

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a AVISTA UTILITIES,

Respondent.

DOCKET NOS. UE-080416 AND UG-080417

DIRECT TESTIMONY OF MICHAEL J. MAJOROS, JR. (MJM-1CT)

ON BEHALF OF

PUBLIC COUNSEL

AND THE

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

September 19, 2008

NON-CONFIDENTIAL VERSION

DIRECT TESTIMONY OF MICHAEL J. MAJOROS, JR. (MJM-1T)
DOCKET NOS. UE-080416 AND UG-080417

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MICHAEL J. MAJOROS, JR EXHIBIT LIST

Exhibit No. ____ (MJM-2)	Summary of Qualifications and Experience
Exhibit No. ____ (MJM-3)	Appearances as an Expert Witness
Exhibit No. ____ (MJM-4C)	Calculation of General Revenue Requirement
Exhibit No. ____ (MJM-5)	Avista's response to Public Counsel Data Request PC-074
Exhibit No. ____ (MJM-6)	Consolidated Tax Adjustment
Exhibit No. ____ (MJM-7)	<i>The Process of Ratemaking</i> , Leonard Saul Goodman, 1998 Public Utilities Reports, page 165-166.

1 **I. INTRODUCTION / SUMMARY**

2 **Q: Please state your name, position, and business address.**

3 A: My name is Michael J. Majoros, Jr. I am Vice President of Snavely King Majoros
4 O'Connor & Lee, Inc. (Snavely King), located at 1111 14TH Street, N.W., Suite
5 300, Washington, D.C. 20005.

6 **Q: Describe Snavely King.**

7 A: Snavely King is a progressive economic consulting firm, founded in 1970 to
8 conduct research on a consulting basis into the rates, revenues, costs and
9 economic performance of regulated firms and industries. Our clients include
10 government agencies, businesses and individuals that purchase public utility,
11 telecom and transportation services.

12 In addition to consumer cost and anti-trust issues, we have provided our
13 expertise in support of a clean environment and personal damages resulting from
14 discrimination in agricultural programs. We believe in accountability, fair
15 competition and effective regulation. We seek and use new ideas and we
16 challenge traditional methods based on flawed premises.

17 The firm has a professional staff of eleven economists, accountants,
18 engineers and cost analysts. Most of our work involves the development,
19 preparation and presentation of expert witness testimony before Federal and state
20 regulatory agencies. Over the course of our 38-year history, members of the firm
21 have participated in more than 1,000 proceedings before almost all of the state
22 commissions and all Federal commissions that regulate utilities or transportation
23 industries.

1 **Q: Have you prepared a summary of your qualifications and experience?**

2 A: Yes, Exhibit No.____ (MJM-2) is a summary of my qualifications and experience.
3 Exhibit No.____ (MJM-3) contains a tabulation of my appearances as an expert
4 witness before state and federal regulatory agencies.

5 **Q: For whom are you appearing in this proceeding?**

6 A: I am appearing on behalf of the Public Counsel Section of the Washington State
7 Attorney General’s Office (Public Counsel) and the Industrial Customers of
8 Northwest Utilities (ICNU).

9 **Q: Do you have any specific experience in the public utility field?**

10 A: Yes, I have been in the field of public utility regulation since the late 1970s. My
11 testimony has encompassed numerous complex revenue requirement issues.
12 Furthermore, I and other members of my firm specialize in the field of public
13 utility depreciation. We have appeared as expert witnesses on this subject before
14 the regulatory commissions of almost every state in the country.

15 **Q: Does your experience specifically include electric and gas utilities?**

16 A: Yes, I have appeared as an expert in several electric and gas utility proceedings.

17 **II. SUBJECT AND PURPOSE OF TESTIMONY**

18 **Q: What is the subject of your testimony?**

19 A: This case involves Avista Corporation’s (Avista or the Company) 2008 general
20 rate case filing. My testimony addresses the Company’s revenue requirement.

21 **Q: What is the purpose of your testimony?**

22 A: I have reviewed the Company’s filing. Based upon my findings and the input of
23 others, I am recommending monetary adjustments to the Company’s filed request.

1 **III. SUMMARY OF COMPANY’S FILING**

2 **Q: Summarize the Company’s filing.**

3 A: The Company filed its original case based on a revenue requirement model
4 reflecting a test-year ending December 31, 2007. The Company made several
5 adjustments to the test-year book numbers to pro form the numbers to March
6 2009. Overall the Company requested a \$36.617 million electric revenue increase
7 and a \$6.587 million gas increase for a total of \$43.204 million in its original
8 filing.

9 On July 25, 2008 Avista filed a Motion for Leave to File Supplemental
10 Testimony and Exhibits, which was approved by the Commission on August 8,
11 2008. Avista’s supplemental filing “updates Avista’s power costs for the 2009
12 rate year, corrects certain pro forma and restating adjustments from the original
13 filing, and updates various adjustments based on more recent data than the
14 information Avista had available to it when it prepared its original filing.”¹ As a
15 result, Avista calculated an updated electric incremental revenue requirement of
16 \$47.364 million, a \$10.747 million increase over its original filing.² The
17 Company did not make any changes to its gas revenue increase.

18 **Q: Has Avista updated its tariff filing to reflect the changes in its supplemental**
19 **filing?**

20 A: No. The Company did not update its tariff filing and has not changed its request

¹ Avista Corporation, Motion for Leave to File Supplemental Testimony and Exhibits, July 25, 2008, p. 1.

² Supplemental Direct Testimony of Elizabeth M. Andrews, Exhibit No.____(EMA-4T), p. 4:14-15.

1 for electric rate relief beyond the original \$36.6 million.³ Therefore, my
2 recommendations will use the original filing as a starting point.

3 **IV. AVISTA'S RATIONALIZATION OF INCREASE**

4 **Q: How does the Company rationalize its requested electric revenue increase?**

5 A: The \$36.6 million electric revenue increase is driven by the following factors:⁴

- 6 1. 36 percent is related to increased net plant investment of
7 approximately \$55 million (less that related to the hydro
8 relicensing discussed below), including return on investment,
9 depreciation and taxes, offset by the tax benefit of interest;
- 10 2. 30 percent is related to hydro relicensing and compliance issues
11 including the intangible and production net rate base and expenses
12 associated with the Spokane River Relicensing, and the Montana
13 Riverbed Lease Settlement lease expense;
- 14 3. 21 percent is related to increased production and transmission
15 expense, including increased loads, Mid Columbia Purchase
16 expenses and Colstrip and Kettle Falls thermal fuel expenses; and
- 17 4. 13 percent is related to increased distribution and other expenses,
18 including distribution operation and maintenance costs and
19 administrative and general expenses.

20 **Q: How does the Company rationalize its requested gas revenue increase?**

21 A: Although changes in various operating cost components contribute to the

³ *Id.*, p. 2:17-18.

⁴ Direct Testimony of Elizabeth M. Andrews, Exhibit No. ____ (EMA-1T), pp. 6:7 - 3:16.

