BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a AVISTA UTILITIES,

Respondent.

DOCKET NOS UE-090134 & 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 No. UG-060518 (*consolidated)*

DIRECT TESTIMONY OF HUGH LARKIN, JR. (HL-1T)

ON BEHALF OF

PUBLIC COUNSEL

REVISED (RED-LINED AND SHADED)

SEPTEMBER 3, 2009

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HUGH LARKIN, JR. EXHIBIT LIST

I. INTRODUCTION / SUMMARY

Q: Please state your name and business address.

A: My name is Hugh Larkin, Jr. I am a Certified Public Accountant licensed in the States of Michigan and Florida and the senior partner of the firm of Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q: Please describe the firm Larkin & Associates, PLLC.

A: Larkin & Associates, PLLC, is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorney general, etc.). Larkin & Associates, PLLC, has extensive experience in the utility regulatory field as expert witnesses in more than 800 regulatory proceedings including numerous electric, gas, water and sewer, and telephone utilities.

Q: Have you previously testified before the Washington Utilities & Transportation Commission?

A: Yes. I testified in two cases a number of years ago before the Washington Utilities & Transportation Commission (Commission or WUTC).

Q: Have you prepared an exhibit which describes your qualifications and experience?

A: Yes. I have attached Exhibit No. ___ (HL-2) which is a summary of my regulatory qualifications and experience.

II. PURPOSE OF TESTIMONY

Q: On whose behalf are you appearing?

A: Larkin & Associates, PLLC, was retained by the Public Counsel Section of the Washington State Attorney General's Office (Public Counsel) to review the rate case filing submitted by Avista Utilities for its Washington electric and gas operations.

Q: What is the purpose of your testimony?

A: I will be addressing various rate base and revenue requirement issues.

Q: Who will be sponsoring the PC's overall revenue requirement recommendation regarding Avista's Washington electric and gas operations?

A: I will be sponsoring the exhibits which incorporate my recommendations and those of PC's power cost witness Mr. Kevin Woodruff and PC's cost of capital witness Mr. Michael Gorman.

III. RECOMMENDATION

Q: What recommendation are you making regarding the revenue requirements of Avista's Electric and Gas Operations in the State of Washington?

A: Based on the adjustments that I am recommending and those of PC's witnesses Kevin Woodruff and Michael Gorman, electric rates should be increased by no more than $4.336 million ~~reduced by $12,817,000~~ and gas rates should be increased by no more than $431,000.[1]

[1] Mr. Gorman’s testimony is also sponsored by the Industrial Customers of Northwest Utilities (ICNU).

IV. OVERVIEW OF FILING

Q: In the Direct Testimony of Elizabeth M. Andrews, Exhibit No.___ (EMA-1T), she states that the Company's actual return on rate base for the electric and gas operations of Avista in Washington were 6.50% and 6.72%, respectively. Do you believe that this is an accurate representation of the Company's actual return on rate base for the test year ended September 30, 2008?

A: No, I do not. As shown in Column "b" on page 1 of 11, Exhibit No.___ (EMA-2), and Column "b", on page 1 of 8 of Exhibit No.___ (EMA-3), Ms. Andrews calculates the Company's return by taking the net operating income and dividing it by net plant in service to arrive at 6.50% and 6.72%, for electric and gas, respectively. Ms. Andrews' calculations do not reflect any reduction of net plant in service for deferred income taxes. Deferred taxes result from timing differences related to expenses recorded for financial reporting purposes in one accounting period and deductions taken on the Company's tax return in a different accounting period. Deferred income taxes represent a source of cost free capital to the Company and should be deducted from rate base because they do not require a rate of return since they have been provided by ratepayers through rates. According to Ms. Andrews' exhibits, there was $142,713,000 of deferred income tax for the electric operations and $27,674,000 for the gas operations related to the test year.

While these amounts may not represent the total amount of cost-free capital the Company has available to it for financing the rate base, at a minimum these deferred taxes should have been deducted from rate base before calculating what the Company terms as the "actual" rate of return for the test year.[2] Reflecting these deferred tax amounts in the calculation of the Company's return would show that rate of return for the electric operations was 7.52% and 7.95% for the Company's gas operations. If Ms. Andrews' calculation was approved, it would allow the Company a return on funds which represent cost-free capital provided by ratepayers. Utilizing the Company's rate of return calculation gives the impression that Avista's returns are much lower than they really are.

Q: Do you believe that the Company's filing includes other elements which have the effect of overstating the revenue requirements?

A: Yes, I do.

Q: What is your understanding of the matching principle used by the Washington Utilities and Transportation Commission?

A: In Washington Administrative Code (WAC) 480-07-510, the Commission has set out methodologies to be used for adjusting test year data in setting rates. WAC 480-07-510(3), "Workpapers and Accounting Adjustments," identifies the following criteria for making adjustments to the test year:

> (ii) "Restating actual adjustments" adjust the booked operating results for any defects or infirmities in actual recorded results that can distort test period earnings. Restating actual adjustments are also used to adjust from an as-recorded basis to a basis that is acceptable for rate making. Examples of restating actual adjustments are adjustments to remove prior period amounts, to eliminate below-the-line items that were recorded as operating expenses in error, to adjust from book estimates to actual amounts, and to eliminate or to normalize extraordinary items recorded during the test period.

