Exhibit No. ___ T (AMCL-1T)
Dockets UE-090134/UG-090135
and UG-060518 (consolidated)
Witness: Ann M. C. LaRue

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **Respondent.** **. . . . .**	)	**DOCKETS UE-090134 and UG-090135** ***(consolidated)***
In the Matter of the Petition of **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **For an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism.** **. . . . .**	)	**DOCKET UG-060518** **(*consolidated*)**

TESTIMONY

OF

ANN M. C. LaRUE

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

August 17, 2009

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Ann M. C. LaRue. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My email address is alarue@utc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission as a Regulatory Analyst.

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

A. I graduated from Sam Houston State University in Huntsville, Texas with a Bachelor of Business Administration (BBA) in Accounting in 1998 and a Masters of Business Administration (MBA) in 1999. I am licensed in Washington State as a Certified Public Accountant (CPA).

I testified in Northwest Natural Gas Company's General Rate Case, Docket UG-080546. I was a staff member on the following contested cases:

- Cascade Natural Gas Corporation, UG-061256
- Puget Sound Energy, UE-072300
- PacifiCorp, UE-080220
- Avista Corporation, UE-080416

I attended the 49th Annual National Association of Regulatory Utility Commissioners (NARUC) Regulatory Studies Program held at Michigan State University in East Lansing, Michigan in 2007. I also attended the 29th Annual NARUC Western Rate School in San Diego, California in 2008.

II. SCOPE OF TESTIMONY

Q. What is the scope of your testimony?

A. I am responsible for the review of 14 adjustments proposed by the Company.

Q. Which adjustments have you reviewed and are uncontested by Staff?

A. Staff does not contest the following four adjustments:

- R22(x) Electric and R18(t) Gas, Miscellaneous Restating Adjustments
- PF12 Electric, Coeur d'Alene Tribe Settlement
- PF13 Electric, Montana Riverbed Lease

Q. Please identify the adjustments you are responsible for that Staff is contesting.

A. Six of the remaining ten adjustments are related to employee compensation for both the electric and natural gas operations of Avista Utilities (Avista or Company), which includes non-executive and executive wages and incentives. Avista's proposed adjustments to test year company employee compensation were sponsored by Company witness Ms. Elizabeth M. Andrews in her direct testimony[1]. Ms. Andrews labeled her employee compensation related adjustments as:

- PF3 Electric and PF1 Gas, Pro Forma Labor – Non Executive
- PF4 Electric and PF2 Gas, Pro Forma Labor – Executive
- PF15 Electric and PF7 Gas, Pro Forma Incentives

I maintain the same labels and adjustment titles for my proposed adjustments.

I am also responsible for four other contested adjustments. The same issues were addressed in adjustments sponsored by Ms. Andrews in her direct testimony[2]. Ms. Andrews proposes the following adjustments which I address in my testimony:

- PF14 Electric, Pro Forma Colstrip Mercury Emission O&M (Operations & Maintenance)
- PF16 Electric, Pro Forma O&M Plant Expense
- PF18 Electric and PF10 Gas, Pro Forma Insurance[3]

I maintain the same labels and adjustment titles for my proposed pro forma adjustments.

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

A. Yes. I have prepared the following exhibits in support of my testimony:

- Exhibit No. ___ (AMCL-2C), Non-Executive Labor, PF3 and PF1
- Exhibit No. ___ (AMCL-3C), Executive Labor, PF4 and PF2
- Exhibit No. ___ (AMCL-4), Mercury Emission O&M, PF14

[1] Exhibit No. ___ (EMA-1T).
[2] *Id.*
[3] Adjustments PF12, Pro Forma Coeur d'Alene (CDA) Tribe Settlement and PF14, Pro Forma Colstrip Mercury Emission O&M were also discussed by Mr. Richard L. Storro in his direct testimony, Exhibit No. ___ (RLS-1T).

