

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

REVISED 9/15/09 (Table 1 on Page 3)

I. INTRODUCTION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21

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 forma 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 Settlement¹, 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,

1 primarily the Staff of the Washington Utilities and Transportation Commission (Staff) or by the
 2 Public Counsel Section of the Washington State Attorney General's Office (Public Counsel) in
 3 their direct testimony.

4 A table of contents for my testimony is as follows:

5 **Table of Contents:**

| | <u>Description</u> | <u>Page</u> |
|----|--|--------------------|
| 6 | I. Introduction | 1 |
| 7 | II. Revised Revenue Requirement and Rate Base | 2 |
| 8 | III. Rebuttal of Staff and Public Counsel Proposed Adjustments | 6 |
| 9 | and Avista Proposed Adjustments (Electric and Gas) | |
| 10 | A. Non-Executive and Executive Labor | 6 |
| 11 | B. Incentive Compensation | 12 |
| 12 | C. Employee Pension Benefits | 18 |
| 13 | D. Asset Management | 19 |
| 14 | E. Information Services | 23 |
| 15 | F. Colstrip Mercury Emissions O&M Expense | 25 |
| 16 | G. Insurance Expense (General Liability, Property and | 26 |
| 17 | Director's & Officer's Insurance) | |
| 18 | H. Director's Fees and Board Meeting Expenses | 31 |
| 19 | I. Property Taxes | 33 |
| 20 | J. Customer Deposits | 34 |
| 21 | K. Injuries & Damages | 37 |
| 22 | L. Dues | 39 |
| 23 | M. Capital Additions | 40 |
| 24 | N. Production Property | 41 |
| 25 | O. Spokane River Relicensing | 42 |
| 26 | P. CDA Tribe Settlement | 43 |
| 27 | Q. Lancaster Prudence | 43 |
| 28 | R. Restate Debt | 44 |
| 29 | S. Conversion Factor | 44 |
| 30 | | |
| 31 | | |
| 32 | | |

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.

1 **II. REVISED REVENUE REQUIREMENT AND RATE BASE**

2

3 **Q. Have you prepared a summary table that shows the Company's revised**

4 **revenue requirement and rate base for its electric and natural gas services after reflecting**

5 **the adjustments agreed to within the Partial Settlement as well as the Company's position**

6 **on the remaining issues?**

7 A. Yes, I have. Table 1 below provides a summary of the Company's revised electric

8 revenue requirement and rate base proposed by the Company after taking into consideration the

9 adjustments agreed to within the Partial Settlement (assuming it is accepted by the Commission),

10 and a few other adjustments identified through the discovery process and the Company's position

11 on the remaining issues.

12

13 **Table 1 – Revised Revenue Requirement and Rate Base – Electric**

14

15

16

17

18

19

20

21

22

23

24

| 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 | 5,779 |
| Avista Rebuttal (revised) revenue requirement/rate base: | \$ 37,475 | \$1,012,855 |
| (1) See Partial Settlement Stipulation filed on September 4, 2009. | | |
| (2) See Exhibit No. ___(EMA-5) page 1 for detail listing of adjustments. | | |

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

3 **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. | | |

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

15 A. Yes. Within the Partial Settlement the parties agreed to a revised cost of capital
16 including a 10.2% return on equity, a 46.5% common equity layer, an average cost of total debt
17 of 6.57%, and a revised rate of return of 8.25%. This revised cost of capital reduced the
18 Company's electric requested revenue requirement by \$6,967,000 and its natural gas requested
19 revenue requirement by \$1,233,000. The Partial Settlement also established the power supply-
20 related adjustments agreed to by the parties, with the exception of Lancaster prudence, which is
21 still contested by Public Counsel. These adjustments reduced the electric revenue requirement by
22 approximately \$27,537,000. In addition, the parties agreed to eliminate the generation operation

1 and maintenance (O&M) pro forma adjustment as originally proposed by the Company in its
2 direct filing, reducing the Company's electric request by an additional \$2,372,000. It is
3 important to note however, that, as discussed briefly below in my testimony (and in greater detail
4 by Company witness Ms. Knox), the production property adjustment as proposed by the
5 Company is an offsetting adjustment – that will increase the Company's revenue requirement
6 related to agreed-upon power supply adjustments and the generation O&M adjustment noted
7 above.