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[2] Direct Testimony of Elizabeth M. Andrews, Exhibit No.___(EMA-1T), p. 13, Illustration 1 and p. 36, Illustration 3.

> (iii) "Pro forma adjustments" give effect for the test period to all known and measurable changes that are not offset by other factors. The work papers must identify dollar values and underlying reasons for each proposed pro forma adjustment.
>
> (h) A representation of the actual rate base and results of operation of the company during the test period, calculated in the manner used by the commission to calculate the company's revenue requirement in the commission's most recent order granting the company a general rate increase.

Q: What is your interpretation of the methodology approved for use by the Washington Commission?

A: I interpret the above rule as requiring that any "restating actual adjustment" or "pro forma adjustment" must properly match the test year data. The adjustments must first be known and measurable, and second, relate to the level of the service performed during the test year. Adjustments which do not properly match current test year level sales, are not known and measurable, or are offset by other factors do not meet the rule's requirements or the well established matching principle of ratemaking.

Q: Please explain the "matching principle."

A: The matching principle requires that a relationship be maintained between the rate base, revenues, expenses and capital costs consistent with the test year chosen.

Q: Could you provide some examples where adjusting only one cost of service component creates a violation of the matching principle?

A: Yes. Adjusting only the rate base component of the formula creates a mismatch because the rate base would not match the level of service provided by the investment in plant or revenues generated in the test year.

Another example would be utilizing a future level of sales. This again results in a mismatch in the formula, i.e., revenues are overstated and the underlying investment and expenses remain at the test year level which generated a lower sales level.

A third example would be a major addition to the production facilities of the company occurring outside the test year. In this situation, a pro forma adjustment may be justified because this additional investment could distort the future relationship. However, in this scenario it is the Company's responsibility to demonstrate that such a distortion would exist and the additional investment should be reflected in the test year in order to maintain the appropriate relationship between rate base, revenues, expenses and cost of capital.

Q: Do all Cost of Service components, i.e., revenues, expenses, and cost of capital change over time?

A: Yes, they do. However, the "matching principle" dictates that all of the cost of service components should be considered and evaluated in relation to the specific test year. That is why a test year is chosen and utilized so that a proper relationship is established between revenues, expenses, and the cost of capital. The assumption is that, going forward, this relationship will be maintained. allowing the utility to earn its authorized rate of return.

Q: In your opinion, has Avista's filing followed the ratemaking principles specified in the Washington Administrative Code?

A: No, they have not, as I will explain in discussing certain adjustments below.

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V. UNCONTESTED ADJUSTMENTS

Q: Please identify the Company's restating and pro forma adjustments that you are not contesting.

A: In Table 1 I list the Company's adjustments that I do not contest in this testimony. While I have not contested the following adjustments, my silence on these issues should not be interpreted as endorsement of these adjustments. Other parties may raise valid objections to these items.

Table 1- List of Uncontested Adjustments

Elec	Gas	Adjustment
c	c	Deferred FIT Rate Base
d	d	Deferred Gain on Office Building
e		Colstrip 3 AFUDC Elimination
	e	Gas Inventory
	f	Weatherization & DSM Investment
f		Colstrip Common AFUDC
g		Kettle Falls Disallowance
h	g	Customer Advances
i	h	Depreciation True-Up
j		Settlement Exchange Power
k	j	Eliminate B&O Taxes
m	l	Uncollectible Expense
n	m	Regulatory Expense
p	o	FIT
q		Eliminate WA Power Cost Defer
r		Nez Perce Settlement Adjustment
s	q	Eliminate A/R Expenses
t	r	Office Space Charges to Subsidiaries
u	s	Restate Excise Taxes
v	p	Net Gains/Losses
w	i	Revenue Normalization
x	t	Miscellaneous Restating Adjustments
	PF3	JP Storage
PF5		Transmission Rev/Exp
PF8		Noxon Generation 2010
PF11		Spokane River Relicensing
PF13		Pro Forma Montana Lease
PF17	PF9	Employee Benefits
PF19		Pro Forma Clark Fork PM&E

VI. REVENUE CONVERSION FACTOR

Q: Have you utilized a different revenue conversion factor than that shown in the Company's filing?

A: Yes. Avista's Response to Public Counsel Data Request No. 25 states that Avista Witness Ms. Andrews' Exhibit Nos. ___ (EMA-2) and (EMA-3) do not reflect the uncollectible and Washington Excise tax allocation factors applicable in this case. They appear to be the factors utilized in the Company's previous rate case. Schedule A-2 reflects the Company's corrected allocation factors and conversion factor shown in that response. The Company stated that the corrected conversion factor has a net impact of reducing the Company's revenue requirement by $6,000 for electric and $1000 for gas.

VII. RESTATING ADJUSTMENT—PROPERTY TAX ADJUSTMENT L (ELECTRIC)

Q: Do you have any restating adjustments?

A: Yes, I have one restating adjustment, related to Avista's property tax expense as filed in this case. The Company has made an estimate of its 2009 property taxes and adjusted the test year ending September 30, 2008 to reflect this higher level of property taxes. In my opinion, this adjustment violates the underlying principles in the Commission rules. An estimate of the 2009 property taxes is not known and measurable and also does not match the rate base at September 30, 2008.

Q: What were the actual property tax levels Avista has experienced for the years 2006, 2007, and 2008?

