Exhibit No.__(EMA-4T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-090134

DOCKET NO. UG-090135

DOCKET NO. UG-060518

(consolidated)

REBUTTAL TESTIMONY OF

ELIZABETH M. ANDREWS

REPRESENTING AVISTA CORPORATION

REDACTED

I. INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corporation.

A. My name is Elizabeth M. Andrews and my business address is 1411 East Mission Avenue, Spokane, Washington. My current position is Manager of Revenue Requirements in the Department of State and Federal Regulation.

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

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

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

A. My rebuttal testimony will first explain the Company’s revised revenue requirements for both electric and natural gas after taking into consideration the agreed to components of the Partial Settlement[1], and to reflect a few corrections and adjustments to actual costs that have been identified through the discovery process. After these adjustments the Company’s revised revenue requirement for its Washington electric and natural gas services is $37,475,000 and $2,849,000 respectively. The revised rate base for the Company’s electric service is $1,012,855,000, while the natural gas rate base remains unchanged from that filed in its direct case at $178,263,000.

In addition, I will address each of the revenue requirement and rate base adjustments incorporated by the Company for known changes, or as proposed by other parties to this case, primarily the Staff of the Washington Utilities and Transportation Commission (Staff) or by the Public Counsel Section of the Washington State Attorney General's Office (Public Counsel) in their direct testimony.

A table of contents for my testimony is as follows:

Table of Contents:

[1] On September 4, 2009 the Company filed a Partial Settlement Stipulation with all parties to Docket Nos. UE-090134, UG-090135 and UG-060518 (consolidated) agreeing to an agreed upon capital structure, power supply adjustments and removal of the Company's pro forma generation O&M adjustment filed in its direct case.

II. REVISED REVENUE REQUIREMENT AND RATE BASE

Q. Have you prepared a summary table that shows the Company's revised revenue requirement and rate base for its electric and natural gas services after reflecting the adjustments agreed to within the Partial Settlement as well as the Company's position on the remaining issues?

A. Yes, I have. Table 1 below provides a summary of the Company's revised electric revenue requirement and rate base proposed by the Company after taking into consideration the adjustments agreed to within the Partial Settlement (assuming it is accepted by the Commission), and a few other adjustments identified through the discovery process and the Company's position on the remaining issues.

Table 1 – Revised Revenue Requirement and Rate Base – Electric

SUMMARY TABLE OF ADJUSTMENTS TO ELECTRIC REVENUE REQUIREMENT & Rate Base 000s of Dollars			
		Revenue Requirement	Rate Base
Amount As Filed by Avista		**$ 69,762**	**$1,007,076**
Agreed Upon Adjustments through Partial Settlement: (1)			
Net Power Supply Adjustments		(27,537)	0
Cost of Capital			
	Adjust return on equity to 10.20%	(6,152)	0
	Adjust common equity to 46.50%	(815)	0
O&M Generation - remove 2010 pro forma costs		(2,372)	0
Summary Total of Avista Contested and Uncontested Adjustments (2)		4,589	0
Avista Rebuttal (revised) revenue requirement/rate base:		**$ 37,475**	**$1,007,076**
(1) See Partial Settlement Stipulation filed on September 4, 2009. (2) See Exhibit No. __(EMA-5) page 1 for detail listing of adjustments.			

Table 2 below provides a similar summary for the Company's revised natural gas revenue requirement and rate base after reflecting similar adjustments.

Table 2 – Revised Revenue Requirement and Rate Base – Natural Gas

SUMMARY TABLE OF ADJUSTMENTS TO NATURAL GAS REVENUE REQUIREMENT & Rate Base 000s of Dollars			
		Revenue Requirement	Rate Base
Amount As Filed by Avista		$ 4,918	$ 178,263
Agreed Upon Adjustments through Partial Settlement: (1)			
Cost of Capital			
	Adjust return on equity to 10.20%	(1,088)	0
	Adjust common equity to 46.50%	(145)	0
Summary Total of Avista Contested and Uncontested Adjustments (2)		(836)	0
Avista Rebuttal (revised) revenue requirement/rate base:		$ 2,849	$ 178,263
(1) See Partial Settlement Stipulation filed on September 4, 2009. (2) See Exhibit No. __(EMA-5) page 2 for detail listing of adjustments.			

Q. In Table 1 and 2, above, you have shown items agreed to in the Partial Settlement, could you please briefly explain their impact on the revised revenue requirement?

A. Yes. Within the Partial Settlement the parties agreed to a revised cost of capital including a 10.2% return on equity, a 46.5% common equity layer, an average cost of total debt of 6.57%, and a revised rate of return of 8.25%. This revised cost of capital reduced the Company's electric requested revenue requirement by $6,967,000 and its natural gas requested revenue requirement by $1,233,000. The Partial Settlement also established the power supply-related adjustments agreed to by the parties, with the exception of Lancaster prudence, which is still contested by Public Counsel. These adjustments reduced the electric revenue requirement by approximately $27,537,000. In addition, the parties agreed to eliminate the generation operation and maintenance (O&M) pro forma adjustment as originally proposed by the Company in its direct filing, reducing the Company's electric request by an additional $2,372,000. It is important to note however, that, as discussed briefly below in my testimony (and in greater detail by Company witness Ms. Knox), the production property adjustment as proposed by the Company is an offsetting adjustment – that will increase the Company's revenue requirement related to agreed-upon power supply adjustments and the generation O&M adjustment noted above.

Q. Are you sponsoring an exhibit that summarizes the remaining issues?

A. Yes. A table is provided in Exhibit No.__(EMA-5), (see page 1 – electric and page 2 – natural gas), which provides a detailed listing of each adjustment proposed by Staff, Public Counsel, or the Company, and compares the revenue requirement and rate base changes. Each of the adjustments will be described in Section III below. I discuss the areas where the Company has agreement with the parties and where we do not.

I am also sponsoring Exhibit Nos.__(EMA-6) (Electric) and (EMA-7) (Gas), which were prepared under my direction, and consist of worksheets showing the calculation of the revised electric and natural gas revenue requirement including each adjustment as proposed by the Company. In addition, Exhibit No.__(EMA-8) has been included to provide supporting information for certain adjustments discussed in this testimony.

III. REBUTTAL OF STAFF AND PUBLIC COUNSEL PROPOSED ADJUSTMENTS AND AVISTA PROPOSED REVISED ADJUSTMENTS

Q. Please summarize the revenue requirement adjustments proposed by Staff and/or Public Counsel that the Company is addressing in its rebuttal testimony, and any adjustments to the Company's case identified through the discovery process.

A. Certainly. These adjustments are described in detail below. Please also see Exhibit No. __(EMA-5) pages 1 and 2 for the revenue requirement associated with each adjustment as proposed by Staff, Public Counsel and/or the Company.

A. Non-Executive and Executive Labor

Q. Please describe the labor adjustments proposed by the Company in its direct filed case and any corrections to those adjustments proposed by the Company at this time?

A. In the Company's direct case the Company: (i) annualized the 2008 salary increases which went into effect March 1, 2008 for administrative and union employees; (ii) adjusted the executive employee salaries to actual in 2008 for the current executive team; (iii) pro formed the average salary increases expected for 2009, at the time of filing, of 3.8% for administrative and executive employees, and 4% for union employees; and (iv) pro formed in the salary increases expected for March 1, 2010 of 3.8% for administrative, union and executive employees. The Company now proposes to adjust the Company's non-executive and executive labor adjustments for the 2009 actual increases paid to employees on March 1, 2009 of 2.5% for administrative employees and 0% for executives. This reduces the Company's electric revenue requirement requested by $219,000 for non-executive and $35,000 for executive labor, and the natural gas revenue requirement requested by $59,000 for non-executive and $13,000 for executive labor.