- Exhibit No. ___ (AMCL-5), Insurance Expense, PF18 and PF10
- Exhibit No. ___ (AMCL-6C), Insurance Expense

III. SUMMARY OF TESTIMONY

Q. Please summarize your testimony.

A. For the contested adjustments identified above, Staff proposes the following:

- PF3 Electric and PF1 Gas, non-executive compensation expense and PF4 Electric and PF2 Gas, executive compensation expense, Staff proposes to remove the future compensation that is not known and measurable.
- PF15 Electric and PF7 Gas, incentive expense, Staff proposes to accept the test year level of expense and remove the six-year average and CPI adjustment.
- PF 14 Electric, Colstrip Mercury Emission O&M, Staff proposes to use updated information reflecting a reduction of approximately 50% from the amount originally filed.
- PF16 Electric, O&M Plant expense, Staff proposes to remove the adjustment because the amounts are not known and measurable and because no offsetting factors have been identified.
- Finally, PF18 Electric and PF10 Gas, insurance expense, Staff proposes that 50% of Director and Officer (D&O) Insurance should be allocated to the shareholders.

IV. DISCUSSION

A. Contested Adjustments

1. PF3 Electric and PF1 Gas, Pro Forma Labor – Non-Executive

Q. Please summarize the Company's adjustment to its non-executive wages.

A. The Company's adjustment to non-executive wages increases Washington expenses by $2,988,482 and $786,764 (PF3 Electric and PF1 Gas, respectively). The Company's non-executive labor adjustment includes changes to test year wages and salaries, excluding executive salaries.

The Company made three adjustments to non-executive wages. The first adjustment normalizes test year wages for an increase in wages that was effective in March 2008. The second adjustment was made to wages for 2009 increases in wages that were approved by the board and negotiated by the unions. The third adjustment was made to wages for 2010 for anticipated wage increases.

Q. What numbers are you using for the compensation adjustment?

A. The Company filed new compensation numbers in confidential response to Staff Data Request 96. I will be referring to the updated numbers submitted by the Company in this data request.[4]

[4] Although the Company's response to Staff Data Request 96 contains some confidential numbers, the numbers that I refer to in my testimony are composite numbers that are not confidential. This is also true with respect to the Company's response to Staff Data Request 142, which I refer to later in my testimony regarding insurance expense.

Q. Did you review these adjustments?

A. Yes. I reviewed wages for the total company including the review of the allocations to both the electric and gas operations. My review found that the Company's adjustment to normalize non-executive 2008 wages is correctly applied along with the associated annualization of the non-executive negotiated 2009 wages. However, the Company's proposed increase of $1,250,733 for its electric operations and $329,510 for its gas operations for 2010 wages is inappropriate.

Q. Please explain why Staff is contesting the Company's proposed adjustment to non-executive wages for 2010 increases?

A. The Company's proposal to pro form 2010 wages fails to meet the Commission's criteria of a pro forma adjustment.

Q. Please explain why, in your opinion, the Company's pro forma adjustment of non-executive wages for 2010 does not meet the Commission's definition of a pro forma adjustment.

A. WAC 480-07-510 specifies that pro forma adjustments "… give effect for the test period to *all known and measurable changes* that are not offset by other factors." (*Emphasis added*). Accordingly, pro forma adjustments are not merely estimates added to test year results. Instead, they are rooted in historical data. Historical test-year data that have been affected by a measurable change may be adjusted to recognize the impact on future revenues or the impact on future costs.

For example, the Company could experience a known change in the cost of its insurance premiums. The new insurance costs would be applied to the historical data using the new rates, thus producing a measurable change in costs.

In other words, pro forma adjustments are not merely forecasted estimates of future expenses based on someone's "judgment." Accordingly, because the Company's 2010 pro forma non-executive adjustment is based solely on management's judgment, it is not "known and measurable" and it should be rejected by the Commission.

Q. Has Staff proposed a pro forma adjustment for non-executive wages?

A. Yes. Staff Adjustment PF3 Electric and PF1 Gas recognize the 2009 wage increase approved by the board. PF3 and PF1 also adjust for an accounting error discovered during the staff review. My adjustments do not include 2010 anticipated wage increases proposed by the Company for the reason described above. [5]

Q. How does the removal of the Company's 2010 anticipated wage increases affect these adjustments?

A. Staff adjustment PF3 decreases net operating income by $1,129,537 after income taxes and increases the overall revenue requirement by $1,816,265 for electric operations. Staff adjustment PF1 decreases net operating income by $297,215 after income taxes and increases the overall revenue requirement by $477,809 for gas operations.

[5] Exhibit No. ___ (AMCL-2C).