A: On a total Company basis, property taxes for both the electric and gas operations have declined. Per Avista’s Response to Public Counsel Data Request No. 196, on a total Company basis, property taxes were $19.3 million in 2006, $18.7 million in 2007 and $18.6 million in 2008. The actual property tax for the electric operations was $15.4 in 2006, $14.9 in 2007 and $15.0 in 2008. In general, electric property taxes have also declined from 2006 to 2008. There was a slight increase of about $53,000 between 2007 and 2008.

Q: What is the Company's electric rate case filing based on as it relates to property taxes?

A: The Company is basing its property tax request on projected property taxes in 2009 of $20,277,000 for its electric operations. This is an approximate 35% increase over the actual 2008 electric property tax assessment. Approximately 20% of this increase relates to a projected increase in property tax rates for the Coyote Springs Power Plant in Oregon in 2009.

Q: What adjustment are you recommending?

A: The only known and measurable tax rates are those in effect at December 31, 2008. These rates would not result in an increase in property taxes for the test year ended September 30, 2008. The Company's adjustment does not properly match the property taxes with the period in which it will be incurred and expensed. I am therefore rejecting the Company's restating adjustment increase of $1,445,000 for property taxes since it is not known and measurable and is not properly matched with the revenues generated during the test year. I believe that the Company's restating adjustment that reduces property taxes for its gas operations is appropriate.

VIII. PRO FORMA ADJUSTMENTS

A. Power Supply PF1 (Electric)

Q: What amount have you reflected for Power Supply Costs?

A: I have incorporated PC's Power Cost witness Kevin Woodruff's decrease to power costs of $31,440,911 ~~48,685,00~~ on Schedule A-1.

B. Production Property Adjustment PF2 (Electric)

Q: The Company is proposing an adjustment that increases operating income and decreases rate base which it states will match the test year investment (including property additions for 2009 and 2010) with the test year retail load. Do you agree with that adjustment?

A: No, I do not. The Company has made a pro forma adjustment to remove a percentage of production and transmission expense and plant in order to match the load actually experienced during the test year ended September 30, 2008 with the production plant and transmission plant necessary to serve the load which will be experienced in the periods between September 30, 2008 and December 31, 2009 and 2010. The percentage increase in load beyond the test year used by the Company was calculated by dividing the test year normalized load by the projected load for the years ended December 31, 2009 and 2010, and the results were then subtracted from 100%. The percentages used for 2009 and 2010 were 1.9372 % and 4.795%, respectively . The growth in sales between these two periods is projected by the Company to be 276,397 MWh.

Q: Do you agree that an adjustment of this type should be made?

A: Yes, I do. However, the Company's adjustment includes projected additions for the years 2008 and 2009. It also includes projected increases in property tax, operating and maintenance expense, and other expense levels that I do not agree with.

Q: What adjustment are you recommending?

A: Only those plant additions which have been utilized in the calculation of power costs should be used in calculating the production property cost adjustment. In addition, those expenses used in calculating this adjustment, which I feel are overstated, should be reduced and the net level of expense should be used in calculating a reduction in operating expenses related to production property. As shown on Schedule C-1 my adjustments reduce the Company's expenses by $10.947 million and rate base by $11.564 million.

C. Labor Non-Executive Adjustment PF3 (Electric) And PF1 (Gas)

Q: Can you explain the labor adjustment which Avista is requesting in this case?

A: Yes. Avista is requesting that the wage increases, which took effect in March 2008 for both union and administrative employees, be annualized. The Company is also requesting that the wage increase, which took effect in March 2009, also be reflected in the rates to be set in this docket. Additionally, the Company reached ahead to March 2010 and reflected an allocated portion of that wage increase in the test year ended September 30, 2008.

Q: Are you suggesting any adjustments to the Company's wage request?

A: Yes, I am. The increases that took place in March of 2008 and March of 2009 are currently in effect, are known and measurable, and are reasonably related to the test year ended September 30, 2008. However, the administrative wage increase approved by the Board of Directors in March 2009 was only 2.5%, as opposed to the 3.8% increase reflected in the Company's filing.[3] I have estimated this difference to be $202,694 for electric and $57,904 for gas. The wage increase, which the Company has estimated to be implemented in March 2010, is not known and measurable and it relates to a future period when the sales will be at a different level. It would be inappropriate to reflect this wage adjustment in the test year ended September 30, 2008.

Q: What adjustment are you recommending?

A: I have reduced the March 2009 administrative increase to reflect the amount approved by the Board. I am also recommending that the proposed 2010 wage increases of $1,249,929 for electric and $329,329 for gas be removed from the test year ended September 30, 2008. In total, these adjustments reduce the Company's pro forma increases of $2,986,598 and $786,340 for the electric and gas operations by $1,452,623 and $387,233, respectively.

D. Labor Executive Adjustment PF4 (Electric) PF2 (Gas)

Q: Are you proposing a similar adjustment to the executive labor increase that you are proposing for union and administrative employees?

A: Yes. I am reducing the level of executive level increases to the same percentage annualization level as was received by administrative employees in 2008.

[3] Testimony of Donn English for Idaho Public Utilities Commission Staff in Avista Rate Case No. AVU-09-1/AVU-G-09-1 recommended on adjustment on this issue.

