the following adjustments proposed by the Company:

- (1) Adjustment C, Payroll Overhead - the increase of health and life insurance expenses allocated to O&M;
- (2) Adjustment D, Bonus - test-period expenses for bonuses;

- (3) Adjustment E, 401K - O&M expense for the higher corporate match to the non-bargaining unit employee retirement plan; and
- (4) Adjustments L and M, CIS.

Q. WHAT EXHIBITS ARE YOU PRESENTING IN YOUR TESTIMONY?

A. I present the following Exhibits:

- (1) Exhibit____(KH-2) - Payroll Analysis Report Summary, (1 page);
- (2) Exhibit____(KH-3) - Employee Summary, (1 page);
- (3) Exhibit____(KH-4) - "Key Goals Program" and "Memorandum" to employees, (5 pages);
- (4) Exhibit____(KH-5) - Testimony of Mary L. Schouten, (10 pages);
- (5) Exhibit____(KH-6) - Oregon Order 99-697, CIS, (15 pages);
- (6) Exhibit____(KH-7) - Attachment 2 from NWNG, (1 page); and
- (7) Exhibit____(KH-8) - CIS calculation, (1 page).

Q. PLEASE EXPLAIN YOUR ADJUSTMENT B, PAYROLL.

A. The Company is asking for a \$52,551 (Washington portion) increase in the total payroll expense. Staff disagrees with the Company's contention that payroll expense should increase by 3 percent for employees and at least 10 percent for officers. After taking into consideration all known and measurable factors, Staff has concluded that this amount should be zero.

Q. TO WHAT KNOWN AND MEASURABLE FACTORS ARE YOU REFERRING?

A. The first factor is bonus programs, known as the "Performance Bonuses" and "Key Goals" programs. These are incentive programs for supervisors, managers, and employees with the goal to increase productivity thereby reducing the cost of serving customers. Each year, the Company tracks the results in a "Key Goals Bulletin" or in a "Memorandum" to employees. Exhibit ____ (KH-4). A significant item in these publications shows the "Expense per Customer," also labeled "Productivity Serving Customers." This item is shown because it is a benchmark for evaluating performance. It would appear that these incentive programs have had a positive effect of lowering the O&M cost because the "Expense per Customer" has steadily decreased over the years as follows: 1997 - \$195.27, 1998 - \$190.42, and 1999 - \$188.56. This trend is expected to continue, as the Company has projected a target of \$181.00 for the year 2000. This would amount to more than a four percent reduction in cost per customer. Because labor cost is a major portion of O&M expense (more than 61 percent of the 1999 O&M expense), this cost should have a corresponding reduction rather than the increase resulting from the Company's proposed adjustment.

The second factor is the Customer Information System (CIS). In response to Staff Data Request No. 7, which requested information on "all benefits of CIS in terms of dollars saved," the Company responded by providing a copy of testimony before the Public Utility Commission of Oregon in October 1998 by Mary L Schouten, Exhibit ____ (KH-5). At the time, she was a member of the Company's CIS Team. Schouten stated

that, "to date, the Customer Service Department reports a 3.5 FTE (full-time employee) reduction as a result of the implementation of the new CIS. Exhibit ____ (KH-5), page 4. This represents a savings of \$85,000 per year." Exhibit ____ (KH-5), page 4. In addition, Schouten stated that the new CIS had shortened the time for training new customer service representatives by two to three weeks. *Id.* Schouten also reported various savings in programmer hours. The foregoing are all valid reasons to expect that CIS would contribute to reducing the payroll expense.

The third factor is data from the Payroll Analysis Report provided by the Company. Exhibit ____ (KH-2). This report substantiates the testimony I just presented on the effect of bonuses and CIS on employment expense. In 1997, which included about two months of the new CIS, there were 1337 total employees at the Company. In 1998, the payroll decreased to 1303. In 1999, the payroll decreased to 1275, or an average drop of about two percent per year. Exhibit ____ (KH-3).

The fourth factor is the inclusion of non-regulated utility activity of approximately \$62 million total payroll expense for 1998 and 1999. This amounts to at least two percent of the total payroll and should also be removed from the requested increase.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT G, YEAR 2000 (Y2K).

A. Y2K refers to the Company's efforts to make computers compliant with the Year 2000. The Company is asking for \$7,073,765. Staff recommends that this total amount should be disallowed for the following reasons.

First, the Company has not provided sufficient information for Staff to review this request. The person in charge of the Company's Y2K effort was not available to Staff. Staff also requested information in several data requests. This information included a request for names of vendors, supporting documents including invoices paid with a description of work done, checks paid, and receipts for all items more than \$10,000.