1 increase, Avista's \$6.6 million gas revenue increase request is primarily driven by
2 the addition of the Jackson Prairie expansion project, which is planned for
3 completion in the fourth quarter of 2008.⁵

4 **Q: What are the results of your investigation of the Company's rate request?**

5 A: We have propounded numerous data requests related to the Company's rate
6 request, as well as reviewed those propounded by other intervenors. As a result of
7 this investigation, and in combination with the recommendations of Public
8 Counsel witness Charles King, I recommend that the Company's base rates be
9 increased by \$20.118 million for electric, as shown on Exhibit No.____ (MJM-4)
10 Schedule 1(E), and by \$0. 627 million for natural gas as shown on Exhibit
11 No.____(MJM-4) Schedule 1(G), which together amounts to \$20.75 million
12 overall.

13 **V. PROPOSED ADJUSTMENTS**

14 **Q: Do you have individual adjustments to the Company's filed cost of service?**

15 A: Yes. I will discuss each adjustment below. My discussions will cite to any
16 exhibits necessary for an understanding of the adjustments. However, all of the
17 actual adjustments are incorporated as Schedules to Exhibit No.____ (MJM-4).
18 My adjustment explanations contain two designations: (E) electric and (G) gas.

19 **A. Adjustment No. 1(E) and (G) – Reclassify SFAS No. 143 Regulatory Liability**

20 **Q: Please explain this adjustment.**

21 A: In this case, there is an important issue related to Avista's collections for future
22 cost of removal. As of December 31, 2007, the Company had a \$209.4 million

⁵ *Id.*, pp. 29:30 – 21:1.

1 over-collection for future cost of removal, which it recognized as a regulatory
2 liability for Generally Accepted Accounting Principles (GAAP) reporting
3 purposes.⁶

4 **Q: Please explain the regulatory liability issue.**

5 A: The Financial Accounting Standards Board's (FASB) Statement of Financial
6 Accounting Standard No. 143 (SFAS No. 143) addresses asset retirement
7 obligations associated with long-lived plant. SFAS No. 143 was implemented by
8 the Federal Energy Regulatory Commission's (FERC) in Order No. 631. Both
9 SFAS No. 143 and FERC Order No. 631 identify and highlight utilities' prior
10 excess collections for future cost of removal.

11 When a company has a legal asset retirement obligation, SFAS No. 143
12 requires capitalization of the discounted fair value of the liability and depreciation
13 as a component of the original asset cost. If it is determined, upon
14 implementation that a regulated utility has already collected too much
15 depreciation relating to the asset retirement obligation, the utility must report the
16 excess as a regulatory liability.⁷ If a utility does not have a legal obligation to
17 incur asset retirement costs for which it has previously collected money in the
18 form of future cost of removal embedded in depreciation rates, SFAS No. 143 and
19 the SEC still require reporting the excess as a regulatory liability.⁸ In other
20 words, if a regulated utility has collected for future cost of removal in its

⁶ Avista's Response to Public Counsel Data Request No. 232.

⁷ SFAS No. 143.

⁸ *Id.*, ¶ B.73.

1 depreciation rates, but does not, and never had, a legal obligation to spend the
2 money, it must segregate these excesses and report them as a regulatory liability.⁹

3 FERC identified such amounts as “non-legal” asset retirement obligations,
4 meaning that utilities do not have an actual legal obligation to incur these costs in
5 the future. However, even though current GAAP and SEC accounting rules
6 require reporting these excess collections as regulatory liabilities, FERC Order
7 No. 631 does not have the same requirement. FERC Order No. 631 merely
8 requires separate identification and reporting within account No. 108-
9 Accumulated Depreciation. Consequently, even though SFAS No. 143 and the
10 SEC require that excess collections amounts be reported as a regulatory liability,
11 Avista continues to include these amounts in accumulated depreciation for
12 regulatory accounting and ratemaking purposes.

13 **Q: How does GAAP define a regulatory liability?**

14 A: SFAS No. 71 – Accounting for the Effects of Certain Types of Regulation -
15 defines regulatory liabilities from a GAAP perspective. I have summarized
16 paragraph 11 below. It provides the GAAP definition of a regulatory liability.
17 Please note paragraphs 11 and 11.b.

18 **SFAS No. 71 – Regulatory Liabilities**¹⁰

19 11. Rate actions of a regulator can impose a
20 liability on a regulated enterprise. Such liabilities are
21 usually obligations to the enterprise’s customers. The
22 following are the usual ways in which liabilities can be
23 imposed and the resulting accounting:
24

⁹ *Id.*, ¶ B.73.

¹⁰ SFAS No. 71, ¶ 11. Only the first sentence of each subparagraph is included.

1 a. A regulator may require refunds to
2 customers

3
4 b. A regulator can provide current rates intended to
5 recover costs that are expected to be incurred in the future
6 with the understanding that if those costs are not incurred
7 future rates will be reduced by corresponding amounts. If
8 current rates are intended to recover such costs and the
9 regulator requires the enterprise to remain accountable for
10 any amounts charged pursuant to such rates and not yet
11 expended for the intended purpose, the enterprise shall not
12 recognize as revenues amounts charged pursuant to such
13 rates. Those amounts shall be recognized as liabilities and
14 taken to income only when associated costs are incurred.

15
16 c. A regulator can require that a gain or other
17 reduction of net allowable costs be given to customers over
18 future periods

19
20 **Q: What ratemaking implications are raised by the identification of the \$209.4**
21 **million regulatory liability?**

22 A: It is the manifestation and quantification of a past intergenerational inequity,
23 because prior ratepayers were charged for cost of removal that has not occurred.

24 **Q: What do you recommend?**

25 A: The Commission must specifically recognize that Avista has a \$209.4 million
26 regulatory liability for these amounts.¹¹ Avista should reclassify this from
27 accumulated depreciation to Account 254-Other Regulatory Liabilities for
28 regulatory accounting, reporting and ratemaking purposes. This will result in
29 equivalent GAAP and regulatory accumulated depreciation and regulatory

¹¹ Avista's Response to Public Counsel Data Request No. 232.

1 liability amounts for “non-legal” cost of removal.¹² Regardless of being included
2 in accumulated depreciation, these amounts are dollars *already* collected from
3 ratepayers for future cost of removal. There is no reason that the utility should be
4 entitled to keep these dollars if it turns out they are never spent on future costs of
5 removal. The funds represent a refundable liability to ratepayers until spent on
6 their intended purpose. Now that SFAS No. 143 has identified them, they should
7 be recognized as the regulatory liability they are.

8 Furthermore, \$209.4 million is a substantial amount. By definition, the
9 Company has collected, but not spent, \$209.4 million for cost of removal, and it
10 does not have a legal obligation to incur the related cost of removal. Therefore,
11 the Commission must protect this amount in Uniform System of Accounts
12 (USOA) account 254-Other Regulatory Liabilities. Without that protection,
13 current and future ratepayers face the strong possibility of losing substantial
14 prepaid funds they have submitted to the Company for future cost of removal.

15 **Q: Why is it necessary for the UTC to protect the \$209.4 million as a regulatory**
16 **liability?**

17 A: Avista, and virtually all other utilities, consider amounts in accumulated
18 depreciation, even excessive amounts, to be *their* money, i.e. capital recovery
19 with no refund obligation. It is certainly fair and reasonable for any Commission
20 to recognize excessive cost of removal collections as a refundable regulatory

¹² The phrase “non-legal” emanates from the FERC’s Order No. 631. It is used to distinguish legally required asset retirement obligations from those which lead to the cost of removal regulatory liability discussed above. Importantly, the phrase “non-legal” should not be construed to imply any “illegality.”