The test year ended September 30, 2008, includes executive compensation in various expense accounts that totals $1,389,585. For its electric operations, the Company is requesting a $239,543 or 17.23% increase to that level. This amount includes increases through March of 2010. I have annualized executive compensation for 2008 using the same rate of 1.519% used for the administrative employees. Since the Company's executives did not receive a wage increase in 2009 and the actual wage increase for 2008 is not known, I utilized the last administrative wage increase applied in March 2008 of 1.519% in calculating my adjustment. The 2010 increase should not be included because it is not known and measurable. This results in an increase to executive compensation of $21,108. This is $218,435 less then the Company's requested increase of $239,543.

The Company's gas operations filing includes a 17.20% increase for executives. Test year executive compensation was $386,936 and the increase requested by Avista is $66,560 through 2010. As I previously mentioned, executives did not receive an increase in 2009 and the 2010 increase should not be included because it is not known and measurable. My adjustment for the gas operations allows the same annualized administrative increase of 1.519% received by administrative employees. My adjustment decreases the Company's adjustment by $60,682 as shown on Schedule C-2.

E. <u>Capital Additions 2008 PF6 (Electric) AND PF4 (Gas)</u>

Q: What do the Company's pro forma adjustments purport to accomplish?

A: According to Ms. Andrews' testimony, these adjustments reflect capital additions for the remainder of 2008 and the associated expenses through December 31, 2008. These adjustments would change the average-of-monthly averages (AMA) balances to a year-end plant balance as of December 31, 2008.

Q: How does this adjustment comport with the Commission's underlying ratemaking principle of "matching"?

A: This is a violation of the matching principle because the revenue reflected in this case was generated over the average period from October 1, 2007 through September 30, 2008 with the corresponding average plant in service during that time period. As previously stated, the pro forma adjustment changes the Company's rate base from an average-of-monthly averages to an end-of-period rate base by moving the rate base from September 30, 2008 to December 31, 2008. Doing so without reflecting any corresponding increase in revenues clearly creates a mismatch between revenue and rate base. This adjustment violates the ratemaking principle of matching revenues, expenses, and capital costs.

Q: What adjustment are you recommending?

A: For the electric operations, I am recommending that this adjustment be rejected with the exception of the 2008 additions to production plant which were reflected in the power supply model. I have adjusted production plant for 2008 based on information provided by the Company. The Company's pro forma increase of $728,000 to expenses on a Washington electric jurisdictional basis should be removed. Additionally, the corresponding pro forma increase to electric rate base of $21,445,000 should also be removed.

I am recommending a similar adjustment to the Company's gas operations. I have removed the Company's pro forma adjustment to operating expenses of ($453,000) as well as the increase of $1,234,000 to gas rate base. Any 2008 addition to plant which was utilized in the power cost model would be appropriate to include in the test year because the benefits (reduced power cost) would be reflected in the test year. I have shown those amounts on Schedule C-4 (Electric) of my Exhibit No. ___ (HL-3) and also on my summary schedule A-1 (Electric).

F. <u>Capital Additions</u>

1. 2009 PF7 (Electric) and PF5 (Gas)

Q: These pro forma adjustments proposed by the Company reflect projected capital additions for the year 2009. Do the Company's proposed adjustments comply with Commission policy and the rule?

A: In my opinion they do not, with the exception of the Noxon Unit 1 upgrade. The Noxon Unit 1 upgrade has been included in the Company's dispatch model and therefore the corresponding benefits of these additional cost increases have been reflected in fuel costs for the adjusted test year ended September 30, 2008. All the other 2009 projected rate base additions and operating expenses should be rejected. I have adjusted rate base for production plant additions through June 2009 as provided by the Company.

2. Capital Additions 2010 PF8 (Electric)

Q: Have you made an adjustment to the Company 2010 plant additions?

A: No, I have not. The 2010 additions are for the upgrade of Noxon 3. The additional generations from this upgrade has been reflected in the power cost model.

G. Pro Forma Asset Management PF9 (Electric) and PF6 (Gas)

Q: Please describe the Company's Asset Management Program.

A: Avista's Asset Management Program attempts to manage assets in order to provide the best value to customers by minimizing life cycle costs and maximizing system reliability. The Asset Management program is relatively new, but consists of well established programs such as vegetation management, wood pole inspections, transformer management, etc.

Q: What amount of Asset Management expense has the Company included in the test year?

A: Avista is requesting $12,382,000 on a total system basis, an increase of $4,486,000 or 57% over the test year level. On a Washington jurisdictional electric and gas basis, this amounts to $2,896,403 and $88,084, respectively. This adjustment to asset management expense is contradictory to the WAC requirement for pro forma adjustments, i.e., a pro forma adjustment must be offset with the cost savings or benefits of the increased expense. The amounts are merely budgeted costs rather than known and measurable costs and they do not incorporate any offsetting impacts such as costs savings or increased system reliability. In Avista's recent rate case filed in Idaho, the Commission recognized that there are cost savings associated with these programs.[4]

Q: What adjustment are you recommending?

[4] Order No. 30856, July 17, 2009, Avista Rate Case No. AVU-09-1/AVU-G-09-1.

A: I have removed the Company's pro forma adjustments of $2,896,403 and $88,084 for the electric and gas operations, respectively.

H. <u>Pro Forma Information Services PF10 (Electric) and PF8 (Gas)</u>

Q: Please explain your adjustment to PF10 and PF8 - Information services expense.