Q. Have you prepared an exhibit detailing Staff's calculation?

A. Yes. The calculation can be found in Exhibit No. ___ (AMCL-2C).

2. PF4 Electric and PF2 Gas, Pro Forma Labor – Executive

Q. Please summarize the Company's adjustment to its executive compensation.

A. The Company's adjustment to executive compensation increases Washington expenses by $204,396 and $55,678 (PF4 Electric and PF2 Gas, respectively). The Company's executive labor adjustment includes "changes in executive staffing made during 2008 and … compensation for the planned executive team in 2010 only."[6]

The Company made two adjustments to executive compensation. The Company removed the effect of 2008 officer compensation and adjusted test year compensation for wage increases anticipated for 2010. There was no adjustment for 2009 because no officer increases were approved for that year.

Q. What numbers are you using for the compensation adjustment?

A. The Company filed new compensation numbers in confidential response to Staff Data Request 96. I will be referring to the updated numbers submitted by the Company in this data request.

[6] Exhibit No. ___ (EMA-1T), Page 23, Lines 2-3.

Q. Did you review Avista's executive compensation adjustment?

A. Yes. I reviewed executive wages for the total company including the review of the allocations to both the electric and gas operations. My review found that the Company's adjustment to normalize the effect of 2008 executive wages is correctly applied. However, the Company's proposed increase of $53,208 for its electric operations and $14,820 for its gas operations for 2010 executive wages is inappropriate.

Q. Please explain why Staff is contesting the Company's proposed adjustments to executive wages for 2010 increases?

A. The Company's proposal to pro form 2010 executive wages fails to meet the Commission's criteria of a pro forma adjustment.

Q. Did you apply the same methodology and reasoning as in the other salary adjustment?

A. Yes.

Q. How does the removal of the Company's 2010 anticipated wage increases affect these adjustments?

A. Staff adjustment PF4 decreases net operating income by $98,272 after income taxes and increases the overall revenue requirement by $158,019 for electric operations. Staff adjustment PF2 decreases net operating income by $26,558 after income taxes and increases the overall revenue requirement by $42,695 for gas operations.

Q. Have you prepared an exhibit detailing the calculation of your adjustment?

A. Yes, Exhibit No. ___ (AMCL-3C).

3. PF13 Electric and PF6 Gas, Pro Forma Incentives

Q. Please summarize the Company's adjustment to incentives.

A. The Company's adjustment to incentives increases Washington expenses by $550,456 and $152,144 (PF15 Electric and PF7 Gas, respectively). The Company makes three adjustments to its incentive expense. First, the Company adjusts 2008 incentives paid to actual amounts paid. Second, the Company uses a six-year average to normalize incentives paid. The Company further uses the Consumer Price Index (CPI) to bring past year incentives paid to current year dollars.

Q. Did you review these adjustments including reviewing the associated accounting and workpapers?

A. Yes. My review found that the Company's adjustment to adjust 2008 incentives to actual incentive amounts paid is appropriate. However, the Company's use of a six-year average and CPI is inappropriate.

Q. Please explain why Staff is contesting the Company's proposed adjustments to incentives.

A. The Company's adjustment includes a six-year average for incentives. Averages are used to determine a representative dollar amount to be used when the test year is not "normal." The Company has provided no support for the proposition that the 2008 incentives are not "normal," or why the prior six years are more representative than the test year. Therefore, the use of an average is not necessary.

Staff also does not agree with the Company's use of the Consumer Price Index (CPI) to "reflect …costs in 2008 dollars."[7] As stated in the previous paragraph, the purpose of normalizing is to set a reasonable level of expense in the rate year based on actual historical data. Using an inflation factor is not appropriate for determining rate year levels. The CPI is not an indicator of what the Company will pay in incentives in the rate year. Therefore, the Commission should reject the Company's attempt to inflate past costs above historical amounts.

Q. Has Staff proposed a pro forma adjustment for incentives?

A. Yes. Staff adjustment PF15 Electric removes the effect of the six-year average and removes the CPI adjustment proposed by the Company for the reasons described above. PF7 Gas also removes the effect of the six-year average and removes the CPI adjustment proposed by the Company for the reasons described above.

Q. How does the removal of the six-year average and CPI affect these adjustments?

A. Staff adjustment PF7increases net income by $11,320 after income taxes and decreases the overall revenue requirement by $18,202 for electric operations. Staff

[7] Exhibit No. ___ (EMA-1T), Page 30, Line 4.

adjustment PF15 increases net income by $3,128 after income taxes and decreases the overall revenue requirement by $5,029 for gas operations.

