

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-080416

DOCKET NO. UG-080417

REBUTTAL TESTIMONY OF

ELIZABETH M. ANDREWS

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

1
2 **Q. Please state your name, business address, and present position with Avista**
3 **Corp.**

4 A. My name is Elizabeth M. Andrews. My business address is 1411 East Mission
5 Avenue, Spokane, Washington. I am employed by Avista Corporation, doing business as Avista
6 Utilities (“Avista” or “Company”), and my current position is Manager of Revenue
7 Requirements in the Department of State and Federal Regulation.

8 **Q. Have you previously provided direct testimony in this Case?**

9 A. Yes. My testimony covered accounting and financial data in support of the
10 Company's need for the proposed increase in rates. I explained pro formed operating results,
11 including expense and rate base adjustments made to actual operating results and rate base.

12 **Q. What is the scope of your rebuttal testimony in this proceeding?**

13 A. My rebuttal testimony will first compare the revenue requirements for both
14 electric and natural gas proposed by the Public Counsel Section of the Washington State
15 Attorney General’s Office (Public Counsel) and the Industrial Customers of Northwest Utilities
16 (ICNU) in their direct testimony, with various components agreed to by the parties within the
17 Multiparty Settlement. I will then address certain revenue requirement adjustments proposed by
18 Mr. Majoros and Mr. King, which impact the Company’s proposed electric and natural gas
19 revenue requirements. Specifically, I will address certain of the more significant proposed
20 adjustments with which the Company does not agree. A table of contents for my testimony is as
21 follows:

1 **Table of Contents:**

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2

3 **II. COMPARISON OF MULTIPARTY SETTLEMENT AND PROPOSED PUBLIC**
4 **COUNSEL/ICNU REVENUE REQUIREMENTS**

5

6 **Q. Have you prepared a summary table of adjustments that compares the**
7 **recommendations of Public Counsel/ICNU with certain items that are contained in the**
8 **Multiparty Settlement?**

9 A. Yes, I have. Table 1 below provides a recap of the revenue requirement
10 adjustments proposed by Public Counsel/ICNU, and compares certain adjustments included in
11 the Multiparty Settlement revenue requirement. This table also points out computational errors
12 found by the Company in Mr. Majoros' FIT adjustment calculation, which if corrected, would
13 reduce Public Counsel/ICNU's overall electric adjustments from \$16.498 million to \$12.140
14 million, thereby increasing their overall revenue requirement from \$20.118 million to \$24.477
15 million. (It would also serve to increase the overall natural gas revenue requirement from
16 \$627,000 to \$3.341 million, as shown later in Table 3.)

17 Since the revenue requirement items discussed throughout my testimony have been
18 recommended by Public Counsel/ICNU, for convenience, I will be using the Column references
19 that can be found in Public Counsel/ICNU's summary exhibit sponsored by Mr. Majoros. The
20 adjustments to electric rate base and the incremental revenue requirement can be found on pages
21 3 through 4 of Exhibit No. ___(MJM-4C).

1 **Table 1 – Comparison of Public Counsel/ICNU’s Electric Revenue Requirement with**
 2 **Adjustments Accepted in Multiparty Settlement**

PC Adj. #	Electric Revenue Requirement Adjustments (Dollars are in thousands)	Public Counsel Adjustments - Detail	Public Counsel Adjustments - Total	Adjusted in Multiparty Settlement
	Amount as Filed:		\$ 36,617	
	Cost of Capital (Adjust return on equity to 10.20% / Adjust cost of debt to 6.51%)		\$ (3,047)	\$ (3,212) ⁽¹⁾
	Reclassify SFAS No. 143 Regulatory Liability (no revenue requirement impact)		\$ -	
1E				
2E	Federal Income Taxes	\$ (3,441)		
	Conversion Factor Impact - using revised Federal Income Tax Effective Rate, flow through of revised rate	\$ (2,122)		
	Federal Income Taxes - Total		\$ (5,563)	- (2)
3E	Depreciation Expense		\$ (3,057)	-
4E	Confidential Litigation		\$ (2,411)	\$ (2,796) (3)
	Administrative and General Expenses:			
5E	Union and Non-Exec Salaries	\$ (8)		
6E	Officers' Salaries	\$ (389)		
7E	Incentives (Adjust to actual)	\$ (383)		
8E	Advertising	\$ (29)		
9E	Sporting Events	\$ (110)		
10E	Dues & Membership Fees	\$ (159)		
11E	Charitable Donations	\$ (16)		
12E	Directors' Compensation & Other	\$ (396)		
13E	D&O Insurance	\$ (406)		
	Administrative and General Expenses - Total		\$ (1,896)	\$ (1,852) (4)
14E	Interest Synchronization		\$ (524)	pass through
	Total Adjustments		\$ (16,498)	\$ (7,860)
	Adjusted Amount		\$ 20,119	
	Correction of Error found by Company to FIT Adjustment		\$ 4,358	(2)
	Corrected Adjusted Amount (Public Counsel)		\$ 24,477	(2)

(1) Difference due to change in cost of debt impact included in interest synchronization adjustment by Public Counsel & ICNU witness Mr. Majoros, versus within the Cost of Capital line within the Multiparty Settlement. Mr. Majoros accepted the Cost of Capital and Rate of Return agreed to by the Parties to the Settlement in his calculation of the Revenue Requirement.