A: The Company's pro forma adjustment to information services expense is also contradictory to the WAC's definition of pro forma adjustments. These are merely budgeted amounts rather than known and measurable costs, and do not incorporate any offsetting cost savings or other benefits. The most significant component of this pro forma adjustment relates to the New Work Management System, as is estimated by the Company to cost $1,120,000. This system would be used for scheduling customer work, managing energy delivery crew work, and for tracking the time worked by Avista's crews. Avista's Response to Public Counsel Data Request No. 318 stated that the New Work Management System was originally scheduled to be implemented by 2009 but has been delayed until 2010. Since these costs are not known and measurable and the Company has not reflected any cost savings or benefits associated with these Information Services expenses coupled with the implementation of the New Work Management System being delayed, I have removed the Company's pro forma adjustments of $1,752,387 and $450,000 for the electric and gas operations, respectively.

I. <u>CDA Tribal Settlement Costs PF 12 (Electric)</u>

Q: Please explain your adjustment to PF12- CDA Tribal Settlement Costs.

A: The Commission's order in the previous Avista rate case authorized the Company to defer the CDA Tribal Settlement costs as a regulatory asset in Account 182.3 -

Other Regulatory Assets. PF12 is comprised of fees for 2010 as well as the amortization of the deferred asset. Public Counsel has appealed those costs related to past conduct. Since Public Counsel is challenging the recovery of these costs, I have removed them from this adjustment. I have reduced the Company's pro forma adjustment for CDA Tribal Settlement Costs by removing the portion of this expense that is related to the amortization of past costs and the deferred balance included in rate base. As shown on Schedule C-6, this adjustment reduces the Company's pro forma adjustment for the Washington electric operations by $570,255 for the amortization of the deferred costs which appear to be related to the past conduct. Since the deferred balance also appears to be entirely related to past conduct, I am removing the entire deferred balance of $16,819,000.

J. <u>Colstrip Mercury Emissions O&M PF14 (electric)</u>

Q: Please explain the costs associated with Colstrip Mercury Emissions Adjustment PF14.

A: As stated in the Company's Response to Staff Data Request No. 45, PF14 relates specifically to the expected annual chemical costs for mercury emissions that will be part of the O&M budget for the Colstrip Steam Electric Station Units 3 and 4.

Q: Did the Company provide information indicating that this pro forma adjustment should be reduced?

A: Yes. Avista’s supplemented its Response to Staff Data Request No. 45 based on a revised project plan (2010 Business Plan) received from the Colstrip plant operator, PPL Montana (PPLM). The revised 2010 Business Plan identified a decrease in the projected cost for mercury control chemicals in 2010.

Q: By what amount should PF14 be reduced?

A: The system portion of the costs decreased from $2.9 million to $1.922 million. The Washington jurisdictional electric portion of these costs decreased from $1.873 million to $1.241 million. I have reflected this reduction of $631,690 on Schedule C-7.

K. <u>Pro Forma Incentives PF15 (electric) and PF7 (gas)</u>

Q: Please explain the Company's pro forma adjustment to Incentive Compensation Expense.

A: The Company's pro forma adjustment increases Incentive Compensation expense by $550,457 and $152,143 for the Company's electric and gas operations, respectively. This adjustment is computed by first reducing the test period expense to reflect actual incentives paid in 2008 then increasing that amount to a six year average level.

Q: How does the Company's pro forma level of expense compare with historical levels?

A: As can be seen on workpaper PF15[7] and in the table below, incentive compensation has expense has progressively declined in recent years.

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Table 2- Total O&M Incentive Expense

2003	$	3,469,127
2004	$	3,788,428
2005	$	6,182,891
2006	$	4,722,467
2007	$	3,392,515
2008	$	2,856,368
6 Yr Avg	$	4,068,632
TY Incentive Exp.	$	2,856,368
Pro forma increase	$	1,212,264

Q: What is your recommended adjustment?

A: The Company's actual 2008 amount of incentives is a more representative figure of this expense. In Avista's Response to Staff Data Request No. 98, the Company provided target incentive amounts and actual payout amounts. The Company stated in that response that in each of the years 2002 through 2008, the actual incentive payout was less than the target incentive payout because not all of the components of the incentive plan were achieved.

This expense has been declining in recent years. Moreover, due to the Country's current economic situation, it is unlikely that incentive expense will increase to the Company's projected level. I have removed the portion of the Company's pro forma adjustment that increases this expense to a six-year average level. Therefore, my adjustment decreases the Company's incentive expense for electric and gas operations expense by $17,414 and $4,814, respectively rather than increasing it by $550,457 and $152,143 as the Company has proposed.

L. Pro Forma O&M Plant Expense PF16 (electric)

Q: Please explain your adjustment to PF16.

A: This pro forma adjustment to O&M Plant Expense is inconsistent with the WAC definition of pro forma adjustments. These amounts are merely budgeted rather than known and measurable costs and do not incorporate any offsetting impacts such as costs savings or other benefits. During my review of the workpapers supporting this adjustment, it appeared that some of these items such as the turbine overhaul, unit #1 rewedge, and cooler retube may be capital improvements rather than maintenance expenses. As such, there would be benefits associated with these improvements such as reduced maintenance costs, improved efficiency, and reliability that should be reflected as well. Since the Company has not demonstrated any benefits to the ratepayers of including this as a pro forma adjustment to test year levels, I have removed the Company's pro forma adjustment of $2,268,670 for the electric operations.