In addition, the Company has continued to reevaluate through administrative and executive market studies and union wage analysis what the <u>2010 salary level</u> increases is expected to be for the upcoming year. For administrative and executives labor, results of these studies as of September 2009 indicate an average expected increase of approximately 2.8% for all companies participating (3.2% for the Utilities & Energy Industry Sector). Although these studies are preliminary at this time, and the Company historically has used the Utilities & Energy Industry Sector when evaluating Company increases for administrative and executive salary increases, to be conservative the Company is proposing to reduce the pro forma 2010 increase from 3.8% to 2.8% for this case. Please see Exhibit No.__(EMA-8), page 6.

For union labor, although negotiations have not been completed for the upcoming 2010 union contract, to be conservative, the Company is also proposing to adjust the union salary increases previously included in the Company's direct filed case, down slightly from [redacted] In support of the 2010 revised increase included here, as shown at Exhibit No.__(EMA-8), page 7, the Company analysis includes a comparison of historical journeyman/lineman classification wages in the Northwest. As can be seen on this exhibit, Avista union employees are currently <u>below</u> the average wage (which includes Puget Power, Idaho Power and Central PUD's) included in this comparison by approximately 2%. The 2010 line on this exhibit shows results of current contract negotiated wage increases for 2010 for the comparable utilities (Idaho Power is unavailable until late in the year). As shown on the exhibit, if one were to average the wage increases for those Companies whose wage information is available at this time, prior to any 2010 wage increase for Avista union employees, Avista employees will be under the average wage by approximately 6%. Therefore, the Company believes the increase included for the Company's revised union 2010 labor is conservative, and the minimum increase anticipated.

These additional adjustments to the Company's direct case, further reduces the Company's revenue requirement by approximately $409,000 for electric administrative and union labor and $15,000 for electric executive labor. For the natural gas section, these additional adjustments reduce the Company's revenue requirement by approximately $108,000 for natural gas administrative and union labor and $4,000 for natural gas executive labor. Supporting information for these revised adjustments are provided at Exhibit No.__(EMA-8), pages 1 through 8.

Q. Taking into consideration the above revisions to the Company's direct filed labor adjustments, could you please summarize the net impact on the Company's revenue requirement?

A. Certainly. The net impact to the Company's revenue requirement for adjusting for actual 2009 increases, and revising expected increases for 2010 due to more current information, reduces the electric revenue requirement by approximately $628,000 for administrative and union employees and $50,000 for executive employees. For natural gas, the net impact is a revenue requirement reduction of approximately $167,000 for administrative and union employees and $17,000 for executive employees.

Q. Have Staff and Public Counsel addressed the non-executive and executive labor adjustments?

A. Yes. At pages 5 through 10 of Staff witness Ms. LaRue's direct testimony, and page 11 through 13 of Public Counsel witness Mr. Larkin's direct testimony, both proposed adjustments to the Company's non-executive and executive labor expense. Public Counsel accepted the non-executive annualization of 2008 labor (however as described further below, they did not agree with the initial annual 2008 level of officer labor included in the Company's direct filing), and recognized the 2009 salary corrections noted above. Staff accepted the 2008 annualization of non-executive labor and the 2008 expense level for executive labor. However, Staff only recognized the 2009 correction for officers noted above, and did not include the non-officer 2009 adjustment.

Q. Did Staff and Public Counsel make additional salary adjustments for non-executive and executive labor for 2010?

A. Yes. Both Staff and Public Counsel argue that the 2010 salary increases pro formed into this case for administrative, union and executive employees are not known and measureable and should be excluded. For administrative and union labor, they each reduced the Company's revenue requirement requested by approximately $1,300,000 for electric and $344,000 for natural gas. For the executive labor component, their adjustment reduced the Company's revenue requirement by $55,000 electric and $16,000 natural gas.

Q. Do you agree with this assessment that the 2010 labor increases are not known and measurable and therefore should not be accepted?

A. No, I do not. First, as stated above, for administrative and executive labor, during 2009 the Company has continued to evaluate through market studies and union analysis of what the latest 2010 salary level increases are expected to be for the upcoming year. These market studies, as of September 2009, are showing expected increases to be between 2.8% and 3.2%. To be conservative, the company is expecting this increase to be no less than 2.8%.

Q. In Avista's prior rate case did Public Counsel support a rate period adjustment for non-officer and union wages?

A. Yes. Specifically, in Avista's recently concluded case in Docket No. UE-080416 and UG-080417, Public Counsel witness Mr. Majoros, supported the inclusion of a $1.19 million adjustment to capture pro forma, estimated, non-officer compensation for the prospective rate period by stating:

> I have made this change because I am not objecting to the increase to 2009 levels [rate period increase]. Ordinarily I would object to Avista's increase to 2009 levels on the grounds that it is beyond the test year. Because the rates resulting from this proceeding will not be in effect until 2009 [January 1, 2009], I have not challenged the increase of wages to a 2009 level. However, that estimated increase should be conservative. (Emphasis added) (Exhibit No.__(MJM-4T), page 19, lines 10-14.)

Q. Returning to this case, did Public Counsel make any additional salary adjustment for executive labor?

A. Public Counsel also reduced executive labor expense, reducing the Company's revenue requirement by an additional $137,000 for electric and $35,000 for natural gas relating to the 2008 level of executive salaries included (before adjusting for 2009 and 2010 increases). With the correction for the 2009 actual salary increase of 0% for 2009, and their removal of 2010 salary increases, Public Counsel attempts to annualize the salary increases included in the Company's 2008 test period for executive employees. However, to annualize the 2008 salary levels, Public Counsel argues that the percentage used to annualize the 2008 executive employee salaries should be no higher than that used to annualize the administrative salaries, which was approximately 1.519% (3.67% effective 03/26/08 * 177 (10/1/07-3/26/08) / 365.) Mr. Larkin argues this adjustment is appropriate because the 2008 increases for executive officers were not known.

Q. Do you agree with this adjustment?

A. No, I do not. First, the actual executive salary information for 2008 for each officer was provided to all parties with my workpapers to this case. In addition, if Public Counsel believed this information was not provided, they had an opportunity to ask for this information through discovery. Second, due to changes in the officer team (and changes in the level of responsibilities) during 2007 and 2008[2], to determine the appropriate 2008 salary level to start with before pro forming in 2009 and 2010 increases, the Company did not simply annualize the test period (10/1/2007 to 9/30/2008) actual executive labor expenses, as Public Counsel proposes. More appropriately, the Company instead used actual salary information for each executive charged to the utility operations for the current executive team.

Q. In summary, other than the changes to the non-executive and executive labor adjustments proposed by the Company, should any other adjustments as proposed by Staff or Public Counsel be approved by this Commission?

A. No, they should not. Staff and Public Counsel provide no arguments regarding prudence of, nor do they adjust the level of, non-executive or executive labor expense charged to the Utility and included in the Company's test period expense (other than Public Counsels' failed attempt to annualize the 2008 executive salaries).

[2] The Company reflected actual salary information for the current executive team, reflecting 2007 and 2008 changes for executives and changes in responsibilities (i.e. Gary Ely's retirement as Chief Executive Officer (CEO) on 12/31/2007 and Scott Morris' promotion to CEO on 1/1/2008, are a few examples of the changes.)