4. PF14 Electric, Pro Forma Colstrip Mercury Emission O&M Expense

Q. Please summarize the Company's adjustment to its Colstrip Mercury Emission O&M expense.

A. The Company's adjustment to Colstrip Mercury Emission O&M increases Washington expenses by $1,873,000 (PF14 Electric). The Company's mercury emission adjustment includes "additional 2010 O&M costs associated with the mercury control project at Colstrip."[8]

According to the direct testimony of Richard L. Storro, "Mercury emission laws in Montana are going into effect January 1, 2010."[9]

Q. Did you review Avista's Colstrip Mercury Emission O&M expense adjustment?

A. Yes.

Q. Does Staff contest this adjustment?

A. Yes. Staff contests this adjustment only because since filing the general rate case, updated costs for this project have been provided.

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[8] Exhibit No. ___ (EMA-1T), Page 29, Lines 11-12.
[9] Exhibit No. ___ (RLS-1T), Page 24, Lines 7-8.

Q. Please explain your rationale for contesting the Company's proposed Colstrip Mercury Emission O&M adjustment.

A. Originally the total projected costs for this project were $19.4 million. Because Avista is a 15% owner of Colstrip, the Company's costs associated with this project were $2.9 million. However, the projected costs have decreased approximately 50 percent. Therefore, the total costs assigned to Avista are $1.5 million.

Q. Has Staff proposed a pro forma adjustment for Mercury Emission O&M?

A. Yes. Staff adjustment PF14 Electric uses the updated costs for this project as provided by the Company.[10]

Q. How does the incorporation of the updated numbers affect this adjustment?

A. Staff adjustment PF14 decreases net income by $629,753 after income taxes and increases the overall revenue requirement by $1,012,626 for electric operations.

Q. Have you prepared an exhibit for this adjustment?

A. Yes, Exhibit No. ___ (AMCL-4).

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[10] Exhibit No. ___ (AMCL-4).

5. PF16 Electric, Pro Forma Operation and Maintenance (O&M) Plant Expense

Q. Please summarize the Company's adjustment to its O&M Plant expense.

A. The Company's adjustment to O&M Plant increases Washington expenses by $2,268,670 (PF16 Electric). The Company's O&M plant adjustment "adjusts for incremental non-labor generation plant O&M costs planned for 2010 above the test period."[11] These expenditures are planned for Colstrip, Kettle Falls, and Rathdrum generation plants.

Q. Did you review Avista's O&M Plant expense adjustment?

A. Yes. My review found that the Company is using "forecasted" numbers for this adjustment and therefore, the amounts are not "known and measurable." The amounts used to pro form 2010 O&M Plant expenses fails to meet the Commission's criteria of a pro forma adjustment.

Q. Please explain why, in your opinion, the Company's pro forma adjustment of O&M Plant does not meet the Commission definition of a pro forma adjustment.

A. As stated previously, WAC 480-07-510 specifies that pro forma adjustments "… give effect for the test period to *all known and measurable changes* that are not offset by other factors." (*Emphasis added*). Accordingly, pro forma adjustments are

[11] Exhibit No. ___ (EMA-1T), Page 31, Lines 17-18.

not merely estimates added to test year results. Instead, they are rooted in historical data. Historical test-year data that have been affected by a measurable change may be adjusted to recognize the impact on future revenues or the impact on future costs.

In other words, pro forma adjustments are not merely forecasted estimates of future expenses based on someone's "judgment." Accordingly, because the Company's 2010 pro forma O&M Plant adjustment is based solely on forecasted amounts and management's judgment, it is not "known and measurable" and it should be rejected by the Commission.

Q. Would the projected expense also have offsetting effects?

A. Yes they would, although the Company has not attempted to identify them.

Q. Has Staff proposed a pro forma adjustment for O&M Plant?

A. No. Because the Company's adjustment is not a proper pro forma adjustment, Staff removed this adjustment.

Q. How does the removal of the Company's 2010 O&M Plant expense affect this adjustment?

A. Removal of the Company's 2010 O&M Plant expense brings this adjustment to zero. Staff's adjustment PF16 is zero, which has no effect on net income or revenue requirement.