M. Pro Forma Insurance Expense PF18 (Electric) and PF10 (gas)

Q: Did the Company include a pro forma increase for insurance expense in its filing?

A: Yes, Workpapers PF18$_3$ (electric) and PF10$_3$ (gas) from the Company's filing include pro forma increases of $283,233 and $78,284, respectively for insurance expense.

Q: Did the Company update its pro forma increase for insurance expense in its filing?

A: Yes. The Company's Response to Staff Data Request No. 142C[5] updated workpapers $PF18_3$ (electric) and $PF10_3$ (gas) to reflect final insurance renewal amounts as of December 31, 2008. The final renewal amounts were less than the initial pro forma adjustments by $64,712 (Washington electric) and $17,886 (Washington gas). As shown on Schedule C-9 (electric) and C-4 (gas), I have reduced the Company's pro forma adjustment by these amounts.

Q: Do you propose any other adjustments to insurance expense?

A: Yes, as explained below.

Q: What amount has the Company included in the test year for D&O liability insurance?

A: Avista's Response to Public Counsel Data Request No. 212, Attachment A, stated that test period costs for D&O Insurance allocated to the Washington electric and gas operations in the test period are $816,856 and $217,168, respectively.

Avista's Response to Staff Data Request No. 137 states that in years prior to the test year, D&O insurance was allocated 66.7% to Avista Corp. and 33.3% to non-utility subsidiary Avista Energy. In 2007, Avista Energy was sold and now 100% of D&O insurance is charged to Avista Corp. According to the response to Staff Data Request No. 150, the Company has not allocated any amounts of D&O insurance to its other subsidiaries. Ratepayers should not be expected to fund 100% of this cost since other Avista non-utility subsidiaries may also be covered under these insurance policies.

Q: What is the purpose of D&O insurance?

[5] Counsel for Avista has advised Public Counsel that the information cited here is not confidential.

A: This insurance protects officers and directors when decisions that they have made are challenged in court and/or have been determined to be business decisions detrimental to the Company's shareholders.

Q: Is there any benefit of D&O insurance to ratepayers?

A: The benefit is limited. As the plaintiffs are usually the Company's shareholders, the benefit from any settlements from this insurance flows through to them. Ratepayers typically do not receive any proceeds from settlements in litigation involving the directors and officers of the Company, so they should not be solely responsible for the cost of protecting officers and directors from their own decisions.

Q: What adjustments are you recommending?

A: Consistent with the other expenses I have reduced that primarily benefit shareholders, I am recommending that 50% of the D&O insurance be removed from rates. As shown on Schedule C-10 and C-5, this reduces D&O insurance on a Washington electric and gas jurisdictional basis by $408,428 and $108,584 respectively.

N. <u>Board of Directors Meeting Costs</u>

Q: What amount of Board of Directors Meeting costs are included in the test year?

A: The Avista’s Response to Staff Data Request No. 155 states it included $96,553 in the test year on a total system basis for Board of Directors (Board or Directors) Meeting costs. Allocating these costs based on the jurisdictional factors for directors' fees provided in the response to Public Counsel Data Request No. 328, yields $45,229 and $12,501 charged to the Washington electric and gas operations, respectively.

Q: Please explain the function of a Company's Board of Directors.

A: The Board of Directors is a body elected by shareholders. The Board oversees the activities of the company and is the ultimate governing authority. Typical duties of the Board may include but are not limited to: establishing corporate policies and objectives, selecting the Chief Executive Officer (CEO), approving the company's financial statements, budgets, dividend payments, and strategic plans. The Board's primary responsibility is to protect shareholders' assets and ensure they receive a reasonable return on their investment.

Q: Did the Company provide any workpapers supporting the amount of Board Meeting costs included in the test year?

A: Yes. The Company provided an itemization of test year Board Meeting costs in response to Staff Data Request No. 155. Costs shown on this document include catered meals, candy, gifts, theatre and museum fees, a cruise on Lake Coeur D'Alene some inadvertent charges for first class travel, which are not necessary for the provision of utility service. The Company stated in this response that: These costs for the first class travel will be charged below the line in the future.

Q: What adjustment are you recommending to Board Meeting costs included in the test year?

A: As a publicly traded, shareholder-owned company, it is not unreasonable to ask that shareholders bear half of the costs to conduct these meetings. Therefore, I have removed 50% of the Board Meeting costs. As shown on Schedule C-11 and

C-6, this adjustment reduces the Washington electric and gas operations expenses by $22,615 and $6,251, respectively.

O. Board of Directors Fees

Q: What amount of Board of Directors' fees are included in the test year?

A: According to the response to Public Counsel Data Request No. 328, the total test year system cost of directors' fees is $1,162,018. This response indicates that over 90% of these fees are allocated to the Company's utility operations. The amounts allocated to the Washington electric and gas operations are $544,333 and $150,452, respectively.

Q: Please explain your adjustment to reduce Directors' fees included in the test year.

A: Typically, individuals serving on a Board of Directors do not do so on a full-time basis. Some may be retired individuals or participate in addition to their existing full-time careers. Ratepayers should not be expected to fully fund compensation for directors who are working part-time on behalf of the Company's shareholders. The duties of the Board of Directors are mainly to protect stockholders interests. For this and the reasons stated above in my adjustment to Board Meeting costs, I am removing 50% of the Board of Director's Fees. As shown on Schedule C-12 and C-7, this adjustment reduces the Washington electric and gas operations expenses by $272,167 and $75,226 respectively.