In addition, the Company has historically granted wage increases each year in March using the average rate increases shown in the studies or union analysis (if not otherwise already negotiated by union contract), therefore the increases proposed by the Company are known and measureable, as shown in the table below:

Table 3 – Comparison of Market Wage Studies versus Average Actual Increases

Projected Per Studies: Historical Look - Non-Union	**Report: 2004/2005**	**2005/2006**	**2006/2007**	**2007/2008**	**2008/2009**	**(Preliminary) 2009/2010**
Used For Year:	**2005**	**2006**	**2007**	**2008**	**2009**	**2010 ***
Industry Sector: Utilities & Energy	3.50%	3.50%	3.60%	3.70%	3.50%	3.20%
Year	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Avista Authorized Average pay Increase (Exempt/Supervisors/ Managers)	3.50%	3.00%	3.50%	3.80%	2.50%	To Be Determined (Used 2.8% for Rebuttal)
* Although the Industry Sector: Utilities & Energy is typically used for the Company's upcoming year salary increases, to be conservative, the Company used the average increase for all companies participating in the survey, which was 2.8%.						

For these reasons, Staff and Public Counsels' adjustments to non-executive and executive labor, beyond those identified and proposed by the Company, should be rejected.

<u>B. Incentive Compensation</u>

Q. On pages 10 through 12 of Staff witness Ms. LaRue's, and pages 19 through 20 of Public Counsel witness Mr. Larkin's direct testimony, both propose to reduce the Company's pro forma incentive compensation adjustment from the 6-year average proposed in Avista's direct filing to the actual incentive compensation expense paid for 2008. Do you agree with this adjustment?

A. No. Although Staff or Public Counsel take no issue with the inclusion of the 2008 actual incentives included in the Company's rate case, they both object to the Company's adjustment of the actual incentives paid to reflect a 6-year average. The impact of this adjustment by both parties reduces Avista's revenue requirement for electric by $592,000 and natural gas by $164,000.

Staff argues at pages 10 and 11 of Ms. LuRue's direct testimony that the Company's use of an average is inappropriate because:

> Averages are used to determine a representative dollar amount to be used when the test period 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.

Public Counsel, on the other hand, at page 20 of Mr. Larkin's direct testimony provides the table shown below (Larkin Table 2), created from the information provided in Company workpapers, and simply argues that the Company's actual 2008 amount of incentive compensation is a more representative figure of this expense because this expense has been declining in recent years, and that due to the Country's economic situation, it is unlikely that incentive expense will increase to the Company's projected level.

Larkin 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. Do you agree with Staff's argument that the Company provided no support for the proposition that the 2008 incentives are not "normal" or Public Counsel's argument that the 2008 level of expense is "a more representative figure" of this expense?

A. No, I do not. First, in regards to Staff's argument, I did explain starting at page 30, line 8, why the Company used a 6-year average, as follows:

> Since annual Company incentive plan payouts can often vary year-to-year, the Company has chosen to propose an average of annual pay outs. Often where there are revenues or expenses that can vary significantly from year-to-year and therefore uncertain as to the appropriate level, the Commission has utilized or approved averages to properly reflect a fair and reasonable level of revenue or expense to be included in customers' rates. …Utilizing a 6-year average, using years 2003 through 2008, includes common incentive plans that are comparable from year-to-year, and is consistent with other average methods utilized by this Commission. (Emphasis added)

The Company then went on to provide other examples where the Commission has accepted averages, such as for "injuries and damages" and specific transmission revenues currently approved in Avista's rates today.

Mr. Larkin's table (Larkin-Table 2) shown above, also only serves to support my position. As can be seen from this table the annual incentive expense varies significantly from year-to-year ranging between $2.8 million and $6.2 million, with the average being $4.1 million. This table shows that the Company's incentive expenses have a high degree of variability that has occurred over the last six years. It also shows that the amount included in the test period is not "normal" as defined by Staff, nor is it "a more representative figure" of this expense just because this expense has been declining in recent years. This specifically shows that the expense level does vary significantly from year to year, making it difficult to determine on an annual basis a representative level or "normal" level of what the upcoming rate year expense may be, therefore supporting the use of an average.

Either way, the Company has provided sufficient evidence to support the use of an average to set the appropriate expense, which then helps to avoid peaks and valleys of revenues or expenses in a single year, thereby distorting the revenue requirement of that year. Due to the volatility of levels of incentive payout from year to year, incentive compensation expense is a prime candidate for using some form of an average in order to minimize the fluctuations impacting ratepayers from one year to the next, and helps to normalize incentive expenses through time, so that the expenses included in customer rates do represent a "normal" or "a more representative figure."

Q. Has a form of average for incentive compensation expense been accepted by this Commission in previous dockets?

A. Yes. As stated earlier, I previously provided in my direct testimony, examples of other types of revenues or expenses where this Commission has approved the use of averages in a number of different circumstances (i.e. injuries and damages and transmission revenues). Other examples, which have been approved by this Commission, include power plant availability and storm damages. These are all examples of revenues or expenses where the revenue or expense level do vary significantly from year to year, making it difficult to determine on an annual basis a representative level of what the upcoming rate year expense or revenue may be, thereby supporting the use of an average.

In addition, in the Company's Washington electric and natural gas rate cases (Docket Nos. UE-070804 and UG-070805) the <u>Commission Staff proposed</u> the use of an average during that proceeding for purposes of arriving at an "incentive level" as explained in Mr. Kermode's testimony:

> The Incentive payout from 1999 to 2006 varied from $0 to $5,864,642, according to the Company's response to Staff Data Request #232 -Supplemental. Avista did not pay any incentive payout during two out of the past eight years. It is my opinion that the test year's higher than normal incentive compensation should not be included in the company's results of operations used to determine rates but, rather, a levelized expense should be used instead. ….. I levelized the high and low incentive payouts by averaging the past eight years of incentive payouts.

This adjustment as proposed by Staff, resulted in a reduction to the Company's request, rather than an increase to it, as in this case. An average method needs to be determined based on the merits of the underlying costs (i.e. significant fluctuations from year-to-year), and not whether the adjustment results in a reduction or increase to the Company's results.

Q. Why did the Company choose a 6-year average rather than some other average for your calculation?

A. I used a 6-year average (2003-2008) in which the incentive plans utilized by the Company were similar, if not identical (the current incentive plan was first utilized in the year 2002). This 6-year average was also similar to other examples (i.e. injuries and damages) where a 6-year average was used by the Commission.

Q. What are your thoughts regarding Public Counsel's statement "due to the Country's economic situation, it is unlikely that incentive expense will increase to the Company's projected level"?

A. Public Counsel provided no support for its assertion, and reflects a misunderstanding of how the incentive payouts are triggered. Under the Company's incentive plan, payouts are made if the O&M cost per customer targets are met or exceeded (along with other targets such as CAIDI, SAIFI, and customer satisfaction ratings), meaning the Company's cost per customer must be less than that expected by the Company for the year before any payout can occur. If triggers are met, however, payments are made. This, in effect, serves to reduce costs ultimately charged to customers, and serves as an "incentive" for Company employees to beat those targets. Each year these targets are re-set based on the new year's goals and provide a level of incentive opportunity for employees to achieve. In other words, each year's payouts are independent of what the previous year's payouts were, and are, instead, totally dependent on cost savings achieved by the Company for that year.

Q. Staff also rejected the Company's use of the Consumer Price Index (CPI) to reflect costs in 2008 dollars. Would you respond?