1 liability until the utility spends them on their intended purpose. The FERC rule to
2 which Avista adheres is insufficient.

3 **Q: Why is FERC Order No. 631 insufficient?**

4 A: The FERC has recognized and identified the amounts involved and requires
5 separate accounting for those amounts.¹³ However, the FERC has deferred
6 recognition of the regulatory liability to the states. Consequently, until the
7 Commission provides it, there is no *regulatory* recognition of the liability.
8 Accordingly, there is no provision for a refund to ratepayers if Avista does not
9 spend the cost of removal amounts they have collected for the intended purpose.
10 In fact, it is highly likely that Avista has actually already spent that money for
11 things other than cost of removal.¹⁴

12 In other words, nothing holds Avista directly accountable for these excess
13 collections from a regulatory standpoint. Regardless of the transparency provided
14 by FERC, Avista failed to mention the regulatory liability in this rate case. This
15 is wrong and unfair to ratepayers who have paid these excess costs in rates.
16 Experience indicates that it is highly unlikely that these amounts will be spent for
17 cost of removal in the magnitude they have been collected. Furthermore, even if
18 it was highly probable that Avista would spend all this money for cost of removal,
19 it is fair and reasonable for the Commission to recognize the ratepayers' security
20 interest in these monies until spent on their intended purpose. Otherwise, the
21 money is at risk.

¹³ FERC Docket No. RM02-7-000, Order No. 631, ¶ 38.

¹⁴ This is the obvious result since what Avista reports as a regulatory liability is the excess of what they have collected versus what they have spent for non-legal cost of removal.

1 **Q: Have any other Commissions recognized non-legal asset retirement**
2 **obligations as regulatory liabilities?**

3 A: Yes. Recently, in Application No. 04-12-014, involving Southern California
4 Edison Company, the California Public Utilities Commission specifically
5 recognized that Company's non-legal asset retirement obligations collections as a
6 regulatory liability.¹⁵

7 **Q: Is the \$209.4 million all related to Washington utility plant?**

8 A: No, that is the system amount. I have not attempted to allocate it to Washington,
9 Idaho and Oregon because for my adjustments I do not believe that is necessary.
10 The entire amount should be protected for Avista's ratepayers. However, based
11 on the allocations Avista has used for other expenses, the Washington jurisdiction
12 clearly would receive the majority.

13 **Q: Do you have an exhibit showing your recommended reclassification?**

14 A: Yes, on page 9 of Exhibit No.____ (MJM-4) , Adjustments No. 1(E) and 1(G) on
15 Schedule 5, show the reclassification of the SFAS No. 143 Regulatory Liability.

16 **Q: Does this adjustment have any revenue requirement effect?**

17 A: No, it is merely a revenue neutral reclassification of a rate base reduction from
18 one account to another.

19 **B. Adjustment Nos. 2(E) and (G) – Federal Income Taxes**

20 **Q: Have you adjusted Avista's federal income tax calculations?**

¹⁵ Southern California Edison 2006 GRC, Application No. 04-12-014, Decision 06-05-016, issued May 11, 2006, p. 204:16.7.1.

1 A: Yes, I have reduced Avista's federal income tax expense to reflect Avista's
2 effective corporate tax rate. Page 10 of Exhibit No.____ (MJM-4), Schedule 5
3 shows my adjustment. These adjustments reduce the revenue requirements for
4 electric and gas by \$3.4 million and \$3.1 million, respectively.

5 **Q: Explain the tax rate adjustment.**

6 A: My tax rate adjustment reduces Avista's federal statutory tax rate from 35.00
7 percent to its 31.00 percent average effective federal tax rate for the years 2005 to
8 2006.

9 **Q: What is the basis for this adjustment?**

10 A: I examined Avista's corporate federal income tax returns and calculations for
11 2005 and 2006.¹⁶ I determined that Avista has several subsidiary companies, some
12 of which incurred tax losses, thus reducing Avista Corporation's effective federal
13 statutory income tax rate. However, Avista did not use the lower rate in its filing.
14 Instead, Avista used a 35 percent statutory tax rate. The result is that Avista's
15 ratepayers pay taxes to Avista Corporation at a higher rate than Avista
16 Corporation pays to the federal government. Avista's approach causes ratepayers
17 to subsidize Avista's non-regulated subsidiaries. I have reduced Avista's federal
18 income tax expense claim to eliminate that subsidy. This is typically identified as
19 a Consolidated Tax Adjustment (CTA).

20 **Q. Did you adjust the numbers Avista provided to make your adjustment?**

¹⁶ See Avista's Response to Public Counsel Data Request No. 46. Per the response, the 2007 return is not available. No reason was given as to why.

1 A. Yes, I made two adjustments. First, I eliminated Avista Energy from the
2 calculation because Avista effectively sold that subsidiary in 2007. I also
3 adjusted the numbers to isolate the effects of the depreciation normalization
4 requirements specified in the tax code.

5 **Q. Why did you make the second adjustment?**

6 A. Utilities typically respond to CTAs with Private Letter Rulings from the IRS
7 saying that such adjustments would violate the Tax Code and the utility might
8 lose its accelerated depreciation tax benefits as a result. I do not agree with that
9 position for several reasons; nevertheless, it is a common argument.

10 In this case, however, Avista has provided a Private Letter Ruling issued
11 on January 8, 2008, that seems to say there are at least three ways to make a CTA
12 without violating the Code.¹⁷ I have attached that private letter ruling as Exhibit
13 No. ____ (MJM-5). In each of the three methods, the tax liability of the utility or
14 affiliated group is adjusted to remove the benefits of accelerated depreciation and
15 investment tax credits (ITC) claimed with respect to public utility property.

16 Avista's investment tax credits are negligible, but it does benefit from
17 accelerated tax depreciation. Hence, I reduced Avista's taxable income by that
18 benefit in 2005 and 2006 in order to reduce the allocation of losses to it for the
19 purposes of my CTA.

20 **Q. Is the approach precisely what the Private Letter Ruling requires?**

21 A. I have attempted to adjust the numbers in conformity with the IRS's requirements.
22 Furthermore, I have requested the exact calculation from Avista but did not have

¹⁷ Avista's Response to Public Counsel Data Request No. 74.

1 its response at the time I filed this testimony.¹⁸ If necessary, I will update this
2 calculation upon reviewing Avista's response.

3 **Q: Do you have an exhibit in which you have calculated the 31.00 percent**
4 **effective tax rate?**

5 A: Yes, Exhibit No.__(MJM-6) calculates the effective income tax rate.

6 **C. Adjustment Nos. 3(E) and (G) – Depreciation Expense**

7 **Q: Please explain Adjustment Nos. 3(E) and (G).**

8 A: These adjustments implement Mr. King's depreciation rate recommendations.
9 They appear on page 11 of Exhibit No.__(MJM-4), Schedule 5. This
10 incorporates the effect of the cost of removal issue. Mr. King's depreciation
11 expense recommendations result in incremental revenue requirement reductions
12 of \$3.3 million for electric and \$1.3 million for gas.