(2) As noted within the Company's rebuttal testimony, Mr. Majoros overstated this net \$5.563 million adjustment by \$4.358 million, due to computational errors. Correcting for these errors would reduce Public Counsel/ICNU's proposed total adjustments from \$16.498 to \$12.140 million and would revise their proposed revenue requirement from \$20.119 to \$24.477 million.

(3) Please see Majoros' (MJM-4CT) unredacted testimony at Pages 14-18.

(4) The parties to the Multiparty Settlement agreed to various adjustments to adjust or remove certain A&G expenses totaling \$1.852 million, including adjustments to incentives; Officer, Non-officer, and Union salaries; and sporting events. This reflected the give-and-take of negotiation on a number of A&G expense items.

1 **Q. In Table 1, above, you have compared the Confidential Litigation adjustment**
2 **amount included in the Multiparty Settlement with that proposed by Public Counsel/**
3 **ICNU. Could you please explain this?**

4 A. Yes. Although the adjustment in the Multiparty Settlement regarding the
5 Confidential Litigation and the adjustment proposed by Public Counsel/ICNU differ in how this
6 matter should be dealt with, all parties have reduced the overall revenue requirement by roughly
7 a similar amount. The difference between the reduction in the Litigation amount proposed by
8 Public Counsel/ICNU, and that within the Multiparty Settlement, is that Public Counsel/ICNU
9 propose to remove only the amortization of prior period expense amounts, leaving the future
10 payments within their proposed revenue requirement. Within the Multiparty Settlement,
11 however, the parties have agreed to remove and defer for later recovery the entire Confidential
12 Litigation adjustment, including future payments. Moreover, Public Counsel/ICNU do
13 recommend that approximately \$15.1 million of rate base associated with the Confidential
14 Litigation either be removed (which would mean a substantial write off for Avista) or be offset
15 against a portion of the Regulatory Liability proposed by Public Counsel/ICNU in adjustment 1E
16 “Reclassify SFAS No. 143 Regulatory Liability” described later in my testimony and in more
17 detail by Mr. Felsenthal.

18 Finally, the Multiparty Settlement removes a total of \$8.053 million regarding relicensing
19 and other litigation involving the Company, proposing to defer these costs and include these
20 costs in a future rate proceeding. Public Counsel/ICNU make no adjustment to the Company’s
21 revenue requirement regarding these remaining relicensing and litigation adjustments included in
22 the Multiparty Settlement.

1 **Q. Within Table 1, above, you noted an error in the calculation of the FIT**
2 **adjustment which would reduce the overall adjustments proposed by Public Counsel/**
3 **ICNU. Would you please discuss this further?**

4 A. Yes. This error is described in detail by Company witness Mr. Falkner, who also
5 discusses the Company's underlying disagreement with the position taken by Mr. Majoros
6 regarding his federal income tax calculation. I have noted this error within Table 1 above,
7 showing that the overall electric adjustments proposed by Mr. Majoros should be reduced from
8 \$16.498 million to \$12.140 million, thereby increasing their proposed revenue requirement from
9 \$20.118 million to \$24.477 million.

10 If you then also consider certain adjustments that Public Counsel/ICNU did not address
11 within their direct or response testimony, but were agreed to within the Multiparty Settlement,
12 such as the net Power Supply Adjustments of \$7.433 million, this would further increase Public
13 Counsel/ICNU's revenue increase level from \$24.477 million to \$31.910 million, as compared to
14 the proposed Settlement Agreement increase of \$32.538 million. (ICNU in fact did support the
15 Power Supply Adjustments proposed within the Multiparty Settlement.) This \$31.910 million is
16 prior to consideration of any further rebuttal provided by Avista on a host of other adjustments,
17 including, most notably, the depreciation adjustment proposed by Public Counsel/ICNU, that are
18 themselves not reasonable. Acceptance of even a portion of the Company's rebuttal on these
19 issues would result in a revenue increase to Avista that is well above the \$32.538 million that the
20 Company has agreed to accept in the Settlement.

1 **Q. Your Table 1 demonstrates that both the Settlement and Public**
2 **Counsel/ICNU positions on total Administrative and General (A&G) electric expenses are**
3 **remarkably similar – i.e., within \$44,000. How is this so?**

4 A. Table 1 demonstrates that the total adjustments for electric A&G expense in the
5 Settlement reflect a reduction of \$1,852,000, while Public Counsel/ICNU's adjustments to A&G
6 total \$1,896,000. Accordingly, the total adjustment is nearly identical. Of course, how the
7 Stipulating Parties and Public Counsel/ICNU get there is different. With respect to total A&G
8 expenses, the "end result" of the Settlement and the positions of Public Counsel/ICNU are nearly
9 identical.

10 **Q. What are some of the differences in approach on A&G expenses that largely**
11 **cancel each other out?**

12 A. To begin with, the Company agreed to remove 2009 non-officer and union wage
13 increases totaling \$1.19 million for settlement purposes, in order to reduce the overall revenue
14 requirement to an acceptable level for all Stipulating Parties, even though, historically, rate
15 period wage increases have been accepted by this Commission. Mr. Majoros, otherwise
16 supported the inclusion of this \$1.19 million adjustment, to capture non-officer compensation
17 and stated:

18 I have made this change because I am not objecting to the increase
19 to 2009 levels. Ordinarily I would object to Avista's increase to 2009
20 levels on the grounds that it is beyond the test year. Because the rates
21 resulting from this proceeding will not be in effect until 2009, I have not
22 challenged the increase of wages to a 2009 level. (See Exhibit
23 No.__(MJM-4CT), page 19, lines 10-14)

1 In addition, the Settlement agreement itself removed, or otherwise adjusted, a variety of
 2 other A&G items as reflected within Table 2 below. For convenience, Table 2 below shows both
 3 the electric and natural gas A&G expenses removed from the electric and natural gas revenue
 4 requirements agreed to within the Multiparty Settlement.