A. Incentive compensation is based on employees salary levels at the time of payout, which salary levels have increased over time (at an average inflation rate that has been similar to the CPI rate). If one does not adjust the historical years' expenses so that they are based on the same level of salaries as that used in the test period, when the calculation is computed to determine the average, one is not using comparable levels of expenses in order to get to an "apples to apples" comparison.

Given the Company's arguments noted above, I believe a 6-year average adjusted for CPI is appropriate, and Staff and Public Counsel's electric revenue requirement reduction of $592,000 for electric, and $164,000 for natural gas, should be rejected.

C. Employee Pension Benefits

Q. On page 48 of Staff witness Mr. Kermode's direct testimony, Staff proposes to increase the level of 2009 pension expense. Could you please explain this?

A. Yes. The original proposed level of expense included in the Company's direct filing was estimated in late 2008. Since that time, updated information from the Company's actuarial company (Watson Wyatt) has been provided for the actual pension expense planned for 2009. Staff proposes to update the Employee Benefits adjustment for pension expense to reflect this information provided by the Company during the discovery process. The Company accepts Staff's proposed adjustment, increasing the Company's revenue requirement for electric by $551,000 and natural gas by 146,000.

D. Asset Management

Q. On pages 41 through 42 of Staff witness Mr. Kermode's direct testimony, and pages 16 through 17 of Public Counsel witness Mr. Larkin's direct testimony, both propose to eliminate the Company's pro forma Asset Management adjustment arguing this adjustment is not known and measureable, and that all offsetting factors have not been identified. Do you agree with this adjustment?

A. No, I do not. While Mr. Norwood provides testimony regarding Staff and Public Counsel's use of "known and measureable" and the use of "offsetting factors," I will discuss specifically the Asset Management adjustment.

As explained in Company witness Mr. Kinney's direct testimony, Avista's Asset Management program manages key assets of its transmission and distribution systems. Public Counsel's witness Mr. Larkin recognizes the importance of the program at page 16 of his testimony: "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 and transformer management, etc."

It is important to understand, however, that Avista has not based its adjustment on "merely budgeted costs" as suggested by Public Counsel witness Mr. Larkin at page 16. Instead it is founded on sound, historical experience, administered by employees in the Company with many years of utility experience. This knowledge and experiences is combined with the Asset Management program's comprehensive "Asset Management Model," which combines technology and information in a manner that integrates data from a myriad of sources into a comprehensive plan that maximizes the value of these capital assets. Mr. Kinney, in his rebuttal testimony, elaborates on this. The foundation for this plan involves determining the future failure rates and impacts to the environment, reliability, safety, customers, costs, labor, spare parts, time, and other consequences. The failure rate model then becomes the baseline to compare all other options, to assure the most efficient use of Company resources.

Q. Are there "offsetting factors," however, that need to be addressed?

A. As testified by Company witness Kinney, the Company has made every attempt to identify specific identifiable and quantifiable net savings to include in the Company's case. Other than the specific savings identified within Mr. Kinney's direct testimony on specific programs, which have already been reflected within the test period, after taking into consideration all elements impacting the Asset Management program, there are no specific benefits (net reductions to expense) in the short term (through 2010) that the Company can offset against the proposed expenses included in the Company's case. Rather, the benefits will be realized through avoiding even greater increases in costs well into the future. Future capital spending requirements, as well as O&M expenditures will be lower than what they might have otherwise been as we look several years past the rate period (2010).

Finally, considering that the Company's O&M costs built into this case are for the test period ending September 2008, while the actual costs that will be incurred by the Company will be based on actual expenses in 2010 (on average almost two years later), customers rates for O&M related expenses and services received are understated.

Staff and Public Counsel have not otherwise identified any particular expenses that have been imprudently incurred to date as part of this program. I believe the Asset Management expenses included in the Company's case should be accepted, and Staff and Public Counsel's electric revenue requirement reduction of $3,028,000 for electric, and $92,000 for natural gas, should be rejected.

Q. Public Counsel, through Mr. Larkin's testimony at page 16, makes the statement that "in Avista's recent rate case filed in Idaho, the Commission recognized that there are cost savings associated with these [Asset Management] programs." Would you comment?

A. The Company agreed, as part of a compromise of all issues in the Company's case, and within an all-party settlement (ultimately approved by the Idaho Commission), to incorporate some level of offsetting savings presumed to occur by the Commission Staff.

Were this Commission to ultimately decide that certain "offsetting factors" or other impacts are required before accepting this adjustment, then the Company proposes the following with regards to the <u>components</u> of the Company's Asset Management Plan:

1.) <u>Asset Management</u> – The Company has included various distribution, substation, transmission, and network Asset Management programs as fully described in Mr. Kinney's direct testimony starting at page 18. Staff and Public Counsel have criticized the Company for excluding any offsetting factors. The Company disagrees that there are near term (2010) offsets which can be accounted for at this time, but rather only future reductions of required capital spending and costs for improving safety. However, to be conservative an <u>alternate approach</u> would be to <u>reduce</u> the Washington share of expense as follows:
    a. Reduce Distribution expense $30,000 for animal guards, and apply a 20% efficiency adjustment to the remaining expense; this provides an additional reduction of $67,000;
    b. Reduce Substation expense by applying a 10% efficiency adjustment, this provides an additional reduction of $82,000;
    c. Reduce Transmission expense by applying a 20% efficiency adjustment, this provides an additional reduction of $52,000;
    d. Network expense is left at its original cost because this work is being completed for safety purposes.

The total deductions or "offsets" described above total $231,000. Removing these "offsets" reduces the amount to $886,000 of the electric revenue requirement increase requested for this component.

2.) Vegetation Management-Transmission – The Company has an obligation to spend the transmission vegetation expenses included in the Company's case, as discussed further in Company witness Mr. Kinney's rebuttal testimony, because these expenses are required by the North American Electric Reliability Corporation (NERC), and therefore should be included in their entirety. **This portion amounts to $251,000 (electric) of the revenue requirement increase requested for this component**. There are no offsetting amounts.

3.) Vegetation Management-Distribution – The Company is currently required, by Commission Order in Docket UE-050482, to spend approximately $2.8 million per year for electric and natural gas vegetation management (includes distribution and transmission expenses), report this to the Commission annually within the Company's Commission Basis Report, and maintain a one-way balancing account to track any funds under-spent (below the $2.8 million). In the event any dollars for vegetation management are not spent in any given year, that unspent balance will be accounted for and spent in subsequent year(s) or credited back to customers. The Company maintains that there is no additional benefit that can be quantified in the form of savings in this case for vegetation management activities. To provide customers continued certainty that funds collected in rates on a pro forma basis will be dedicated to Avista's vegetation management program, however, the Company would request the Commission increase the required spend level from the current $2.8 million to that requested in this case, approximately $5.7 million (includes transmission and electric and gas distribution). **This portion amounts to $1,611,000 of the revenue requirement increase requested for this component above the test period ($1,519,000 electric and $92,000 natural gas)**.

4.) Wood Pole - The Company is currently required, by Commission Order in Docket UE-070804, to track the level of spending for wood pole capital and expenses annually, as compared to the estimates provided in 2007 in Docket UE-070804, and report actual versus estimated amounts, describing any discrepancies, as part of the Company's annual Commission Basis Report. The Company, therefore, already has an obligation to spend, and report to the Commission, the level of 2010 expenses pro formed into this case of approximately $.9 million (system). This can be seen in the Company's 2008 Commission Basis Report (2010 estimated total column). This level adds $207,000 (system) in expense above the test period. **This portion amounts to $141,000 (electric) of the revenue requirement increase requested for this component**.