P. American Gas Association (AGA) Dues

Q: Please explain your adjustment for American Gas Association (AGA) Industry dues.

A: This adjustment is shown on Schedule C-9 and reduces test year gas operations expense by $21,436 to reflect the removal of AGA dues that pertain to lobbying, advocacy or promotional activities which are not necessary for the provision of gas service.

Q: Did the Company remove any portion of AGA dues from the test year?

A: Yes. From a review of the attachment provided in response to Staff Data Request No. 22, and the Avista's Response to Public Counsel Data Request No. 458, the Company removed 4% of AGA dues expense that relate to lobbying expenses.

Q: Do you agree with this amount?

A: No.

Q: What is your basis for further reducing the amount of AGA dues included in the test year?

A: The National Association of Regulatory Utility Commissioners (NARUC) sponsors Audit Reports of the Expenditures of the American Gas Association. The audit report categorizes the AGA's expenditures funded by membership dues. A 2001 memo to the Chairs and Chief Accountants of State Regulatory Commissions included with the NARUC-sponsored audit report of 1999 AGA expenditures: stated "these expense categories may be viewed by some State commissions as potential vehicles for charging ratepayers with such costs as lobbying, advocacy or promotional activities which may not be to their benefit."

The table below shows a breakdown of the categories of expenditures funded by AGA member dues.

Table 3: NARUC Recommendation for AGA Dues

	March 2005 NARUC Audit Report for Year Ended 12/31/02		AGA 2008 Budget	
NARUC Operating Expense Category	% of Dues	Recommended Disallowance	2008 % Allocation	Recommended Disallowance
Public Affairs	24.13%	-24.13%	24.44%	-24.44%
Advertising			1.18%	-1.18%
Communications	15.53%			
Corporate Affairs and International	10.54%	-10.54%	9.14%	-9.14%
General Counsel & Corp Secretary	5.20%	-2.60%	4.17%	-2.09%
Regulatory Affairs	15.51%			
Policy Planning & Regulatory Affairs			15.78%	
Marketing Department	2.37%	-2.37%		
Operating & Engineering Services	15.85%		21.71%	
Policy & Analysis	12.94%			
Industry Finance & Admin. Programs	4.75%		3.36%	
General & Administrative			20.22%	
Total Expenses	106.82%	-39.64%	100.00%	-36.85%

As can be seen in table above, approximately 40% of AGA dues fund expenses related to public and corporate affairs, general counsel and marketing and are recommended to be disallowed. For reference purposes, a copy of AGA's 2008 budget is shown which contains a comparable percent of dues related to public corporation affairs, general counsel, and marketing.

Q: What additional amount are you recommending?

A: Based on the 2008 AGA dues budget, I am recommending that the Commission remove an additional 33% (37% of 2008 dues that should be disallowed minus 4% of dues already removed by the Company) of AGA dues so that a similar level of AGA dues that relate to public and corporate affairs, general counsel and marketing is removed from the test year.

Q: Have other state utility commissions disallowed a similar percent of AGA dues in rate cases?

A: Yes. The Arizona Corporation Commission disallowed 40% of AGA dues in UNS Gas Inc.'s rate case Docket No. G-04204A-06-0463. The Florida Public Service Commission disallowed 40% of AGA dues in City Gas' rate case Dockets 030569-GU and 940276-GU and 45.10% in Chesapeake Utilities Corporation's rate case Docket No. 000108-GU.

Q. <u>Customer Deposits</u>

Q: What are customer deposits?

A: Customer deposits are monies paid by customers prior to receiving utility service as security for future payment of monthly bills. These deposits are returned to customers after a certain time period, or whenever the customer terminates service with the Company. The Company has an obligation to return these deposits to customers with interest; however, during the time that the deposits are held by the Company, these ratepayer-supplied funds are available for use by the Company.

Q: Have you reduced the Company's rate base for the average of monthly average balance of customer deposits held by the Company in the test year?

A: Yes. The average of monthly averages amount of customer deposits held by the Company are $2,473,108 and $1,352,864 for the electric and gas operations, respectively. I have reduced the Company's rate base by these amounts to reflect the fact that these are not investor supplied funds.

Q: Are the customer deposits cost-free capital to the Company?

A: No. The Company is required to pay customers interest for the period of time that the deposits are held by the Company.

Q: Have you reflected an adjustment to include this interest expense in the Company's operating expense in the test year?

A: Yes. I have increased the Company's operating expenses by $95,765 and $52,386 for the Washington electric and gas operations, respectively for interest expense on the customer deposits paid by the Company during the test year.

R. <u>Injuries and Damages Reserve</u>

Q: Has the Company deducted the injuries and damages reserve balance from rate base?

A: No. Avista's Response to Public Counsel Data Request No. 43states:

> B. The Company is required to account for injuries and damages pursuant to the Washington Commission Order in Docket No. U-88-2380-T. As shown on Andrew's workpapers, section O1-O4 (electric) and N1-N4 (gas) the Company adjusts the accrued expense included in the historical test period (twelve months ended September 30, 2008) to a six year average of injuries and damages payments. By adjusting the Company's results of operations accrued expense to the six year average of actual claims expense, this in effect eliminates the reserve balance.