13 **[Begin Confidential]**

14 **D. XX**

15 **XX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.**

16 **XX XXX**

17 **XX**

18 **XX**

19 **XX**

20 **XX.**

21 **XX XXX?**

¹⁸ Avista's Response to Public Counsel Data Request No. 295.

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22 XX XXXXXXXXXXXXXXXXXXXXXXXXXXXX

¹⁹ Exhibit No. ____ (TEP-3), p. 10.

1 XX XXXXXXXXXXXXXXXXXXXXXXXXXX

2 XX

3 XXXXXXXXXXXXXXXXXXXXXXXXXX.²⁰

4 XX XX

5 XXXXXXXXX?

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8 XX²¹ XXXXXXXXXXXXXXXXXXXX

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11 XX²² XXXXXXXXXXXX

12 XX.

13 XX XX?

14 XX XX

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17 XX

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19 XX

20 XX

21 XX.

²⁰ *Id.*, p. 11.
²¹ Exhibit No. ___ (EMA-1T), p. 24:10-13.
²² *Id.*, p. 24:13-15 and Andrews’ workpapers, section PF 10.

1 XX [REDACTED]

2 XX [REDACTED]

3 [REDACTED].²³ [REDACTED]

4 [REDACTED].²⁴ [REDACTED]

5 [REDACTED]
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED].

12 [REDACTED]
13 [REDACTED]
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15 [REDACTED]
16 [REDACTED]
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18 [REDACTED]
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21 [REDACTED]
22 [REDACTED]
23 [REDACTED]

24 [REDACTED].
25 [REDACTED]
26 [REDACTED]

27 [REDACTED]
28 [REDACTED].
29 [REDACTED]

30 [REDACTED]

31 XX [REDACTED]

32 XX [REDACTED]

33 [REDACTED]

²³ *The Process of Ratemaking*, Leonard Saul Goodman, 1998 Public Utilities Reports, p. 165.
²⁴ *Id.*, pp. 165-166.

1 [REDACTED]

2 [REDACTED].

3 [REDACTED]

4 [REDACTED]?

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]. [End Confidential]

15 **E. Adjustment Nos. 5(E) and 4(G) – Non-Executive Compensation**

16 **Q: Please explain Adjustment Nos. 5(E) and 4(G).**

17 A: Adjustment Nos. 5(E) and 4(G) reduce the Company’s pro forma adjustment for
18 2009 non-executive labor expense. These adjustments are shown on page 13 of
19 Exhibit No.__(MJM-4), Schedule 5.

20 **Q: Why have you reduced this expense?**

21 A: Avista calculated its 2009 pro forma non-executive wages by increasing 2007
22 amounts by 3.5 percent for union and 3.32 percent for administrative personnel to

1 reach a 2008 level. The company then increased union wages by 3.5 percent and
2 administrative wages by 3.8 percent to reach estimated 2009 levels.

3 In Avista's response to UTC Staff Data Request No. 80, the Company
4 acknowledged that the 2009 administrative increase was an estimate, and
5 provided some of the materials it is using to project the final increase. Using the
6 2009 projected increases for the utility industry provided in Attachment B to that
7 response indicates that a more reasonable projected increase for 2009 is 3.75
8 percent, instead of the 3.8 percent Avista has used.

9 **Q: Why have you made this minimal change?**

10 A: I have made this change because I am not objecting to the increase to 2009 levels.
11 Ordinarily I would object to Avista's increase to 2009 levels on the grounds that it
12 is beyond the test year. Because the rates resulting from this proceeding will not
13 be in effect until 2009, I have not challenged the increase of wages to a 2009
14 level. However, that estimated increase should be conservative. These
15 adjustments result in an \$8,159 reduction to electric revenue requirement and a
16 \$2,125 reduction to gas revenue requirement.

17 **F. Adjustment Nos. 6(E) and 5(G) –Executive Compensation**

18 **Q: Please explain Adjustment Nos. 6(E) and 5(G).**

19 A: Adjustment Nos. 6(E) and 5(G) reduce the Company's pro forma adjustment for
20 2009 executive labor expense.

21 **Q: Do you have any concerns about executive compensation in general?**

22 A: Yes. In addition to general concerns over increased executive compensation
23 levels and the widening gap between what is paid to executives versus non-

1 executives, I have specific concerns with the manner in which Avista determines
2 the compensation it pays its executives. Recently there has been increased
3 scrutiny regarding the use of paid consultants to assist in setting executive pay
4 levels.²⁵ Avista relies upon Towers Perrin to assist in this task. Avista's
5 executive compensation levels are influenced heavily by Towers Perrin
6 compensation studies. Not only are the studies circular, Avista uses an
7 inappropriate proxy group in setting its compensation levels.

8 **Q: Has the UTC addressed the subject of executive compensation and the use of**
9 **compensation consultants?**

10 A: Yes, the Commission has addressed the issue several times. In its Order in
11 PacifiCorp's 2005 rate case, the Commission provided its overall strategy
12 regarding executive compensation, stating as a conclusion of law:

13 In determining the reasonableness of executive
14 compensation, the Commission will consider compensation
15 as a whole, not limited to whether executive incentive
16 compensation is paid in stock or whether compensation is
17 similar in level or benefits to that of other comparable
18 companies.²⁶

19 In its Final Order for PacifiCorp's 2006 rate case, the Commission noted
20 the "increasing attention to and criticism of excessive levels of executive
21 compensation and bloated severance packages" and acknowledged the ongoing
22 investigation into that matter and the use of compensation consultants by
23 Congress.²⁷ As such, the Commission stated, "Therefore, we are inclined to be

²⁵ *Executive Pay: Conflicts of Interest Among Compensation Consultants*, United States House of Representatives, Committee on Oversight and Government Reform, December 2007, Executive Summary.

²⁶ PacifiCorp GRC, Docket No. UE-050684, Order 04 at ¶ 350 (emphasis added).

²⁷ Final Order UE-061546 and UE-060817, ¶174.

1 wary of studies by consultants that potentially are self-serving and may not
2 provide objective information that is useful to us.”²⁸ Both of these Orders
3 indicate that the “everyone else is doing it” argument is not persuasive when it
4 comes to executive compensation.

5 **Q: Do you think Avista’s overall executive compensation levels are excessive?**

6 A: Yes. As I will discuss in detail below, Avista’s executive compensation is pegged
7 to the compensation paid to similar executives at much larger companies. This
8 alone would cause Avista’s executive compensation to be excessive. In addition,
9 the increase in total compensation received by the top executives is greater than
10 that received by other employees.

11 **Q: What are the Towers Perrin compensation studies you mentioned above?**

12 A: Towers Perrin conducts annual compensation surveys and maintains a database of
13 compensation information from which it can then prepare specialized reports.
14 The surveys address all types of compensation, from base salary to incentive
15 payments. These studies are then used by subscribing companies, such as Avista,
16 to set compensation levels.

17 **Q: How does Avista use these studies to set compensation levels?**

18 A: Avista’s March 31, 2008 Proxy Statement states:

19 When determining the types and amounts of compensation
20 to be paid to executives of the Company, the Compensation
21 Committee and management consider it important to
22 provide an overall plan that reflects compensation paid to
23 similarly situated executives of our peer companies.... To
24 achieve this end, the Compensation Committee establishes
25 base salaries, short-term annual incentives, and long-term

²⁸ Final Order UE-061546 and UE-060817, ¶175.