To summarize, as shown in Table 4 below, taking into consideration all components of the Asset Management program reduced by the estimated offsets ($231,000) described above, would provide an alternative revenue requirement adjustment of $2,797,000 electric and $92,000 for natural gas. Supporting information for these alternate adjustments are provided at Exhibit No.__ (EMA-8), page 13.

Table 4 - Summary of Asset Management Program Costs – Alternative Revenue Requirement Amount After Possible Offsets

Asset Management Programs - Revenue Requirement Amounts			
	Requested Amount	Less Available Offsets	Alternative Amount
Asset Management	$ 1,117,000	$ (231,000)	$ 886,000
Vegetation Management - Transmission	$ 251,000	$ -	$ 251,000
Vegetation Management - Distribtuion Electric	$ 1,519,000	$ -	$ 1,519,000
Wood Pole	$ 141,000	$ -	$ 141,000
	$ 3,028,000	$ (231,000)	$ 2,797,000
Vegetation Management - Distribtuion Gas	$ 92,000	$ -	$ 92,000

<u>E. Information Services</u>

Q. On pages 43 through 44 of Staff witness Mr. Kermode's direct testimony, and page 17 of Public Counsel witness Mr. Larkin's direct testimony, both propose to eliminate the Company's pro forma Information Services adjustment, arguing this adjustment is not known and measureable, with all offsetting factors identified. Do you agree with this adjustment?

A. No. At the time of the Company's filing, these Information Services (IS) costs had been determined to be expenditures that the Company would start to incur sometime during 2009, and was expected to continue at the annualized level during the rate period (2010) forward. At that time no known efficiencies could be determined for these IS Department expenses because these costs, as explained in the Company's direct filing, were for increased labor to support existing applications, and for increased non-labor dollars costs such as increased software maintenance and licensing fees, and new and replacement software and hardware for existing business applications.

Also during the discovery process, the Company provided information on each expense related item showing that the majority of these costs had either been incurred (i.e. new employees had been hired, or invoices are currently being paid for certain requested expenses) or would soon be incurred prior to the end of 2009 (i.e. contract labor expense for which the Company provided its EDS contract rate). Mr. Kensok speaks to this information within his rebuttal testimony.

Q. Is the Company still proposing the same level of IS adjustment as filed in its direct case?

A. No, the Company has revised its Washington IS expense downward, <u>reducing</u> its original revenue requirement request by $717,000 electric and $182,000 natural gas.

During the discovery process the Company, identified that one of the projects previously requested by the Company for its Work Management System has now been postponed to 2010. Company witness Mr. Kensok discusses this project and the reasons for its delay in his rebuttal testimony, and explains that this project is now planned as a capital project in 2010. Accordingly, the Company will not experience costs associated with this project that will be expensed until 2011. Therefore the Company will postpone its request for recovery of these costs until a future rate case.

In addition, Mr. Kensok discusses in his rebuttal testimony each requested expense item and explains that based on updated information, although there are minimal efficiencies, to be conservative (err on the side of over-stating benefits) the Company has included "offsets" to its request.

Therefore, the Company believes the revised revenue requirement of $1,114,000 for electric and $287,000 for natural gas should be accepted. Supporting information for these revised adjustments are provided at Exhibit No.__(EMA-8), page 9.

F. Colstrip Mercury Emissions O&M Expense

Q. The Company has proposed to revise its "Colstrip Mercury Emission O&M Expense" adjustment. Can you please explain this?

A. Yes. As explained in Company witness Mr. Storro's direct testimony, the Company and the owners of Colstrip Units #3 and #4 are required to mitigate the mercury emissions from these projects. The proforma period adjustment for this expense (related specifically to the expected annual chemical costs to be incurred) for 2010 was originally estimated to be approximately $3 million (system). However, based on updated information these chemical costs are now expected to be approximately 50% less. The Company has revised its mercury abatement expenses required for its Colstrip to approximately $1.5 million (System). This reduces the Company's original requested electric revenue requirement by $978,000. Supporting information for this revised adjustment is provided at Exhibit No.__(EMA-8), page 10.

Q. What is the position of Staff and Public Counsel regarding the Company's original adjustment?

A. Both revised the Company's original request by an earlier updated estimate provided by the Company, which reduced the mercury chemical costs by only one third or 33%, rather than 50% as now proposed by the Company.

G. Insurance Expense (General liability, Property, and Director's & Officer's Insurance)

Q. Staff and Public Counsel both included adjustments regarding the Company's Insurance Expense adjustment. Could you please explain?

A. Yes. At pages 16 through 18 of Staff witness Ms. LaRue's direct testimony and at pages 21 through 23 of Public Counsel witness Mr. Larkin's direct testimony, both adjust for updated information regarding general liability, property and Directors' and Officers' (D&O) insurance, and both propose the removal of 50% of the Company's D&O insurance, sharing D&O insurance costs between ratepayers and shareholders.

Q. Do you agree with these adjustments?

A. I agree with that portion of their adjustment updating insurance costs to actual, which the Company has also adjusted for in its revised revenue requirement (reducing the Company's revenue requirement by $68,000 electric and $19,000 for natural gas).

However, I do not agree with Staff or Public Counsel's reduction of 50% of the D&O insurance expense. As described further below, D&O insurance is a necessary and reasonable utility operating expense. The proposal to disallow half of the amount charged to Avista's ratepayers for D&O liability insurance costs is entirely arbitrary and is not based on any demonstration whatsoever of imprudence.

In addition, both parties calculated the impact of the combination of these adjustments differently. Staff combined their adjustment, comparing the Company's test period level of expense to Staff's calculated combined adjustment (updating for actual costs and removing 50% for D&O insurance). They then removed the difference, reducing the Company's revenue requirement requested by $300,000 for electric and $82,000 for natural gas.

Public Counsel, however, did two separate adjustments. First to update the Company's original insurance adjustment to the final renewal amounts as provided by the Company during the discovery process, and a second to remove 50% of the Company's test period D&O insurance level of expense, failing to recognize in the process, however, that D&O insurance had already been revised in the preceding insurance adjustment. (This in effect, overstated Public Counsel's revenue requirement adjustment for D&O insurance by $126,000 electric and $32,000 natural gas, as compared to Staff's adjustment). Public Counsel's D&O insurance adjustment, therefore, reduced the Company's revenue requirement requested by $426,000 for electric and $114,000 for natural gas.

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

A. Avista purchased combined limits of $110 million in D&O liability insurance against potential claims made in 2008 and paid insurers $1.7 million for it. Avista's self-insured retention was $2 million per claim, meaning that no insurance was available for any claims until costs exceeded $2 million. For the 2009 renewal amount, Avista allocated 97.5% of this expense to Utility operations before allocating among Avista Utilities' jurisdictions.

Q. Is this 97.5% allocation different than the allocation in past years to Utility operations?

A. Yes, it is. Historically, prior to 2008, the Company had allocated approximately 33% of its D&O insurance expense to its subsidiary operations, mainly Avista Energy. However, after the sale of Avista Energy in 2007, the Company's 2008 D&O insurance premium dropped related to the sale of Avista Energy. After giving effect to this, the remaining D&O insurance premium expense for 2008 then was not materially different than the 66% expensed to the Utility operations in 2007. The 2009 premium has since dropped even further than that of 2008, as reflected in this case. (For example, the D&O insurance expense for 2007 allocated first to the Utility and then to Washington electric operations was approximately $787,000. For the revised amount included in this case for the 2009 premium, 98% was allocated to the Utility and then to Washington electric operations of approximately $721,000. A decrease of 8%.)