Q: Does adjusting the results of operations accrued expense to the six year average of actual claims expense, "in effect" eliminate the reserve balance as the Company claims?

A: No. The reserve balance is not eliminated by doing this.

Q: Why should the injuries and damages reserve be deducted from rate base?

A: The utility has collected amounts in rates to build up a reserve for future injuries and damages costs. In the event of an injury, an amount is charged to expense on the income statement and a corresponding amount is credited to an injuries and damages reserve account. The expense is reflected in the utility's cost of service collected from ratepayers and the reserve is reflected as a liability on the

Company's balance sheet to be applied to future injuries and damages claims. To properly match the rate base with the expense, the injuries and damages reserve liability must be deducted from rate base.

Q: What amount should be deducted from rate base related to the injuries and damages reserve?

A: The Company was asked to provide the test year injuries and damages reserve monthly balances in Public Counsel Data Request No. 480. The Company's response provided the monthly transaction amounts rather than the monthly balances. I was able to calculate the average of monthly averages of the injuries and damages reserve balances from trial balances provided in response to Public Counsel Data Request No. 210. As such, I have deducted $7,625,606 and $1,215,879 from the electric and gas operations rate base respectively for the injuries and damages reserve.

Q: Are there any other adjustments that should be made in association with the injuries and damages reserve?

A: Yes. A tax timing difference occurs because this expense is recorded on the Company's books, but it is not deductible for income tax purposes. As such I have calculated the associated accumulated deferred income tax associated with the injuries and damages reserve by multiplying the AMA amount by the Company's tax rate of 35%. This increases rate base by $2,668,962 for the electric operations and $425,557 for the gas operations. I have reflected these adjustments on Schedule C-14 (electric) and C-10 (gas).

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S. Restate Debt Interest (Interest Synchronization) R-23 (electric) and R-19 (gas)

Q: Have you calculated an interest synchronization adjustment?

A: Yes, I have. PC's recommended adjustments to rate base and the capital structure impact the amount of interest deduction for tax purposes. The amount of the adjustments to income taxes for interest synchronization is shown on Schedule C-15 for the electric operations and C-11 for the gas operations.

IX. AVISTA'S REQUEST FOR CARRYING CHARGE ON CONTRIBUTIONS IN EXCESS OF THE PENSION EXPENSE

Q: Would you explain your understanding of Avista's request regarding pension costs and related contributions to the pension plan trustee?

A: Avista determines its pension expense based on Financial Accounting Standard No. 87 (FAS 87). In the current case, Avista is requesting pension expense on a total Company basis of $22.2 million. However, Avista's contributions to the pension plan trustee are predicated on different criteria based on IRS regulations. Subsequent to the passage of the Pension Protection Act of 2006 (PPA), the Company is required to make pension contributions at a level which will maintain pension plan assets at a certain percentage in relationship to the pension plan liability obligations.

For the year 2009, Avista asserts it is required to maintain a 94% relationship between plan assets and pension plan liabilities, i.e., the obligation to be able to make pension plan payments to employees when they retire. While Avista asserted in its testimony that it must be at the 94% funding level under the provisions of the PPA, employers may make additional contributions to make up a shortfall over a seven year period. In response to Public Counsel Data Request No. 468, the Company acknowledged it is permitted to maintain a funding level of less than 94% at some points in time. In fact, under current projections, the Company is now projecting to achieve a funding level of only 85 % in 2009. In Mark T. Thies' testimony, he states that the Company will need to make a contribution of at least $42 million for the year 2009, and may need to make contributions as high as $67 million under more recent analysis.[6] Presumably, his projections were based on the 94% funding levels discussed in his testimony without using the seven-year shortfall provision in the PPA. According to the Company's Response to Public Counsel Data Request No. 468(b), the Company has selected a $48 million funding level for 2009.

Mr. Thies is requesting that the Company be allowed to recover a carrying charge on the difference between the amount of expense recognized in rates and the actual contribution by the Company to the pension plan. The carrying charge on the difference between the expense collected in rates and the payment to the pension plan would be recorded as a regulatory asset, which presumably the Company would collect at some time in the future. Mr. Theis also proposes that the carrying charge be calculated starting February 1, 2009. This would appear to be retroactive rate making since Avista would collect carrying costs incurred in the past in its future rates.

Q: What is your recommendation regarding the Company's request?

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[6] Direct Testimony of Mark T. Thies, Exhibit No. ___ (MTT-1T), p. 34.

A: I recommend that this request be denied. First, it should be acknowledged that the increase in the pension contribution is directly related to the current recession that the country is experiencing. The market value of plan assets have decreased substantially over the last year. This is triggering both an increase in FAS 87 pension expense and required pension contributions under IRS requirements and the PPA. Over time, the assets will recover and the pension plan expense will likely exceed pension plan contributions as has occurred in the past, though to a lesser degree than what is currently occurring. It would be unfair to ratepayers, who are suffering the consequences of the current recession, to require a carrying charge be paid. The Company is requesting that it receive a return on the difference between expense recovered in rates and contributions to the pension plan at the overall rate of return. This would be exorbitant. If any return is authorized, which I do not recommend, it should be at a lower rate such as the short-term borrowing rate rather then the overall rate of return. My ultimate recommendation is that this request by the Company should not be approved because it will rectify itself over time. The consequences of this relatively temporary situation should not be built in to permanent rates.

Q: Does this conclude your testimony?

A: Yes, it does.