5 **Table 2 – Administrative & General Expenses Reduced in Multiparty Settlement**

Administrative & General Expenses Reduced in Multiparty Settlement	Impact on Revenue Requirement	
	Electric	Natural Gas
(Dollars are in thousands)		
Non-Officer Compensation	\$ (1,188)	\$ (320)
Officer Compensation	\$ (140)	\$ (37)
Incentive Compensation	\$ (415)	\$ (109)
Sponsorship expenses	\$ (109)	\$ -
Total A&G Adjustments	\$ (1,852)	\$ (466)

12 **Q. Have you prepared a table for the Natural Gas revenue requirement, which**
 13 **compares amounts included in the Multiparty Settlement with what was proposed by**
 14 **Public Counsel/ICNU?**

15 **A.** Yes, I have, as shown in Table 3 below. As noted previously, since the revenue
 16 requirement items discussed throughout my testimony have been recommended by Public
 17 Counsel/ICNU, for convenience, I will again be using the Column references that can be found
 18 in Public Counsel/ICNU's summary exhibit sponsored by Mr. Majoros. The adjustments to
 19 natural gas rate base and the incremental revenue requirement can be found on pages 5 through 6
 20 of Exhibit No. ___(MJM-4C).

1 **Table 3 -- Comparison of Public Counsel/ICNU's Natural Gas Revenue Requirement with**
 2 **Adjustments Accepted in Multiparty Settlement**

PC Adj. #	Natural Gas Revenue Requirement Adjustments (Dollars are in thousands)	Public Counsel Adjustments - Detail	Public Counsel Adjustments - Total	Adjusted in Multiparty Settlement
	Amount as Filed:		\$ 6,587	
	Cost of Capital (Adjust return on equity to 10.20% / Adjust cost of debt to 6.51%)		\$ (554)	\$ (584) ⁽¹⁾
1E	Reclassify SFAS No. 143 Regulatory Liability		\$ -	
2E	Federal Income Taxes	\$ (3,109)		
	Conversion Factor Impact - using revised Federal Income Taxes Effective Rate, flow through of revised rate	\$ (379)		
	Federal Income Taxes - Total		\$ (3,488)	- ⁽²⁾
3E	Depreciation Expense		\$ (1,197)	-
	Administrative and General Expenses:			
5E	Union and Non-Exec Salaries	\$ (2)		
6E	Officers' Salaries	\$ (102)		
7E	Incentives (Adjust to actual)	\$ (100)		
8E	Advertising	\$ (31)		
9E	Sporting Events	\$ (68)		
10E	Dues & Membership Fees	\$ (39)		
11E	Charitable Donations	\$ (8)		
12E	Directors' Compensation & Other	\$ (103)		
13E	D&O Insurance	\$ (106)		
	Administrative and General Expenses - Total		\$ (559)	\$ (466) ⁽³⁾
14E	Interest Synchronization		\$ (162)	pass through
	Total Adjustments		\$ (5,960)	\$ (584)
	Adjusted Amount		\$ 627	
	Correction of Error found by Company to FIT Adjustment		\$ 2,714	⁽²⁾
	Corrected Adjusted Amount (Public Counsel)		\$ 3,341	⁽²⁾
	⁽¹⁾ Difference due to change in cost of debt impact included in interest synchronization adjustment by Public Counsel & ICNU witness Mr. Majoros, versus within the Cost of Capital line within the Multiparty Settlement. Mr. Majoros accepted the Cost of Capital and Rate of Return agreed to by the Parties to the Settlement in his calculation of the Revenue Requirement.			
	⁽²⁾ As noted within the Company's rebuttal testimony, Mr. Majoros overstated this net \$3.488 million adjustment by \$2.714 million, due to computational errors. Correcting for these errors would reduce Public Counsel/ICNU's proposed total adjustments from \$5.96 to \$3.246 million and would revise their proposed revenue requirement from \$.627 to \$3.341 million.			
	⁽³⁾ The parties to the Multiparty Settlement agreed to various adjustments to adjust or remove certain A&G expenses totaling \$466,000, including adjustments to incentives; Officer, Non-officer, and Union salaries; and sporting events. This reflected the give-and-take of negotiation on a number of A&G expense items.			

1 Q. Do the same comments regarding the FIT error and grouping of
2 administrative and general expenses related to the earlier electric revenue requirement
3 table apply to the Natural Gas table?

4 A. Yes. And specifically, as with the electric table discussed previously, the removal
5 of the FIT error alone would cause the overall adjustments proposed by Public Counsel/ICNU to
6 be reduced from \$5.961 million to \$3.247 million, revising their revenue requirement from \$.627
7 million to \$3.341 million, without consideration of the Company's rebuttal on the other issues.