Q. What is directors and officers' liability insurance?

A. D&O insurance was created as a means to address the financial cost of risks incident to serving as a director or officer of the corporation. The insurers that underwrite D&O liability coverage aggregate the risks of many companies and their respective directors and officers. D&O insurance policies typically have an annual term that responds to claims made during the period of coverage.

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

A. The Company would be unable to attract or retain capable individuals for the board of directors or to otherwise serve as officers. No qualified individual would agree to serve as a board member or officer without the benefit of such insurance. The fundamental governance and direction of the Company would not be possible without these individuals, therefore it is an essential part of the operation of a utility.

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

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

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

A. Yes, and Ms. LaRue is apparently in agreement with its necessity. Quoting Ms. LaRue' direct testimony at page 17, starting at line 3:

> (D&O) Liability Insurance financially protects corporate directors and officers when legal claims are brought against them while performing their corporate duties. D&O insurances is a necessary cost of doing business.

Ms. LaRue, however, then continues that these costs benefit both ratepayers and shareholders. Staff and Public Counsel both then recommend that D&O insurance costs should be shared at 50%, or stated another way 50% should be disallowed. Neither, however, provide an adequate explanation why this necessary cost should be partially disallowed.

Public Counsel witness Mr. Larkin simply argues at page 23, line 1, of his revised testimony that:

> 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. …… 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.

First, D & O coverage is a necessary adjunct to operating as a publicly traded company, and as a publicly traded company, it needs access to the public capital markets to finance its operations for the benefit of customers.

Second, D & O coverage provides a measure of protection to directors and officers against what could otherwise be crippling financial exposure to litigation brought on by litigation. It also reimburses the Company for its indemnity obligation to the directors and officers. No qualified director or officer would ever agree to serve without this protection. The purpose of the insurance is not to pay shareholders, but to address the financial exposure risks of directors and officers.

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

Q. What would you recommend as a sharing percentage between Customers and shareholders?

A. Based on my arguments above, I believe the revenue requirement reduction proposed by Staff and Public Counsel should be rejected. However, if the Commission were to decide that some level of sharing of director compensation is appropriate, then the Company would propose a 90% customer / 10% shareholder percentage split. This is the average split utilized by the Company for officer compensation, and may be appropriate for these types of expenditures. Based on the 2009 premium included in the Company's revised revenue requirement, this would equate to a revenue requirement reduction of $72,000 electric and $20,000 for natural gas.

H. Directors' Fees and Board Meeting Expenses

Q. Although Staff makes no adjustment relating to Board of Directors' Fees, Public Counsel proposes a 50% reduction arguing there should be a sharing between rate payers and shareholders. Could you please explain?

A. Yes. Although Public Counsel's adjustment is not based on any demonstration whatsoever of imprudence, Public Counsel proposes a 50% reduction for directors' fees. This adjustment, in effect, reduces the Company's revenue requirement for electric by $284,000 and by $78,000 for natural gas.

Q. Staff and Public Counsel both propose a 50% sharing of Board of Director's Meeting Expenses. Could you please explain this?

A. Staff and Public Counsel both proposed the same adjustment, to remove 50% of the board meeting fees included in the Company's case. Washington electric fees expensed in the Company's case was $45,000 electric and $13,000 gas. Public Counsel therefore removed 50%, or $23,000 for electric and $6,000 for natural gas. However, when Staff removed this adjustment they inadvertently removed 100% of the fees in error. Therefore, Public Counsel's reduction to the Company's revenue requirement was $24,000 for electric and $6,000 for natural gas, while Staff's reduction to the Company's revenue requirement was $47,000 for electric and $13,000 for natural gas.

Q. Calculated correctly, do you agree with either of the adjustments described above relating to Board of Directors' fees or meeting expenses?

A. No, I do not. As a publicly-traded company, these costs are <u>a necessary expense of doing business</u> to support financing of the Utility and to maintain access to capital from investors. Access to capital markets is necessary in order to allow the Utility to build and maintain the infrastructure necessary to provide safe, reliable and efficient service to its Utility customers. It is clearly necessary to incur costs to maintain this access to markets for the benefit of our customers.

Specifically regarding Director's fees, Mr. Larkin states at his revised direct testimony, at page 25, lines 12 through 16:

> 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."

This argument does not demonstrate that such expenses are unnecessary or imprudent. He has not shown that overall director compensation levels are out of line with industry averages. Avista's Directors are paid based on market value for their services as provided. Moreover, the recruitment and retention of qualified directors who provide overall guidance for the utility inures to the benefit of customers, who count on it to provide safe, reliable, and efficient service. A publicly-traded utility simply cannot operate effectively – or at all – without a board of directors. As such, it is a necessary cost of doing business. Therefore, neither of the adjustments as proposed by Staff or Public Counsel has merit and should be rejected in their entirety.

Q. What would you recommend as a sharing percentage between Customers and shareholders?

A. If the Commission were to decide that some sharing of director compensation is appropriate, than the Company would propose a 90% customer / 10% shareholder percentage split. As already explained above, this is the average split utilized by the Company for officer compensation, and could be used for these types of expenditures. This would equate to an electric revenue requirement reduction for directors' fees and director's meetings of $56,000 and $5,000, respectively. For natural gas, the revenue requirement reduction for directors' fees and director's meetings would be $16,000 and $1,000, respectively.

I. Property Taxes

Q. The Commission Staff and Public Counsel each proposed different adjustments for property taxes. Does the Company accept either of the proposed adjustments?

A. Yes, the Company accepts the adjustment proposed by Staff. When the original adjustment was prepared in late 2008, the Company's property tax returns for 2008 had not been prepared, so estimates were made for the 2009 pro forma period using 2007 data. The Company has since filed its 2008 returns so the Company has revised its estimate with the updated information. This revision reduces the revenue requirement requested by the Company for electric operations by $1,306,000 and for natural gas operations by $471,000.

Public Counsel proposed to eliminate altogether the Company's pro forma adjustment for electric service, which would have had the effect of increasing the <u>electric</u> revenue requirement, which results in leaving the expense at the test period 2008 levels. They argue that the Company violated the known and measurable principle by adjusting the expense to an estimated amount, even though it has since been trued up to actual. Public Counsel's adjustment would result in a reduction to the electric revenue requirement of $1,510,000. Interestingly enough, Public Counsel accepted the Company's proposed <u>natural gas</u> adjustment, which <u>decreased</u> the revenue requirement. Public Counsel is being inconsistent in its approach to this adjustment, i.e., they rejected the electric adjustment that resulted in an increase to the revenue requirement, but rejected the natural gas adjustment that resulted in a decrease to the revenue requirement, although both were based on the same method to determine the pro forma level.

<u>J. Customer Deposits</u>

Q. The Commission Staff, at page's 17 through 19 of Mr. Kermode's direct testimony, and Public Counsel, at pages 28 through 29 of Mr. Larkin's direct testimony, each proposed adjustments related to customer deposits. Can you please explain these adjustments?