6. PF18 Electric and PF 10 Gas, Pro Forma Insurance

Q. Please summarize the Company's insurance adjustment.

A. The Company's adjustment to insurance "adjusts the test period insurance expense for general liability, directors and officers (D&O) liability, and property to the actual cost of insurance policies that are in effect for 2009."[12] The Company proposed Pro Forma Insurance adjustment increases Washington expenses by $283,233 and $78,284 (PF18 Electric and PF10 Gas, respectively).

Q. What numbers are you using for the insurance adjustment?

A. The Company filed updated insurance numbers in confidential response to Staff Data Request 142. I will be referring to the updated numbers submitted by the Company in this data request.

Q. Did you review Avista's insurance adjustment?

A. Yes. I reviewed insurance for the total company including the allocations to its subsidiaries and its allocations to both the electric and gas operations. My review found that the Company correctly allocated costs to its subsidiaries and to the electric and gas operations. However, Staff believes that the costs of D&O insurance should be shared equally between the ratepayers and the shareholders.

[12] Exhibit No. ___ (EMA-1T), Page 34, Lines 13 – 15.

Q. Please explain your rationale for sharing the cost of D&O Insurance equally between ratepayers and shareholders.

A. Director and Officer (D&O) Liability Insurance financially protects corporate directors and officers when legal claims are brought against them while performing their corporate duties. D&O insurance is a necessary cost of doing business and it provides benefits to both ratepayers and shareholders. Staff believes that ratepayers should bear some of the cost of this insurance, as they benefit from it, but the directors and shareholders also benefit from D&O Insurance and should therefore bear some of the costs.

Other jurisdictions have held that the sharing of D&O insurance costs is appropriate. In 1996, the California Public Utilities Commission stated, "we are funding half of the [D&O Insurance] premium with ratepayer funds. However, To the extent that shareholders also benefit from this insurance coverage, they should also share in the expense."[13] In 2005, the Arkansas Public Service Commission held that "the expense for D&O insurance should be shared on a 50-50 basis between shareholders and ratepayers."[14]

In 1991, The Connecticut Department of Public Utility Control held that "such [D&O Insurance] coverage benefits shareholders as well as ratepayers and … that the costs should be borne equally between shareholders and ratepayers."[15] And 15 years later, the Connecticut Department of Public Utility Control reaffirmed that "shareholders should bear the weight of their decisions in appointing directors (who

[13] *Re Southern California Edison Co.*, 64 CPUC 2d 241, 1996 WL 33178 (Cal. P.U.C.), at 75.

[14] *Re CenterPoint Arkla, a Division of CenterPoint Energy Resources Corp.*, 245 P.U.R. 4th 384, 2005 WL 3354346 (Ark. P.S.C.), at 409.

[15] *Re Connecticut Light and Power Co.*, 124 P.U.R. 4th 532, 1991 WL 501760 (Conn. D.P.U.C.), at 560.

appoint the officers of the Company). Accordingly, the Department allows … approximately ¼ of the total company [D&O Insurance] expense to be collected in rates as the customers' responsibility."[16] This resulted in shareholders paying 75 percent of the cost of D&O insurance. By contrast, Staff's recommended adjustment would split the cost 50-50 between ratepayers and shareholders, consistent with the California, Arkansas, and prior Connecticut commission decisions.

Q. What are the effects of these adjustments?

A. The reduction in insurance expense for Washington is $140,662 and $38,878 (PF18 Electric and PF10 Gas, respectively). This increases net income after taxes by $91,430 for the Company's electric operations and $25,271 for its gas operations. This is a decrease in revenue requirement of $147,017 and $40,626 (PF18 Electric and PF10 Gas, respectively).[17]

Q. Have you prepared an exhibit for this adjustment?

A. Yes. Exhibit No. ___ (AMCL-5) details the calculation of the effects of my recommendation on D&O Insurance. Exhibit No. ___ (AMCL-6C) provides a calculation of the remaining insurance adjustment.

Q. Does this conclude your testimony?

A. Yes.

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[16] *Re The United Illuminating Co.*, 246 P.U.R. 4th 357, 2006 WL 316835 (Conn. D.P.U.C.), at 403.
[17] Exhibit No. ___ (AMCL-5), and Exhibit No. ___ (AMCL-6C).