8 III. REBUTTAL OF PUBLIC COUNSEL/ICNU'S PROPOSED ADJUSTMENTS

9 A. ELECTRIC SECTION

10 Q. Please summarize the revenue requirement adjustments proposed by Public
11 Counsel/ICNU that the Company is specifically addressing in its rebuttal testimony.
12

13 A. Certainly. Table 4 below sets forth these adjustments.
14

15 **Table 4 – Electric Adjustments**

PC Adj. #	Electric Adjustments	Public Counsel/ICNU Adjustments	
		Rev. Req.	Rate Base
	(Dollars are in thousands)		
1E	Reclassify SFAS No. 143 Regulatory Liability (No revenue requirement impact)	\$ -	
2E	Federal Income Taxes	\$ (3,441)	
	Conversion Factor Impact of using revised FIT Effective Tax Rate (not discussed within Majoros' Testimony)	\$ (2,122)	
3E	Depreciation Expense	\$ (3,057)	\$ 1,555
4E	Confidential Litigation	\$ (2,411)	\$ (15,084)
5E	Non-Executive Compensation	\$ (8)	
6E	Executive Compensation	\$ (389)	
7E	Incentive Compensation	\$ (383)	
12E	Directors' Compensation & Other	\$ (396)	
13E	Directors' and Officers' Insurance	\$ (406)	
	Total	\$ (12,613)	\$ (13,529)

1 **Adjustment No. 1E - Reclassify SFAS No. 143 Regulatory Liability**

2 **Q. Please explain Mr. Majoros' proposed adjustment No. 1E.**

3 A. On pages 5 through 11 of Mr. Majoros' direct testimony, Public Counsel and
4 ICNU propose that Avista set up a regulatory liability in which it should be required to transfer
5 the \$209.4 million accumulated depreciation balance related to its future cost of removal for
6 certain long-lived plant. "Cost of removal" is a part of the Company's depreciation rates and
7 included in accumulated depreciation for purposes of ratemaking. Company witnesses Mr.
8 Spanos and Mr. Felsenthal both discuss why Mr. Majoros's treatment of this cost of removal is
9 flawed and how his analysis is based on a misapplication of Statement of Financial Accounting
10 Standards No. 143, *Accounting for Asset Retirement Obligations* ("SFAS 143"), and what FERC
11 Order No. 631 requires for accounting for retirement obligations. There is no revenue
12 requirement impact resulting from this proposed adjustment; however, for the reasons discussed
13 elsewhere, this adjustment as proposed should be rejected.

14 In addition, Mr. Majoros, at page 18 of his direct testimony also proposes that, if the
15 Commission allows approval of the Confidential Litigation adjustment (see Adjustment No. 4E –
16 Confidential Litigation) proposed by the Company, Avista should be required to use what he
17 characterizes as "the over-collection for future costs of removal" to offset any of the cost of the
18 Confidential Litigation settlement charged to ratepayers. Mr. Felsenthal explains why this is
19 inappropriate and also discusses how Mr. Majoros' use of amounts booked to accumulated
20 depreciation violates FERC accounting guidance.

1 **Adjustment No. 2E – Federal Income Taxes**

2 **Q. On pages 11 through 14 of Mr. Majoros' direct testimony, Public Counsel**
3 **recommends that the Company's statutory Federal Income tax rate be adjusted from**
4 **35.0% to 31.0%. Do you agree with this adjustment?**

5 A. No, I do not. As explained previously, and as will be explained in more detail by
6 Mr. Falkner, even if the Company were to accept Mr. Majoros' methodology – which the
7 Company does not – Mr. Majoros erroneously and significantly overstated his FIT adjustment by
8 \$4.358 million (includes the revenue conversion factor flow-through amount described below)
9 because of computational errors. Furthermore, as explained by Mr. Falkner, the proposed
10 adjustment violates regulated company cost allocation principles, may violate the Internal
11 Revenue Code normalization provisions, and regulatory bodies such as the WUTC and FERC
12 have previously ruled that this type of adjustment is unsupported. As such, this revenue
13 requirement adjustment totaling \$5.563 million (combined FIT adjustment and conversion factor
14 flow-through impact) should be rejected by this Commission in its entirety.

15 **Q. Could you please explain the Conversion Factor Impact item shown in the**
16 **table above and how this relates to Mr. Majoros' FIT adjustment?**

17 A. Yes. The conversion factor, shown on page 3 of 10 of Exhibit No.__(EMA-2), is
18 used to convert the net operating income deficiency to the revenue requirement by adjusting
19 revenue sensitive costs and federal income tax. The revenue-sensitive costs are the Washington
20 State utility tax, Washington WUTC regulatory fees, and bad debts. The conversion factor used
21 in the total revenue requirement calculation by the Company is approximately 0.622%.
22 Although not specifically discussed in his direct testimony, Mr. Majoros uses his calculated
23 effective tax rate of 31% to determine a revenue conversion factor of 0.660%. Mr. Falkner

1 explains why Mr. Majoros' effective tax rate is erroneous and should not be accepted by the
2 Commission. The impact of Public Counsel/ICNU using a conversion factor that reflects an
3 erroneous 31% federal income tax rate reduced the Company's revenue requirement by
4 approximately \$2.1 million (\$382,000 natural gas).