A. Yes. Both Staff and Public Counsel propose to reduce the Company's rate base for the average-of-monthly average balance of customer deposits held by the Company in the test year, amounting to $2,473,000 of electric and of $1,353,000 natural gas rate base, and to include as interest expense an amount for interest paid to customers for deposits held by the Company. Both propose these adjustments, arguing that customer deposits provide a form of financing (supplied by customers) and that by including the interest paid to customers as an operating expense, the Company is made whole. Staff witness Mr. Kermode in his direct testimony starting at page 17, line 22, goes so far as to say that "The effect of the rate base reduction is to recognize that a portion of rate base is funded by the customer deposits, which cost less than the Company's overall cost of capital."

Q. Regarding Staff and Public Counsel' adjustment to include interest paid to customers as an operating expense, did they calculate this portion of the adjustment the same?

A. No. For the operating expense portion of the adjustment related to interest paid to customers, Public Counsel included the actual Washington electric or natural gas interest expense paid to customers during the test period. Staff, however, computed an estimated interest to be paid to customers in 2009 for electric and natural gas by using the test period customer deposits collected from customers multiplied by the 2009 customer deposit interest rate set yearly by the Commission. This interest rate for 2009 is 0.42%.

Q. Does the Company agree with these argument?

A. No, the Company does not. It agrees with neither the adjustment itself nor the way in which they have computed the adjustment. Both Staff and Public Counsel imply that customer deposits, which accrue interest at a short-term interest rate adjusted annually by the Washington Commission, is actually a form of financing for the Company's utility operations and should be used as a rate base reduction, effectively applying the full authorized rate of return against the rate base adjustment made for customer deposits. Generally speaking, the Company finances its utility operations through various long-term financings, both debt and equity. The suggestion that customer deposit balances are yet another financing vehicle is unsupported.

First of all, for a little perspective, Washington's electric rate base in this filing is over $1 billion. The allocated amount of Customer Deposits, as proposed by Mr. Dittmer, is only $2.5 million. As seen from this perspective, it hardly represents a rate base financing vehicle.

More to the point, Customer Deposits are a means by which the Company manages the costs associated with uncollectible accounts receivable. At best it is a short-term balance that should only receive a short-term interest rate, not a full rate of return that combines the cost of primarily long-term debt and common equity – which is implied by Staff and Public Counsel's proposal. This is recognized by the very interest rates that are authorized by the Commission for application to Customer Deposits (0.42%).

It is a matter of established Company policy, through Commission approved rules, that Customer Deposits are <u>automatically returned</u> to the customer after 12 months of solid payment history. Below is the language from the Company's filed Rules Tariff 70:

> B. Deposits
>
> (1) <u>Deposit Requirements</u>. The Company may require a deposit under any of the following circumstances: provided, that during the winter period no deposit may be required of a customer who, in accordance with WAC 480-100-072 (4)(a), has notified the Company of inability to pay a security deposit and has satisfied the remaining requirements to qualify for a payment plan.
>
> (a) Where the applicant has failed to establish a satisfactory credit history or otherwise demonstrate that it is a satisfactory credit risk, in the manner prescribed above;
>
> (b) When, within the last 12 months an applicant's or customer's similar class of service has been disconnected for failure to pay amounts owing, to any gas or electric utility;
>
> (c) There is an unpaid, overdue balance owing to any gas or electric utility for similar class of service;

(d) Three or more delinquency notices have been served upon the applicant or customer by any electric or gas company during the most recent 12 months;

(e) Initiation or continuation of service to a residence where a prior customer still resides and where any balance for such service to that prior customer is past due or owing to the Company.

(2) Amount of Deposit. In instance where the Company may require a deposit, the deposit shall not exceed two-twelfths of estimated annual billings.

(3) Transfer of Deposit. Where a customer of whom a deposit is required transfers service to a new location within the Company's service area, the deposit, plus accrued interest less any outstanding balance from the current account, shall be transferable and applicable to the new service location.

12. ESTABLISHMENT OF CREDIT/DEPOSITS: - continued

(4) Interest on Deposits. Utilities that collect customer deposits must pay interest on those deposits calculated:

(a) For each calendar year, at the rate for the one-year Treasury Constant Maturity calculated by the U.S. Treasury, as published in the Federal Reserve's Statistical Release H. 15 on January 15 of that year. If January 15 falls on a nonbusiness day, the utility will use the rate posted on the next following business day; and

(b) From the date of deposit to the date of refund or when applied directly to the customer's account.

It should be evident from the language of the above quoted rule that Customer Deposits are simply a tool for the management of accounts receivable write-offs – not a financing vehicle. In addition, they are very short-term in nature, and the Company has no control over the timing and amount of deposits that will be made. What is appropriate, is that Customers currently receive a short-term interest rate and <u>that amount is credited to the customers who have made the deposit</u>, consistent with the purpose of the deposit rules.

<u>K. Injuries and Damages</u>

Q. Public Counsel, through witness Mr. Larkin, at page 29, has proposed an adjustment to reduce rate base for "injuries and damages." Do you agree with Public Counsel's reasoning for this adjustment?

A. No, I do not. Public Counsel proposes to reduce the Company's rate base for what it believed was the Washington electric and natural gas injuries and damages reserve account balances included on the Company's balance sheet, adjusted for deferred federal income taxes (DFIT).

First, I will explain Avista's accounting method for financial statement purposes. Avista estimates future potential losses and records an expense with a corresponding amount credited to the injuries and damages reserve account. If Avista settles a claim and a payment is made, the net effect reduces the net reserve balance. As explained in Avista's response to Public Counsel Data Request No. 43, Avista does not recover the estimated costs recorded when the reserve is established for regulatory purposes. Rather, the Company reverses out all estimates accrued during the year and instead uses only actual claims payments made (using a 6-year average). By doing so, only actual claims that have been paid are included in the utilities costs of service. Therefore, <u>the Company has not otherwise collected from ratepayers the reserve</u> that has been recorded for financial statement purposes only.

Q. While the Company does not accept the reasoning for this adjustment, do you otherwise agree with the Public Counsel's calculation of the adjustment?

A. No, I do not. Public Counsel's adjustment has two errors. <u>First</u>, Public Counsel used a trial balance that was provided in response to a data request by the Company to determine the reserve amount (FERC Account 228200 was used.) However, Public Counsel simply failed to include the reserve <u>contra-account</u> that the Company uses to track all payments made for claims (FERC Account No. 228210.). By not including this account, Public Counsel overstated the <u>electric</u> reserve by $7.4 million ($7.6 million used by Public Counsel, versus the actual net reserve amount of only $165,000). In addition, Public Counsel overstated the natural gas reserve by $1.1 million ($1.2 million used by Public Counsel versus the actual net reserve amount of $87,000). Second, Public Counsel used the system reserve and allocated 100% to Washington, when approximately 35% of this reserve should have been allocated to the Company's Idaho jurisdiction. To be clear, if one were to accept Public Counsel's proposal to reduce the Company's gross rate base by the injuries and damages net reserve, correctly accounting for this amount would have required a reduction to gross rate base of approximately $165,000 electric and $87,000 natural gas, not the $7.6 million electric and $1.2 million gross rate base adjustment removed by Public Counsel. Supporting information for the average reserve balances for Washington electric and natural gas are provided at Exhibit No.__(EMA-8), page 14 and 15.

After factoring an adjustment made by Public Counsel for DFIT, the net rate base reduction proposed by Public Counsel was overstated by $4.79 million for electric service and $703,000 for natural gas service. The revenue requirement impact of these adjustments is a reduction of $652,000 for electric and $104,000 for natural gas. The rate base impact of these adjustments is a reduction of $4,597,000 for electric and $790,000 for natural gas. For the reasons discussed above, these adjustments as proposed by Public Counsel should be rejected.