Second, in any rate case extraordinary, non-recurring items should not be included. The Y2K expenses fit this description because this was a one-time effort. To include this in the rate base would distort the dollar amounts in the test period.

Third, the Company did not ask for deferred accounting treatment for this item. The proper procedure would have been for the Company to petition the Commission to book these costs as regulatory assets for future recovery (Account No. 186). This is clearly an extraordinary, one-time effort that requires such an accounting treatment.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT N, CIS RATE BASE.

A. Staff recommends an adjustment to the rate base to \$29.4 million for the total CIS project, including Residential, Commercial, and Industrial. Staff disagrees with the Company's net amount in rate base of \$40.9 million for the CIS investment. The CIS project, which began in 1992, underwent a six-year history of development that began with an initial estimate of \$24 million. The project eventually resulted in a total investment of \$47.2 million. This amount included \$3.8 million for Industrial and Large Customers. The remaining is for Residential and Small Commercial. The Company is

offsetting the total amount by \$3.1 million from the sale of hardware and software sold prior to November 1, 1997.

Q. ARE THERE ANY PRECEDENTS THAT AFFECT STAFF'S RECOMMENDATION?

A. Yes. Staff generally concurs with the Public Utility Commission of Oregon, which conducted a thorough review of this project and allowed the Company \$32 million for the project. Exhibit ____ (KH-6).

Q. IS THIS THE EXTENT OF STAFF'S RECOMMENDATION?

A. No. Staff also recommends that the \$32 million figure should be adjusted downward to \$29.4 million for the following reasons.

Staff attempted to examine project costs and determine what costs should have been accounted for as an expense. However, this approach was complicated and incomplete because the Company could not provide specific data for Staff's review. For example, in Staff Data Request No. 3 in April 2000, the Company was asked to "please state actual dollars spent on CIS from 1992 through 1999, per year, by category as stated in the direct testimony of Charles A. Beyer. Please provide this information in the same order as discussed in his testimony." The Company responded in May 2000 by stating that "no accurate activity-based ('category specific') accounting record relating to the events as described by Mr. Beyer is available." Without this information, Staff could not provide a thorough review of the costs. To simply look at a ledger sheet of general categories does

not provide the thorough review consistent with good accounting practices. Staff's experience was not unlike the experience of the Public Utility Commission of Oregon which also encountered difficulty in obtaining information. In the July 2, 1999 Testimony of Ray Nunez, he states that "Staff asked NWN for costs in a format designed to capture the functionality of the different developmental stages of the project. Activity based on costing would have provided such cost information. NWN could not produce cost information in this way without, in its opinion, introducing inaccuracies. As a consequence, NWN did not provide staff with the information required to pinpoint specific disallowances."

Therefore, Staff is left with the approach of cost comparisons to determine the appropriate level of investment for CIS. According to information provided to Staff by the Company, when the Company had 325,000 customers the "Reported CIS Cost" for Northwest Natural Gas was \$23,434,000 for the CIS project. Exhibit ____ (KH-7). This Northwest Natural Gas study is the most relevant cost comparison data because it is an internal document. Using the "regression comparing number of customers with CIS cost," this amount can be computed based on the Northwest Natural Gas customer level of nearly 500,000 customers in 1999. Staff has updated this information to reflect the test year customer count. Based on this level, the reported CIS cost should not be more than \$29.4 million. The industry-wide average, based on the 12 companies in the Northwest Natural Gas study is only \$28,141,667. Exhibit ____ (KH-7).

Based on the information provided, Staff recommends a disallowance of \$11.46 million, (total company) and \$886,117 (Washington Portion) under Exhibit ____ (KH-8), allocated proportionally between Residential, Commercial, and Industrial.

Q. PLEASE EXPLAIN YOUR ADJUSTMENT Q, CLAIMS.

A. The Company is asking to add more than \$4 million in expenses attributable mostly to the May 1999 Supreme Court of Oregon decision which awarded the Company \$3.9 million in the Chase Gardens case. The Chase Gardens case was about a bad debt involving an unpaid natural gas bill. Staff recommends the entire amount be disallowed.

Q. PLEASE EXPLAIN WHY.

A. Staff Data Request No. 16 asked the Company to provide "all journal entries and booking associated with this case, such as uncollectible bad debt, legal fees, other expenses, etc." The Company has yet to provide all of this information after numerous inquiries by Staff. Lacking information that would show whether or not the ratepayer paid any of the expenses in the past, it would be proper to remove the total amount of more than \$4 million.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.