5 **Adjustment No. 3E – Depreciation Expense**

6 **Q. On page 14 of Mr. Majoros' direct testimony, he incorporates the revenue**
7 **requirement adjustment proposed by Public Counsel/ICNU witness Mr. King. Mr. King**
8 **proposes a change to the cost of removal calculations approved within the Company's last**
9 **general rate cases, Docket Nos. UE-070804 and UG-070805. Do you agree with this**
10 **adjustment?**

11 **A.** No. The impact of the depreciation expense adjustment proposed by Mr. Majoros
12 and Mr. King reduces the Company's filed electric revenue requirement by \$3.057 million, and
13 decreases rate base by \$1.555 million. Mr. Spanos and Mr. Felsenthal address the depreciation
14 adjustments proposed by Public Counsel/ICNU witness Mr. Charles King, which deals with net
15 salvage values and Mr. King's misapplication of financial accounting concepts presented in FAS
16 143, *Accounting for Asset Retirement Costs*, FIN 47, *Accounting for Conditional Asset*
17 *Retirement Obligations* (an interpretation of FAS 143), and FERC Order 631.

18 As explained by Mr. Felsenthal, the traditional and widely-accepted regulatory approach
19 is to recover cost of removal on a straight-line basis through depreciation charges and is the
20 appropriate methodology for such costs. This method appropriately matches the recovery of such
21 costs with the customers who benefit from the use of the fixed asset that causes the retirement
22 obligation. As such, this approach supports intergenerational equity. Mr. King's methodology,
23 based on a FAS 143-type approach, produces an ever-increasing annual charge that requires

1 annual rate cases, burdens future customers and increases the risk that the actual cost of removal
2 will not be recovered. Therefore, Mr. Majoros' proposed adjustment should be rejected by this
3 Commission.

4 **Adjustment No. 4E – Confidential Litigation**

5 **Q. On pages 14 through 18 of Mr. Majoros' direct testimony, Public**
6 **Counsel/ICNU describe their recommendation regarding the Company's Confidential**
7 **Litigation adjustment. Please summarize their proposed adjustment.**

8 A. Mr. Majoros recommends that this Commission deny Avista cost recovery
9 associated with payments regarding the Confidential Litigation adjustment included in the
10 Company's direct filing. Mr. Majoros has recommended an adjustment which would remove
11 \$2.4 million of electric revenue requirement from the Company's original filing, and would
12 reduce electric rate base by approximately \$15.1 million. Mr. Majoros also adds that, if the
13 Commission were to award these costs associated with the Confidential Litigation adjustment,
14 Avista should be required to use the regulatory liability resulting from Public Counsel/ICNU's
15 proposed Adjustment No. 1E Reclassify SFAS No. 143 to "offset" any cost of the Confidential
16 Litigation charged to ratepayers. Mr. Felsenthal's testimony, on behalf of the Company,
17 explains why this proposal to "offset" is not permissible.

18 **Q. Do you agree with the adjustments proposed by Public Counsel/ICNU**
19 **witness Mr. Majoros?**

20 A. No. As discussed in detail by Company witness Ms. Pessemier in her confidential
21 testimony, if the Commission were to deny recovery of these settlement costs as proposed by the
22 Company in its Confidential Litigation adjustment, this would cause the Company to suffer a
23 substantial write-off of prudently-incurred costs. For the reasons detailed in Ms. Pessemier's

1 testimony, Public Counsel/ICNU's proposed revenue requirement reduction of \$2.41 million and
2 rate base reduction of \$15.1 million should be rejected.

3 **Adjustment No. 6E – Executive Compensation**

4 **Q. On pages 25 through 31 of Mr. Majoros' direct testimony, Public**
5 **Counsel/ICNU propose three separate adjustments to Avista's calculation of 2009 salaries.**
6 **Would you please summarize what these three adjustments are and the net impact on the**
7 **Company's revenue requirement?**

8 A. Yes. Mr. Majoros separates his adjustments regarding officer compensation into
9 three components: 1) the estimated rate used for 2008 base pay, 2) the use of an estimated 5% for
10 the 2009 pay increase, and 3) the percentage split of time executives charge utility and non-
11 utility operations. He proposes to make changes related to each of these components, which I
12 will describe further below. The net impact of the combination of these three adjustments by
13 Mr. Majoros reduces the Company's electric revenue requirement by \$389,000 (\$102,000
14 natural gas).

15 **Q. Before you continue describing each of Mr. Majoros' adjustments, were this**
16 **case to be fully litigated, are you recommending a change to the total officers' 2009 salary**
17 **level that was pro formed in the Company's direct case?**

18 A. Yes, based on changes known now and as described further below, for litigation
19 purposes, the Company would revise its pro forma adjustment for executive compensation to
20 \$83,000 electric (\$22,000 natural gas). The Company's electric direct filed case included a pro
21 forma adjustment of \$258,000 (\$69,000 natural gas). This revised adjustment includes the
22 correction of an error found by the Company in its pro forma calculation, as well the substitution

1 of actual for estimates of 2008 base pay, and the use of 4.0% for the 2009 pay increases rather
2 than 5.0%.

3 **Q. What was the primary cause for this revision by the Company?**

4 A. In the process of responding to discovery, the Company discovered an error
5 within the computation of its pro forma executive salary adjustment used to adjust the actual
6 2007 salary level to the 2009 pro forma level, which served to overstate the revenue requirement
7 amount charged to the Utility operations by \$140,000 electric (and \$37,000 natural gas). This
8 correction was included within the Multiparty Settlement agreed to by the parties.