L. Dues

Q. Public Counsel has proposed an adjustment to reduce natural gas dues expenses. Do you accept this adjustment?

A. Yes. Avista accepts Public Counsel's adjustment to reduce the amount of dues allocated to the utility for dues paid to the American Gas Association, based on information that was not available to Avista at the time it filed its case. This adjustment reduces the natural gas revenue requirement by $22,000. In addition, the Company is proposing to correct an error that was found during the discovery process. The Company determined that dues paid to the Edison Electric Institute had been allocated to Washington gas service in error. This proposed adjustment reduces the natural gas revenue requirement by $44,000 (total impact of both adjustments for natural gas is $66,000) and increases the electric revenue requirement by $42,000. Supporting information for these revised adjustments are provided at Exhibit No.__(EMA-8), page 11.

M. Capital Additions

Q. The Commission Staff and Public Counsel rejected the Company's pro forma capital additions adjustment and each proposed different adjustments. Does the Company accept either of the proposed adjustments?

A. No, we do not. As explained by Company witnesses Mr. DeFelice and Mr. Norwood, the Company's original proposed regulatory treatment of capital investments in utility plant is the best method to match revenues, expenses and rate base for ratemaking purposes. Mr. DeFelice specifically addresses the adjustments related to capital expenditures proposed by Staff and by Public Counsel and why their methods do not fairly state costs and rate base. The adjustments as proposed by Staff, which reduced the Company's electric revenue requirement by $6,455,000 and rate base by $14,515,000 and the Company's natural gas revenue requirement by $1,442,000 and rate base by $7,328,000, should be rejected. Likewise, the revenue requirement and rate base adjustments as proposed by Public Counsel, which reduced the Company's electric revenue requirement by $10,807,000 and rate base by $41,340,000 and the Company's natural gas revenue requirement by $1,448,000 and rate base by $7,328,000, should also be rejected.

Q. Mr. DeFelice develops an alternative method to develop pro forma rate base. Is the Company proposing a change to its proposed pro forma rate base using this alternative method?

A. No. The Company's original filing includes the proper calculation of pro forma rate base for rate making purposes, and as explained by Mr. Norwood actually understates the capital investment that will be used to serve customers during the rate year. The alternative method explained by Mr. DeFelice simply shows that a reasonable application of the method employed by Commission Staff would yield a similar result to that proposed by the Company

N. Production Property Adjustment

Q. Both Staff and Public Counsel included adjustments for the Production Property adjustment which impacted both the Company's revenue requirement and rate base for the electric operations. Do you agree with either of these adjustments?

A. No, the Company does not. The Production Property Adjustment is impacted by all pro forma production or transmission revenue, expense and rate base adjustments ultimately included in each of the parties individual revenue requirements. It acts as an offsetting adjustment (opposite of the direct production or transmission related adjustments) and therefore will be derived based on the Commission's ultimate decision on those pro forma adjustments. However, there are also some underlying calculations used that vary between the parties, with which the Company does not agree with. Company witness Ms. Knox discusses this adjustment and the

Company's revised Production Property Adjustment, which increases the Company's electric revenue requirement by $8,003,000, and increases electric net rate base by $6,574,000.

O. Spokane River Relicensing

Q. Both Staff and Public Counsel included in their uncontested adjustments the Company's original proposed Spokane River Relicensing adjustment. Why is the Company then proposing an adjustment at this time?

A. The original adjustment was prepared in late 2008 using an estimated cost of securing the license for its Spokane River hydro projects and an estimated 45 year life. In June 2009, the Company completed its relicensing efforts and received its Federal Energy Regulatory Commission (FERC) 50-year license. No parties to the case opposed the Company's Pro Forma Spokane River Relicensing adjustment included in the Company's direct filing. However, the Company proposes to update the adjustment for actual information. The changes proposed by the Company include: 1) Update (i.e., reduce) the final system cost of securing the license from the estimated cost of $30,011,315 to $28,729,338, which will reduce the annual amortization expense and rate base; 2) Extend the amortization period from 45 years to 50 years, which will also reduce the annual amortization expense; and 3) Recognize approximately $363,000 of actual annual labor costs that had been capitalized, which will be recorded as PM&E costs in the future, since the license was received. The net impact of this proposed change increases the revenue requirement by $194,000 and reduces rate base by $795,000. Supporting information for this revised adjustment is provided at Exhibit No.__(EMA-8), page 12.

P. CDA Tribe Settlement

Q. Staff accepted the Company's pro forma adjustment for the Couer d' Alene Tribe settlement, while Public Counsel removed the costs and rate bases related to past conduct. Do you agree with Public Counsel's adjustment?

A. No, I do not. Public Counsel proposed a reduction to the electric revenue requirement of $2,809,000 and a reduction to rate base of $16,819,000, to reflect the matter on appeal from the Commission's last rate order as it relates to the CDA Tribe Settlement.

Public Counsel, through Mr. Larkin's testimony at pages 17-18, recognizes that the Commission's order in Avista's previous rate case addressed this issue and granted Avista's request to defer these costs for recovery in this case. Public Counsel has appealed this Commission's prior Order in Docket No. UE-080416, as it relates to the settlement of prior trespass claims, in Thurston County Superior Court. That appeal, in and of itself, however, does not impact the effectiveness of that prior Order, which authorized future recovery of the deferred amounts, beginning with this rate case. Accordingly Public Counsel's adjustment should be rejected.

Q. Lancaster Prudence

Q. Public Counsel witness Mr. Woodruff is challenging the prudence of the Lancaster agreement and has proposed to remove $12.348 million of revenue requirement from the Company's original request. Do you agree with this adjustment?

A. No, I do not. Public Counsel, through witness Mr. Woodruff, proposes to remove all net expenses associated with the Lancaster project included in the Company's case. Although

Mr. Woodruff has since revised his original filed testimony, his initially filed testimony included an adjustment to the Company's revenue requirement for the entire system amount of over $18 million because he failed to exclude that portion assigned to the Company's Idaho jurisdiction. Although he has subsequently revised his testimony to correct for this error, the Company does not agree with his adjustment removing the Lancaster net expenses. Company witnesses Mr. Kalich and Mr. Lafferty discuss the Company's position in detail and why Public Counsel's proposed adjustment should be rejected.

<u>R. Restate Debt</u>

Q. With regards to the restate debt adjustment, did the parties agree to the calculation of this adjustment?

A. Yes. Both Staff and Public Counsel do not oppose the restate debt adjustment calculation as proposed by the Company; however, the final adjustment amount will change based on any final adjustments made to rate base by the Commission in its Order. In addition, this adjustment has also changed from that filed in the Company's direct case due to the revised weighted average cost of total debt agreed to by the parties in the Partial Settlement Stipulation of 3.51%.

<u>S. Conversion Factor</u>

Q. Has the Company proposed a revision to the electric and natural gas conversion factors used in this case?

A. Yes. During the discovery process the Company determined it had inadvertently failed to update its electric and natural gas conversion factors used in its direct filed case. The

Company has corrected for this in its revised revenue requirement calculations using .62195 for electric and .62209 for natural gas. These corrections were noted, and used by Public Counsel within their proposed revenue requirement calculation proposals. The net revenue requirement impact of these corrections on the Company's revised revenue requirement is a reduction of $3,000 electric and less than $1,000 natural gas.

Q. Does this conclude your rebuttal testimony?

A. Yes.