1 incentive levels generally targeted to be near the median of
2 the competitive data. However, the Compensation
3 Committee exercises its discretion to set any one or more of
4 the components at levels higher or lower than the
5 median....²⁹
6

7 The Compensation Committee annually compares each
8 element of total direct compensation, which includes base
9 salary, annual cash incentives, and the annualized value of
10 long-term incentive grants, against the specific peer group
11 of publicly-traded companies within the energy/utility
12 industry.³⁰
13

14 **Q: Do you see a problem with the use of compensation studies?**

15 A: Yes. These types of studies are circular in nature. The data included is from
16 companies that choose to participate, both in providing their data and in paying
17 for access to the database. A company that does not set compensation levels
18 based on industry data would not have any incentive to participate. If each
19 participant sets its compensation levels at the 50th percentile or higher, such as
20 Avista does, the average will ratchet up each year. Compensation set in this
21 manner becomes artificial, in that it is not based on business factors specific to
22 Avista, only on what is being paid to the next company down the road. If a
23 company such as Avista bases its compensation on data from larger companies,
24 the database becomes even more skewed.

25 **Q: What did Avista select as its peer group?**

26 A: The peer group selected was comprised of utility companies that had revenues
27 between \$1 billion and \$3 billion.³¹

²⁹ Avista Corporation Proxy Statement, March 31, 2008 Schedule 14A, p. 12.

³⁰ Avista Corporation Proxy Statement. March 31, 2008 Schedule 14A, pp. 12-13.

³¹ Avista Corporation Proxy Statement. March 31, 2008 Schedule 14A, p. 13.

1 compensation studies such as the one by Towers Perrin to set compensation
2 levels. The use of an inappropriate peer group merely adds to those problems.

3 **Q: Why is the use of larger companies in the proxy group a problem?**

4 A: Because the peer group companies are so much larger, they are not truly
5 comparable to Avista. Executive pay should be tied somewhat to the size and
6 complexity of a company. If Avista sets its executive pay to be comparable with
7 that of larger companies, Avista will naturally end up paying its executives more
8 than what is a correct market rate for a company of its size.

9 **Q: What do you recommend regarding Avista's use of compensation studies?**

10 A: I do not recommend setting executive compensation based on what is being done
11 at other companies. As I have discussed above, I believe the sort of compensation
12 studies Avista relies upon are circular in nature, and can lead to compensation
13 levels that would otherwise not occur if normal economic factors were at play.
14 Because Avista has relied upon compensation levels at much larger companies in
15 determining the compensation for its own executives, in my opinion Avista's
16 compensation levels are suspect.

17 **Q: Are ratepayers being charged for all of the compensation paid to Avista's
18 executives?**

19 A: No. Some of the compensation components, such as long-term equity incentive
20 and the portion of the annual cash incentive related to meeting earnings per share

1 are not paid by ratepayers. Also, a small portion of base pay is allocated to
2 subsidiary operations.³³

3 **Q: Have you made any reductions to executive compensation based on Avista's**
4 **use of an inappropriate proxy group?**

5 A: I have not recommended any reductions based on the use of the Towers Perrin
6 studies because any such adjustment would tend to be arbitrary. However, as I
7 will discuss below, I have made adjustments to executive base pay based on other
8 issues. The fact that executive compensation is based on an inappropriate proxy
9 group underscores the need for, and reasonableness of, my adjustments.

10 **Q: What adjustments to executive base pay are you recommending?**

11 A: I am recommending three separate adjustments to Avista's calculation of March
12 2009 executive base pay. My adjustments relate to the following: (1) the
13 percentage split of time between utility and non-utility, (2) the estimated 2008
14 base pay, and (3) the use of 5 percent as the pay increase for 2009.

15 **Q: Please explain the issue related to the Company's allocation of executive time**
16 **between utility and non-utility tasks.**

17 A: In calculating the executive compensation to be included in the revenue
18 requirement, Avista allocated a portion of that pay to non-utility operations
19 because "executives routinely charge a portion of their time to non-utility
20 operations, commensurate with the amount of time spent on such activities."³⁴

³³ Exhibit No. ____ (EMA-1T), p. 21:22-21:4.

³⁴ Exhibit No. ____ (EMA-1T), p. 20:20-21.

1 According to Ms. Andrews, the executive salary allocations were set at their
2 expected pro forma test period utility/non-utility percentage splits.³⁵

3 **Q: How are the salary allocations derived?**

4 A: Public Counsel Data Request No. 290 asked how executives classify their utility
5 versus non-utility time, whether the classifications are based on time sheets (i.e.,
6 they keep track of how much time is spent on each task) or a percentage split
7 selected at the beginning of a time frame and adhered to during that period.

8 Avista responded as follows:

9 Executives classify their time between utility and non-
10 utility operations based on a percentage split that is
11 estimated each year as upcoming budgets are finalized.
12 Individual time spent on non-utility activities is estimated
13 by each executive, and the percentage split is updated in
14 timekeeping and stays constant throughout the year unless
15 there is a significant change or event requiring the
16 allocation to change (i.e. allocations were revised upon the
17 completion of the sale of Avista Energy in 2007).³⁶

18
19 In other words, the classification is merely an estimate.

20 **Q: Do you agree with the percentage splits used by Avista?**

21 A: No. The actual percentage splits used for the calculation in this case were
22 provided in Avista's Response to UTC Staff Data Request No. 69. Avista's
23 Confidential Response to UTC Staff Data Request No. 14C provided executive
24 salaries by month for 2006 and 2007, along with the amounts charged to utility
25 versus non-utility. As can be seen in the summary table below, the actual

³⁵ Exhibit No. ____ (EMA-1T), pp. 20-21: 21-1.

³⁶ Avista's Response to Public Counsel Data Request No. 290.

1 percentage charged to non-utility for several executives in 2007 was far more than
 2 is assumed in the Company's calculation of their pay in this case.

3 **Table 2**

4 **Comparison of Utility / Non-Utility Percentage Splits**

	Per Avista 2009 Pay Calculation ³⁷				Actual 2007 ³⁸			
	Utility		Non-WA	Non-Utility	Utility		Non-WA	Non-Utility
	920	557	Other	417	920	557	Other	417
Feltes	90%			10%	75%			25%
Meyer	100%			0%	97%			3%
Malquist	90%			10%	82%			18%
Durkin	90%			10%	75%			25%
Burmeister- Smith	90%			10%	75%			25%
Kensok	100%			0%	100%			0%
Kopczynski	59%		40%	1%	59%		40%	1%
Morris 1/	90%			10%	75%			25%
Norwood	99%			1%	99%			1%
Vermillion	0%	69%	30%	1%	0%	69%	30%	1%
Wilson	90%			10%	75%			25%
Woodworth	99%			1%	99%			1%

1/ Used Ely 2007 split as proxy for Morris as CEO.

5
 6 The primary difference appears to be an assumption that executives who charged
 7 25 percent of their time to non-utility operations in 2007 will charge only 10
 8 percent of their time to those tasks in 2009.