9 **Q. Would you now address the remaining portions of Mr. Majoros' adjustment**
10 **for executive compensation?**

11 A. Yes. First, regarding the adjustment of the estimated 2008 increase to actual
12 numbers, Mr. Majoros explains that when the Company filed its direct case it used an estimate
13 for the 2008 salary increase of 3.5%, whereas now, actual salary increases are available. I would
14 agree with this adjustment and have revised the Company's pro forma adjustment by a reduction
15 of approximately \$21,000 electric (\$6,000 natural gas) to account for this.

16 Finally, regarding the Company's use of a 5.0% increase for planned 2009 salary
17 increases for officer compensation, Mr. Majoros argues that a 3.75% increase should be used.
18 When Avista filed its case in early 2008, survey information typically relied upon for future
19 salary increases such as 2009 was unavailable. Avista based its estimate on what was best
20 known at that time for 2009 officers' salaries, which was 5.0%.

21 We now have the Conference Board's "2008-2009 Salary Increase Survey Results,"
22 which includes the responses of over 358 organizations. As acknowledged by Mr. Majoros, per
23 this survey result, the projected salary increases budgeted for executives for 2009 for the Utilities

1 industry is 4.0%. Based on this more recent survey information discussed above and Avista's
2 latest review for planning purposes, Avista believes a revised estimate of 4.0% for 2009
3 executive salary increases is reasonable. I have reflected this reduction (totaling approximately
4 \$14,000 electric and \$4,000 natural gas) in the overall revised pro forma executive compensation
5 amount noted above.

6 **Q. Please now discuss Mr. Majoros final adjustment addressing the percentage**
7 **of time allocated to subsidiaries by executives, with which Avista does not agree.**

8 A. Mr. Majoros' final adjustment recommends that, for several of the executives,
9 their percentage of time should be split differently than proposed by Avista, specifically using a
10 75% utility / 25% non-utility. He argues that Avista's allocations are "merely an estimate". He
11 is correct that the individual allocations proposed by each officer are estimates, because it would
12 be difficult and time consuming for each executive to track on a daily basis their exact time spent
13 between utility and non-utility operations. However, while it is an "estimate," it is based on the
14 informed judgment of each officer who is individually surveyed concerning their use of time.
15 Therefore, this estimate is based on the individual knowledge of each officer's own activities
16 associated with their position. This individual estimate is reviewed annually (or sooner if there
17 is a significant event requiring a change to the allocation).

18 **Q. Mr. Majoros bases part of his argument on the fact that the actual 2007**
19 **allocation of time to subsidiaries activities for several of the officers was greater than the**
20 **percentage allocations now proposed in the Company's filing. Can you please explain?**

21 A. Yes. As the Company explained in its response to Public Counsel Data Request
22 No. 290, the change in the 2009 estimate of several of the officers was due to the sale of Avista
23 Energy in mid-2007, resulting in proportionately less time allocated to subsidiaries. Mr.

1 Majoros, however, states he does not believe the change proposed for 2009 is related to the sale
2 of Avista Energy because only a few officers changed their percentage during 2007 to a lower
3 percentage charged to non-utility operations. This misses the point. The individual allocations
4 of time of each executive were for the 2009 pro forma period – not 2007. Therefore, Mr.
5 Majoros' recommendation fails to recognize that the 2009 pro forma period allocations are
6 different than 2007 because of an overall change in the level of subsidiary activities.

7 **Adjustment No. 7E – Incentive Compensation**

8 **Q. On pages 31 through 33 of Mr. Majoros' direct testimony, Public**
9 **Counsel/ICNU propose to reduce the Company's pro forma incentive adjustment from the**
10 **6-year average proposed in Avista' direct filing to the actual expense included in the 2007**
11 **test period. Do you agree with this adjustment?**

12 A. No. Although Mr. Majoros takes no issue with the inclusion of the 2007 actual
13 incentives included in the Company's rate case, he objects to the Company's adjustment of the
14 actual incentives paid to reflect a 6-year average, arguing the Company provided no support for
15 its adjustment. The impact of the adjustment reduces Avista's electric revenue requirement by
16 \$383,000 (\$100,000 natural gas).

17 **Q. Do you agree with Mr. Majoros that the Company provided no support for**
18 **its adjustment?**

19 A. No. In my direct testimony, I provided examples of other types of revenues or
20 expenses which have been accepted by this Commission where the revenues or expenses could
21 vary significantly from year to year, making it difficult to determine on an annual basis a
22 representative level of what the upcoming rate year expense or revenue may be. This argues for
23 the use of averages when appropriate, and in fact, the Commission has approved the use of

1 averages in a number of different circumstances – e.g., injuries and damages, storm damages,
2 power plant availability, transmission revenues, etc. The use of an average may help avoid
3 peaks and valleys of revenues or expenses in a single year, thereby distorting the revenue
4 requirement of that year.

5 In my direct testimony, I also discussed the Company’s last Washington electric and
6 natural gas rate cases where the parties agreed, within the all-party settlement, to accept the 7-
7 year average proposed by the Commission Staff during that proceeding (Docket Nos. UE-
8 070804 and UG-070805). Mr. Majoros dismisses this argument by stating at page 33:

9 The last rate case used a 2006 test year. In that year, the incentive payout
10 was the second highest since 1999, with only 2005’s payment being
11 higher. The Staff witness was merely trying to adjust the incentive
12 payment to an amount more reflective of the Company’s average
13 experience. (See Exhibit No.__(MJM-4CT), page 33, lines 4-7)
14

15 This statement only serves to prove my point. Due to the volatility of levels of incentive
16 payout from year to year, incentive expense is a prime candidate for using some form of an
17 average in order to minimize the fluctuations impacting ratepayers from one year to the next, and
18 helps to normalize incentive expenses through time.

19 **Q. Why did you choose a 6-year average for your calculation?**

20 A. I used a 6-year average (2002-2007) of each year in which the incentive plans
21 utilized by the Company were similar, if not identical (the current incentive plan was first
22 utilized in year 2002). I believe a 6-year average is appropriate, and Mr. Majoros’ electric
23 revenue requirement adjustment of \$383,000 (\$100,000 natural gas) should be rejected.

1 **Adjustment No. 12E – Directors’ Compensation and Other Shareholder-Related Expenses**

2 Q. On pages 37 through 38 of Mr. Majoros’ direct testimony, Public
3 Counsel/ICNU proposes to remove 50% of the director’s compensation and 100% of other
4 expenses related to shareholder services. Do you agree with this adjustment?

5 A. No, I disagree with these adjustments. Mr. Majoros simply removes 100% of
6 other expenses related to shareholder services because he believes that, since Avista is a
7 publicly- traded company, these costs solely benefit shareholders and therefore shareholders
8 should bear the entire cost. As a publicly-traded company, these costs are a necessary expense
9 of doing business to support financing of the Utility and to maintain access to capital from
10 investors. Access to capital markets is necessary in order to allow the Utility to build and
11 maintain the infrastructure necessary to provide safe, reliable and efficient service. It is clearly
12 necessary to incur costs to maintain this access to markets for the benefit of our customers. Mr.
13 Majoros has simply thrown out all such expenses and has not otherwise identified any particular
14 expenses that were improperly incurred.

15 Mr. Majoros also arbitrarily removes 50% of the Director’s compensation,
16 acknowledging, however, at page 38, that he “recognizes that directors play a role in the
17 management of a company.” Here again, without any demonstration of imprudence, he has
18 eliminated 50% of Director’s compensation. He has not shown that overall Director
19 compensation levels are out of line with industry averages. Moreover, the recruitment and
20 retention of qualified directors who provide overall guidance for the utility inures to the benefit
21 of customers, who count on it to provide safe, reliable, and efficient service. A publicly-traded
22 utility simply cannot operate effectively – or at all – without a board of directors. As such, it is a
23 necessary cost of doing business. Mr. Majoros’ electric revenue requirement adjustment of

1 \$396,000 (\$103,000 natural gas) for these adjustments has no merit and should be rejected in its
2 entirety.

3 **Adjustment No. 13E – Directors’ and Officers’ Insurance**

4 **Q. On pages 38 through 40 of Mr. Majoros’ direct testimony, Public**
5 **Counsel/ICNU proposes to remove 50% of the Company’s Directors’ and Officers’ (D&O)**
6 **insurance between ratepayers and shareholders. Do you agree with this adjustment?**

7 A. No. As described further below, D&O insurance is a necessary and reasonable
8 utility operating expense. The proposal to disallow half of the amount charged to Avista’s
9 ratepayers for D&O liability insurance costs is arbitrary and is not based on any demonstration
10 whatsoever of imprudence. Mr. Majoros’ proposed adjustment, which removed \$406,000
11 electric revenue requirement (\$106,000 natural gas) from the Company’s direct filing, should be
12 rejected.

13 **Q. What is the coverage and cost of D&O insurance in the test year?**

14 A. Avista purchased combined limits of \$100 million in D&O liability insurance
15 against potential claims made in 2007 and paid insurers \$2.4 million for it. Avista’s self-insured
16 retention was \$2 million per claim, meaning that no insurance was available for any claims until
17 costs exceeded \$2 million. For the 2007 test period, Avista allocated one third of the expense to
18 subsidiary operations and two thirds, or \$1.6 million, to utility operations. Of the utility
19 operations allocation, it was further allocated among Avista Utilities’ jurisdictions.

20 **Q. What is directors and officers’ liability insurance?**

21 A. D&O insurance was created as a means to address the financial cost of risks
22 incident to serving as a director or officer of the corporation. The insurers that underwrite D&O
23 liability coverage aggregate the risks of many companies and their respective directors and

1 officers and take that risk from each in exchange for insurance premiums. D&O insurance
2 policies typically have an annual term that responds to claims made during the period of
3 coverage.

4 **Q. What would happen if Avista did not purchase D&O insurance?**

5 A. The Company would be unable to attract or retain capable individuals for the
6 board of directors or to otherwise serve as officers. The fundamental governance and direction
7 of the Company would not be possible without these individuals.

8 The rewards of serving as a director or officer are enormously overshadowed by the risks
9 of D&O claims. D&O insurance is the means to remove the financial risk that is inherent with
10 America's corporate governance legal environment.

11 The amount of coverage and its terms are important considerations. The ability of the
12 selected insurers to cover claim occurrences is also of paramount importance. Avista has
13 carefully placed its D&O coverage to assure the amount is adequate, terms are written to respond
14 as desired to potential claims, and insurers are willing and able to respond if necessary. Mr.
15 Majoros has not demonstrated any imprudence with regard to these coverages.

16 **Q. Is D&O insurance a necessary business expense?**

17 A. Yes, and Mr. Majoros is apparently in agreement with its necessity. Quoting Mr.
18 Majoros' direct testimony at page 40: "Yes, I agree that D&O insurance is a necessary business
19 expense." Mr. Majoros, however, recommends that D&O insurance costs ought not to be fully
20 allowed. He does not adequately explain, however, why this necessary cost should be partially
21 disallowed.