9 **Q: Do you think that the change from 25 percent to 10 percent of time spent on**
 10 **non-utility activities is related to the sale of Avista Energy?**

11 **A:** No. According to Avista's Response to Public Counsel Data Request No. 290,
 12 the time change was made during the year, after the sale of Avista Energy.

³⁷ Avista's Response to UTC Staff Data Request No. 69.

³⁸ Avista's Confidential Response to UTC Staff Data Request No. 14.

1 Looking at the amounts charged to non-utility by month, I was able to determine
2 that the only allocations that changed in July 2007 (the time of the sale) were for
3 Mr. Malquist (from 25 percent to 10 percent) and Mr. Meyer (from 5 percent to 0
4 percent).³⁹

5 **Q: Several executives charge little or no time to non-utility operations. Do you**
6 **believe this is appropriate?**

7 A: It depends on the job of the executive in question. For instance, the executives
8 charging 1 percent of their time to non-utility operations all have positions that
9 appear to justify that allocation – they are the VPs of Transmission and
10 Distribution, State and Federal Regulation, Power Resources, and Customer
11 Solutions. In my opinion, the focus of these positions would be entirely on the
12 provision of safe, reliable and efficient electric and gas service.

13 On the other hand, the time for the remaining executives should include
14 not just time spent on unregulated subsidiaries, but time spent on activities
15 designed to benefit shareholders. In any investor-owned utility one would expect
16 the top executives to spend at least some of their time on activities that provide no
17 direct benefit to ratepayers. These activities may include preparing shareholder
18 reports and meetings, monitoring stock performance, and cost reduction efforts
19 where there is no accompanying reduction in rates. Other activities might be
20 designed to increase shareholder value, such as the sale of subsidiaries, or the
21 formation of a holding company. In fact, a portion of the executives' incentive

³⁹ See Avista's Response to Public Counsel Data Request No. 14.

1 pay is determined by earnings per share, which indicates that shareholder-related
2 activities are an important part of their role.

3 **Q: What do you recommend?**

4 A: I recommend that the minimum amount charged to non-utility operations should
5 be 25 percent, with the exception of the positions I discussed above. For the five
6 executives whose non-utility percentage changed from 25 percent in 2007, to 10
7 percent in 2008/2009, this means a return to the 2007 percentage split. For the
8 three remaining executives, this results in an increase over 2007 levels.

9 **Q: Please explain your other adjustments to Avista's calculation of 2009 pro**
10 **forma executive pay.**

11 A: Avista calculated its 2009 executive pay by taking the actual 2007 salaries of its
12 2009 executive team, increasing them by 3.5 percent for 2008 (with the exception
13 of Mr. Morris who received a 50 percent increase) and then increasing the 2008
14 amounts by 5 percent for 2009. I disagree with both the calculated 2008 amounts
15 and the use of 5 percent for the 2009 increase.

16 **Q: Why do you disagree with Avista's use of 3.5 percent increase 2007 salaries**
17 **to a 2008 level?**

18 A: I disagree because the actual 2008 executive salaries are available for use. These
19 salaries were provided in Avista's Response to UTC Staff Data Request No. 67.
20 Use of the actual 2008 salaries leads to a \$35,150 decrease in 2008 executive pay
21 versus simply increasing 2007 salaries by 3.5 percent. This is due to Avista's
22 assumption that Mr. Morris would receive a 50 percent salary increase in 2008.
23 In reality, Mr. Morris's salary increase was closer to 34 percent. Absent this

1 difference, the actual 2008 executive pay was actually \$39,850 more than what
2 Avista calculated using the 3.5 increase.

3 **Q: Why do you disagree with Avista's use of a 5 percent increase to estimate**
4 **2009 salaries?**

5 A: I disagree with the use of 5 percent because: 1) it is not supported, and 2) it is
6 much higher than what is being proposed for non-executives.

7 **Q: Please explain.**

8 A: The Board of Directors has not approved the 2009 salary increase for Avista's
9 executives. From 2005 to 2006, the executive team received a 4.1 percent
10 increase in total base salary.⁴⁰ From 2006 to 2007, the total increase in base
11 salary was 4.45 percent.⁴¹ The change between 2007 and 2008 is only 4.5
12 percent, excluding Mr. Morris whose position change led to an abnormal salary
13 increase. Avista's response to WUTC Data Request No. 80 provides a survey
14 which indicates that the estimated 2009 increase for executives in the utility
15 industry is only 4 percent. Finally, the 5 percent increase used for executive pay
16 is quite a bit higher than the 3.8 percent used to increase administrative non-
17 executive pay. As I have discussed above, I believe even that 3.8 percent increase
18 is overstated. I believe executive pay increases, at least as far as ratepayers are
19 concerned, should not exceed those proposed for the non-executive administrative
20 staff.

21 **Q: What do you recommend?**

⁴⁰ See Avista's Response to UTC Staff Data Request No. 67, Attachment A.

⁴¹ *Id.*, Attachment B.

1 A: I recommend that actual 2008 salaries be used to calculate the 2009 pay, instead
2 of estimated 2008 salaries. I further recommend that the increase for 2009
3 purposes be set at 3.75 percent, which is consistent with my recommendation for
4 non-executive labor.

5 **Q: Have you recalculated executive pay based on your recommendations?**

6 A: Yes. My recommended change in executive pay is shown on page 14 of Exhibit
7 No.__(MJM-4), Schedule 5, and includes the three adjustments I have discussed
8 above. These adjustments result in \$0.4 million reduction to the electric revenue
9 requirement and a \$0.1 million reduction to the gas revenue requirement.

10 **Q: Do your recommendations lead to a reduction in executive pay for 2009 when**
11 **compared to 2007?**

12 A: Yes. This is due to the removal of the previous CEO, Mr. Ely, included in the
13 2007 pay and the substitution of Mr. Morris, who receives a lower salary.

14 **G. Adjustment Nos. 7(E) and 6(G) – Incentive Compensation**

15 **Q: Please explain Adjustment Nos. 7(E) and 6(G).**

16 A: Adjustment Nos. 7(E) and 6(G), shown on page 15 of Exhibit No.__(MJM-4),
17 Schedule 5, reduce the Company’s pro forma adjustment for incentive
18 compensation.

19 **Q: Did you review the Company’s incentive plan?**

20 A: Yes. **[Begin Confidential]** XX
21 XX
22 XX

1 XXXXX⁴² XXXXXXXXXXX⁴³. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

2 XXXXXXXXXXXXXXXXXXXXXXXX.⁴⁴ [End Confidential] The executive plan
3 appears to have an earnings per share component; however, Avista has removed
4 its calculation of that portion in the incentive amount it charges to ratepayers in
5 this case.

6 **Q: Do you take issue with Avista including expenses relating to this program in**
7 **its revenue requirement?**

8 A: Not in theory because the portion included in rates is determined on customer-
9 related objectives. However, Avista has made an adjustment which substantially
10 increases the amount it seeks to charge ratepayers, over its actual 2007 amount,
11 and I object to this adjustment. Avista adjusted its 2007 test year incentive
12 compensation expense to the actual 2007 incentive paid in 2008, and then further
13 adjusted the incentive expense to a six year average. This had the effect of
14 increasing the 2007 incentive amount included in Washington jurisdiction rates by
15 \$461,454.⁴⁵

16 **Q: Does Avista explain why it made the adjustment to increase incentive**
17 **expense?**

18 A: No. Ms. Andrews discusses the adjustment at pages 25 through 28 of her
19 testimony, but she gives no reason for moving to a six-year average. Instead she
20 discusses other areas where averages are used and mentions that Settlement in the

⁴² [Begin Confidential] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX [End Confidential]

⁴³ [Begin Confidential] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX [End Confidential]

⁴⁴ Avista's Confidential Response to UTC Staff Data Request No. 13.