22 He simply argues at page 40 of his testimony that:

1 “... the need for this insurance is brought on, in part, by the Company’s status as
2 a publicly traded company. The insurance is there to protect shareholders in that
3 it provides a source of funds to provide payment should their investment declines
4 due to poor decisions by the Company executives. Therefore, shareholders
5 should bear a share of these costs.” (emphasis added)
6

7 First of all, he implicitly recognizes that D & O coverage is a necessary adjunct to
8 operating as a publicly traded utility. Avista needs access to the public capital markets to
9 finance its operations for the benefit of customers. Secondly, D & O coverage is not designed to
10 protect shareholders, per se; rather, as explained above, it provides a measure of protection to
11 directors and officers against what could otherwise be crippling financial exposure to litigation.
12 No qualified director or officer would ever agree to serve without this protection. The purpose
13 of the insurance is not to pay shareholders, but to address the financial exposure risks of
14 directors and officers.

15 **Q. Would you expand on your views concerning the primary purpose of D&O**
16 **insurance?**

17 A. D&O insurance is intended to stand in the shoes of covered directors and officers
18 to absorb financial impacts of claims against them. It also reimburses the Company for its
19 indemnity obligation to the directors and officers.

20 Mr. Majoros’ understanding of the purpose of D&O insurance is flawed. Investors in
21 common stocks are generally very aware of the risks of investing. They know that investment
22 values may decline, just as they buy or hold shares on the hope that values will rise and
23 dividends will be paid. Shareholders also know that a company’s success is dependent in large
24 part on decisions by executives and directors of the organization. There is nothing implicit in
25 common stock investing to guarantee investment gains or avoidance of losses, and D&O
26 insurance is certainly not designed to provide such assurance.

1 The purpose and benefit of D&O insurance is consistent with other insurance that the
2 company must obtain, such as property insurance and general liability coverage. Insurance
3 transfers risks of financial loss to third party insurers, reducing expense volatility in the company
4 buying the insurance and drastically reducing the threat of catastrophic financial losses.

5 **Q. How did Avista allocate its D&O insurance costs?**

6 A. The cost of D&O insurance was allocated two-thirds to utility operations and one-
7 third to subsidiaries for test year 2007 and several preceding years. This allocation reflects
8 relative D&O liability risk factors that influence the total price of coverage. The risk factors in
9 non-utility operations were predominantly related to Avista Energy operations that were
10 discontinued in the middle of 2007. Future cost allocations will depend on prevailing
11 circumstances.

12 The one-third allocation to subsidiaries is a full and fair sharing of this cost item between
13 shareholders and regulated operations for the 2007 expense. The proposed 50/50 sharing
14 formula proposed by Mr. Majoros would result in utility operations supporting only one-third of
15 the cost of this necessary business expense since the proposed disallowance is calculated only on
16 the two-thirds cost allocated to regulated utility operations.

17
18 **B. NATURAL GAS SECTION**

19 **Q. Before beginning your discussion of the natural gas adjustments that the**
20 **Company is addressing in its rebuttal testimony, what is your response to Public**
21 **Counsel/ICNU's Interest Synchronization Adjustment?**

22 A. The only difference between the Company's Pro Forma Debt Interest, or Interest
23 Synchronization adjustment, and Public Counsel/ICNU's, is the level of authorized rate base and

1 the conversion factor impact caused by Mr. Majoros' FIT effective tax rate adjustment, for both
 2 electric and natural gas used in the calculation. At this point in time Public Counsel is using a
 3 different rate base and conversion factor, but the methodology they are employing is exactly the
 4 same as originally filed by the Company. The Settlement Stipulation includes the correct
 5 adjustment, based on the rate base and conversion factor reflected therein.

6 **Q. Would you please now summarize the natural gas adjustments proposed by**
 7 **Public Counsel/ICNU that the Company is specifically addressing in its rebuttal testimony?**

8 A. Certainly. Please see Table 5 below.

9 **Table 65 – Natural Gas Adjustments**

PC Adj. #	Natural Gas Adjustments	Public Counsel/ICNU Adjustments	
		Rev. Req.	Rate Base
	(Dollars are in thousands)		
1G	Reclassify SFAS No. 143 Regulatory Liability (No revenue requirement impact)	\$ -	
2G	Federal Income Taxes	\$ (3,109)	
	Conversion Factor Impact of using revised FIT Effective Tax Rate (not discussed within Majoros' Testimony)	\$ (382)	
3G	Depreciation Expense	\$ (1,197)	\$ 609
4G	Non-Executive Compensation	\$ (2)	
5G	Executive Compensation	\$ (102)	
6G	Incentive Compensation	\$ (100)	
11G	Directors' Compensation & Other	\$ (103)	
12G	Directors' and Officers' Insurance	\$ (106)	
	Total	\$ (5,101)	\$ 609

20 **Q. In regards to the adjustments that are identical to certain electric**
 21 **adjustments, did Public Counsel/ICNU apply the same methodology and theory to the**
 22 **natural gas revenue requirement and rate base calculations?**

23 A. Yes.

1 **Q. With that in mind, is the Company's position and supporting arguments the**
2 **same as outlined in your previous Electric Section?**

3 A. Yes, they are.

4 **Q. Does this conclude your rebuttal testimony?**

5 A. Yes.