⁴⁵ Andrews Workpaper, p. PF 13.2.

1 last rate case adopted a Staff proposal to use a seven year average for this
2 expense.⁴⁶

3 **Q: Why did Staff recommend the use of a seven-year average in the last case?**

4 A: The last rate case used a 2006 test year. In that year, the incentive payout was the
5 second highest since 1999, with only 2005's payment being higher. The Staff
6 witness was merely trying to adjust the incentive payment to an amount more
7 reflective of the Company's average experience.⁴⁷

8 **Q: What do you recommend?**

9 A: I recommend including only the actual 2007 payout in the revenue requirement.
10 As shown in the table below, the 2007 total is closer to the total experienced in
11 years 2002 through 2004, when adjusted for inflation.

12 Table 3

13 O&M Incentive Payout Adjusted for Inflation⁴⁸

Year	Total Adjusted O&M Incentive
2002	\$ 3,448,470
2003	3,328,567
2004	3,634,931
2005	5,932,377
2006	4,531,125
2007	3,255,059

14
15 I have reversed the portion of Avista's proforma adjustment that relates to the
16 move to a six-year average. The annual revenue requirement impact of these
17 adjustments is a reduction of \$0.4 million for electric and \$0.1 million for gas.

⁴⁶ Exhibit No. ____ (EMA-1T), p. 27:9-12.

⁴⁷ Docket No. UE-070804, Exhibit No. ____ (DPK-1T), p. 23:4-10.

⁴⁸ Andrews Workpaper, p. PF13.4. Amounts include payroll taxes and are adjusted to 2007 dollars.

1 **H. Adjustment Nos. 8(E) and 7(G) – Advertising Expense**

2 **Q: Please explain Adjustment Nos. 8(E) and 7(G).**

3 A: Adjustment Nos. 8(E) and 7(G) remove certain advertising expenses from
4 Avista’s claim. These adjustments are shown on page 16 of
5 Exhibit No.__(MJM-4), Schedule 5, and result in an incremental reduction to
6 revenue requirement of \$29,173 for electric and \$31,432 for gas.

7 **Q: Why have you removed these expenses?**

8 A: Avista has included costs associated with advertising that in my opinion should
9 not be included in rates. These include costs associated with advertisements done
10 for charitable and civic purposes, as well as some advertisements that appear to
11 encourage the use of or switch to natural gas.

12 **Q: What guided you in your removal of advertising expenses?**

13 A: Using Avista’s response to Public Counsel’s Data Request No. 119, I removed
14 any expenses labeled as charitable or civic related. I also removed several sales
15 and marketing expenses over \$10,000 which were discussed in Avista’s response
16 to Public Counsel’s Data Request No. 120. Of these expenses, some relate to the
17 preparation of a website presenting Avista’s legacy. The others appear to be
18 directed at encouraging homeowners to select or switch to natural gas.

19 **Q: Why did you choose to remove these specific expenses?**

20 A: The Washington rule on allowable advertising states the following:⁴⁹

21 The commission will not allow expenses for promotional or
22 political advertising for rate-making purposes. The term
23 "promotional advertising" means advertising to encourage

⁴⁹See WAC 480-100-223 for the electric rule and WAC 480-90-223 for the natural gas rule.

1 any person or business to select or use the service or
2 additional services of an electric utility, to select or install
3 any appliance or equipment designed to use the electric
4 utility's service, or to influence consumers' opinions of the
5 electric utility.
6

7 In my opinion any advertising done for a charitable or civic purpose is
8 intended to influence consumers towards a positive opinion of the utility.

9 I also believe expenses relating to Avista's legacy website are purely for
10 self-promotion purposes. The other expenses I have removed include a
11 print advertisement and two television advertisements designed to
12 encourage the use of natural gas. They clearly fall under the rule quoted
13 above and should not be charged to ratepayers.

14 **I. Adjustment Nos. 9(E) and 8(G) – Sporting Events**

15 **Q: Please explain Adjustment Nos. 9(E) and 8(G).**

16 A: Adjustment Nos. 9(E) and 8(G) remove amounts related to sporting and other
17 entertainment events from the Company's revenue requirement claim. These
18 adjustments are shown on page 17 of Exhibit No.__(MJM-4), Schedule 5.

19 **Q: Why have you made this adjustment?**

20 A: In Avista's Response to UTC Data Request No. 43, the Company acknowledged
21 that they had included in advertising expense certain costs related to "sponsorship
22 agreements in support of community partnerships, such as overall support for our
23 area's colleges and universities" that should have been classified as non-utility.⁵⁰

24 In her Supplemental Direct Testimony, Ms. Andrews removed \$105,365 of
25 electric expenses related to these costs. An additional \$65,200 should be removed

⁵⁰ Avista's Response to UTC Data Request No. 43

1 from the gas revenue requirement, which was not addressed in Supplemental
2 Testimony.⁵¹ I have removed these amounts in addition to the other advertising
3 amounts discussed above. The incremental impact of these adjustments is to
4 reduce the revenue requirement by \$110,125 for electric and \$68,131 for gas.

5 **J. Adjustment Nos. 10(E) and 9(G) – Dues and Membership Fees**

6 **Q: Please explain Adjustment Nos. 10(E) and 9(G).**

7 A: Adjustment Nos. 10(E) and 9(G) remove certain dues and membership fees from
8 the Company's revenue requirement claim. These adjustments are shown on page
9 18 of Exhibit No.____(MJM-4), Schedule 5 and result in a \$159,214 reduction to
10 the electric revenue requirement and a \$39,217 reduction to the gas revenue
11 requirement.

12 **Q: Why have you made this adjustment?**

13 A: Avista included in its revenue requirement claim expenses associated with dues
14 and membership fees for organizations which are not necessary for the safe and
15 reliable provision of electric or gas service. This includes dues related to
16 charitable and civic organizations, as well as fees related to Board of Director's
17 activities. Using the information found in Avista's response to WUTC Data
18 Request No. 45, Attachment A. I have removed these types of expenses.

19 **K. Adjustment Nos. 11(E) and 10(G) – Charitable Donations**

20 **Q: Please explain Adjustment Nos. 11(E) and 10(G).**

⁵¹ These amounts also include the portion of costs related to athletic events that were not recorded as advertising costs.

1 A: Adjustment Nos. 11(E) and 10(G) remove charitable donations from the
2 Company's revenue requirement claim. These adjustments are shown on page 19
3 of Exhibit No.__(MJM-4), Schedule 5 and result in a \$15,670 reduction to the
4 electric revenue requirement and a \$8,283 reduction to the gas revenue
5 requirement.

6 **Q: Why have you made this adjustment?**

7 A: Avista included in its revenue requirement certain charitable donations. These
8 donations are not necessary for the provision of safe, reliable and efficient electric
9 and natural gas service. While it is commendable that Avista is involved in civic
10 and charitable activities, ratepayers should not be expected to finance those
11 activities. As such, I have removed these donations.

12 **L. Adjustment Nos. 12(E) and 11(G) – Directors' Compensation and Other**
13 **Shareholder-Related Expenses**

14 **Q: Please explain Adjustment Nos. 12(E) and 11(G).**

15 A: Adjustment Nos. 12(E) and 11(G) remove half of the Company's claim for
16 directors' compensation and other expenses related to shareholder services.
17 These adjustments are shown on page 20 of Exhibit No.__(MJM-4), Schedule 5.

18 **Q: Why have you made this adjustment?**

19 A: Avista incurs certain costs as a result of its status as a publicly-traded, shareholder
20 owned company. Included in these costs are directors' fees and expenses, trustee,
21 registrar, and transfer agent fees and expenses, stockholder meeting expenses,
22 expenses related to dividend and other financial notices and the printing and
23 mailing dividend checks, expenses related to the publishing and distributing
24 mailing dividend checks, expenses related to the publishing and distributing

1 annual reports to stockholders and expenses related to public notices of financial,
2 operating and other data required by regulatory statutes. In its filing, Avista has
3 charged all of these expenses to utility operations.⁵² In my opinion, these
4 expenses serve to benefit shareholders, and therefore, shareholders should bear
5 the cost.

6 **Q: What do you recommend?**

7 A: I recommend the removal of 100 percent of Avista's expenses related to trustee,
8 registrar, and transfer agent fees, stockholder meetings, dividend and other
9 financial notices, the printing and mailing dividend checks, the publishing and
10 distributing annual reports to stockholders and public notices of financial,
11 operating and other data required by regulatory statutes. Because I recognize that
12 Directors play a role in the management of a company, I have split the Directors'
13 fees and expenses evenly between shareholders and ratepayers. My
14 recommendations result in incremental revenue requirement reductions of \$0.4
15 million for electric and \$0.1 million for gas.

16 **M. Adjustment Nos. 13(E) and 12(G) – D&O Insurance**

17 **Q: Please explain Adjustment Nos. 13(E) and 12(G).**

18 A: Adjustment Nos. 13(E) and 12(G) splits the Company's claim for D&O insurance
19 between ratepayers and shareholders. These adjustments are shown on page 21 of
20 Exhibit No.____(MJM-4), Schedule 5 and result in a \$0.4 million reduction to the
21 electric revenue requirement and a \$0.1 million reduction to the gas revenue
22 requirement.

⁵² Avista's Response to Public Counsel Data Request No. 280.

1 **Q: Why have you made this adjustment?**

2 A: Avista included in its revenue requirement \$979,840 in expenses related to
3 Directors and Officers (D&O) insurance.⁵³ I have adjusted that amount to share
4 this expense on a 50-50 basis with shareholders.

5 **Q: Why do you feel it is appropriate to share the cost of D&O insurance?**

6 A: I base my recommendation on information provided in the Revised Direct
7 Testimony of William. B. Marcus on behalf of Public Counsel in Avista’s last rate
8 case, Docket Nos. UE-070804 and UG-070805. In that case, Mr. Marcus pointed
9 out that in 2007 Avista settled a suit brought on by shareholders, which resulted in
10 its insurance company paying those shareholders \$8.5 million. This demonstrates
11 that D&O insurance benefits shareholders as well as ratepayers – it is used to pay
12 off shareholders when Company executives make poor decisions. Mr. Marcus
13 also pointed out that in at least two jurisdictions – California and Arkansas – these
14 costs are shared between ratepayers and shareholders.

15 **Q: Do you agree with Avista’s statement in its response to Public Counsel Data**
16 **Request No. 278 that:**

17 ...“D&O” coverage is meant to provide insurance for
18 Directors and Officers who would otherwise remain
19 personally financially exposed to large damage awards
20 in the course of discharging their responsibilities for the
21 Corporation. Without sufficient coverage, no
22 individual would knowingly risk this type of personal
23 exposure, by agreeing to serve as a Director or Officer.
24 Accordingly, without such coverage, no corporation
25 could attract and retain Directors and Officers to
26 govern its affairs. As such, premiums paid for such

⁵³ Avista’s Response to Public Counsel Data Request No. 278.

1 **coverage are an important and necessary cost of doing**
2 **business.**⁵⁴
3

4 A: Yes, I agree that D&O insurance is a necessary business expense. However, the
5 need for this insurance is brought on, in part, by the Company's status as a
6 publicly traded company. The insurance is there to protect shareholders in that it
7 provides a source of funds to provide payment should their investment decline
8 due to poor decisions by the Company executives. Therefore, shareholders
9 should bear a share of these costs.

10 **N. Adjustment Nos. 14(E) and 13(G) – Interest Synchronization**

11 **Q: Explain your interest synchronization adjustments as shown on Exhibit**
12 **No.____ (MJM-4), Schedule 5, p. 22.**

13 A: Adjustment Nos. 14(E) and 13(G) adjust the interest expense in the income tax
14 calculation to reflect Avista's current composite weighted interest rate.

15 **O. Rate of Return**

16 **Q. Have you accepted Avista's proposed rate of return?**

17 A: No. I have used the cost of capital to which certain parties have agreed in the
18 proposed settlement in this docket. This adjustment is shown in Exhibit
19 No.____(MJM-4), Schedules 2(E) and 2(G). The calculation of the cost of capital
20 is shown as Schedule 4 to Exhibit No.____(MJM-4).
21

⁵⁴ Avista Response to Public Counsel Data Request No. 278.

1 **VI. Summary**

2 **Q: Please summarize your recommendations.**

3 A: I have made 14 adjustments to the Company's electric revenue requirement
4 proposal and 13 adjustments to its gas revenue requirement proposal. In
5 summary:

- 6 • I recommend that the UTC specifically recognize that Avista has a \$209.4
7 million regulatory liability related to its collection of excess future
8 removal costs. Avista should be required to reclassify this amount to
9 Account 254-Other Regulatory Liabilities for regulatory accounting,
10 reporting, and ratemaking purposes. This adjustment is a revenue neutral
11 reclassification, however, I recommend it be used to offset **[Begin**
12 **Confidential]** ~~XX~~
13 ~~XXXXXXXX~~ **[End Confidential]**
- 14 • I have adjusted the Company's federal income tax rate to reflect its
15 corporate tax rate.
- 16 • I have implemented Mr. King's depreciation adjustments.
- 17 • I have recommended that the portion of **[Begin Confidential]** ~~XXXXXX~~
18 ~~XX~~ **[End**
19 **Confidential]**
- 20 • I have reduced Avista's requests for non-executive compensation,
21 executive compensation and incentive pay.

- 1 • I have eliminated certain expenses relating to advertising, sporting events,
2 dues and membership fees, charitable donations, shareholders' services
3 and D&O insurance.

4 **Q: What is the impact of your adjustments?**

5 A: My adjustments reduce Avista's calculated revenue deficiency by \$16.498 million
6 for electric and \$5.961 million for gas. This results in a \$20.118 million electric
7 revenue increase and a \$0.627 million gas revenue increase.

8 **Q: Does this conclude your testimony?**

9 A: Yes, it does