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

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

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

19
20
21
22
23
24
25

1 **III. REBUTTAL OF STAFF AND PUBLIC COUNSEL PROPOSED ADJUSTMENTS**
2 **AND AVISTA PROPOSED REVISED ADJUSTMENTS**
3

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

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

10
11 **A. Non-Executive and Executive Labor**

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

14 A. In the Company's direct case the Company: (i) annualized the 2008 salary
15 increases which went into effect March 1, 2008 for administrative and union employees; (ii)
16 adjusted the executive employee salaries to actual in 2008 for the current executive team; (iii) pro
17 formed the average salary increases expected for 2009, at the time of filing, of 3.8% for
18 administrative and executive employees, and 4% for union employees; and (iv) pro formed in the
19 salary increases expected for March 1, 2010 of 3.8% for administrative, union and executive
20 employees. The Company now proposes to adjust the Company's non-executive and
21 executive labor adjustments for the 2009 actual increases paid to employees on March 1, 2009 of
22 2.5% for administrative employees and 0% for executives. This reduces the Company's electric
23 revenue requirement requested by \$219,000 for non-executive and \$35,000 for executive labor,

1 and the natural gas revenue requirement requested by \$59,000 for non-executive and \$13,000 for
2 executive labor.

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

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

1 available at this time, prior to any 2010 wage increase for Avista union employees, Avista
2 employees will be under the average wage by approximately 6%. Therefore, the Company
3 believes the increase included for the Company's revised union 2010 labor is conservative, and
4 the minimum increase anticipated.

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

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

15 A. Certainly. The net impact to the Company's revenue requirement for adjusting for
16 actual 2009 increases, and revising expected increases for 2010 due to more current information,
17 reduces the electric revenue requirement by approximately \$628,000 for administrative and union
18 employees and \$50,000 for executive employees. For natural gas, the net impact is a revenue
19 requirement reduction of approximately \$167,000 for administrative and union employees and
20 \$17,000 for executive employees.

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

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

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

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

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

20 A. No, I do not. First, as stated above, for administrative and executive labor, during
21 2009 the Company has continued to evaluate through market studies and union analysis of what
22 the latest 2010 salary level increases are expected to be for the upcoming year. These market

1 studies, as of September 2009, are showing expected increases to be between 2.8% and 3.2%. To
2 be conservative, the company is expecting this increase to be no less than 2.8%.

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

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

9 I have made this change because I am not objecting to the increase to 2009
10 levels [rate period increase]. Ordinarily I would object to Avista's
11 increase to 2009 levels on the grounds that it is beyond the test year.
12 Because the rates resulting from this proceeding will not be in effect until
13 2009 [January 1, 2009], I have not challenged the increase of wages to a
14 2009 level. However, that estimated increase should be conservative.
15 (Emphasis added) (Exhibit No.__(MJM-4T), page 19, lines 10-14.)
16

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

19 A. Public Counsel also reduced executive labor expense, reducing the Company's
20 revenue requirement by an additional \$137,000 for electric and \$35,000 for natural gas relating to
21 the 2008 level of executive salaries included (before adjusting for 2009 and 2010 increases).
22 With the correction for the 2009 actual salary increase of 0% for 2009, and their removal of 2010
23 salary increases, Public Counsel attempts to annualize the salary increases included in the
24 Company's 2008 test period for executive employees. However, to annualize the 2008 salary
25 levels, Public Counsel argues that the percentage used to annualize the 2008 executive employee
26 salaries should be no higher than that used to annualize the administrative salaries, which was

1 approximately 1.519% (3.67% effective 03/26/08 * 177 (10/1/07-3/26/08) / 365.) Mr. Larkin
2 argues this adjustment is appropriate because the 2008 increases for executive officers were not
3 known.

4 **Q. Do you agree with this adjustment?**

5 A. No, I do not. First, the actual executive salary information for 2008 for each
6 officer was provided to all parties with my workpapers to this case. In addition, if Public
7 Counsel believed this information was not provided, they had an opportunity to ask for this
8 information through discovery. Second, due to changes in the officer team (and changes in the
9 level of responsibilities) during 2007 and 2008², to determine the appropriate 2008 salary level to
10 start with before pro forming in 2009 and 2010 increases, the Company did not simply annualize
11 the test period (10/1/2007 to 9/30/2008) actual executive labor expenses, as Public Counsel
12 proposes. More appropriately, the Company instead used actual salary information for each
13 executive charged to the utility operations for the current executive team.

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

17 A. No, they should not. Staff and Public Counsel provide no arguments regarding
18 prudence of, nor do they adjust the level of, non-executive or executive labor expense charged to
19 the Utility and included in the Company's test period expense (other than Public Counsels' failed
20 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.)

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

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

| Projected Per Studies: Historical Look - Non-Union | Report: | | | | | (Preliminary) 2009/2010 |
|---|-------------|-------------|-------------|-------------|-------------|---|
| | 2004/2005 | 2005/2006 | 2006/2007 | 2007/2008 | 2008/2009 | |
| 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%. | | | | | | |

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

16 **B. Incentive Compensation**

17 **Q. On pages 10 through 12 of Staff witness Ms. LaRue's, and pages 19 through**
 18 **20 of Public Counsel witness Mr. Larkin's direct testimony, both propose to reduce the**
 19 **Company's pro forma incentive compensation adjustment from the 6-year average**
 20 **proposed in Avista's direct filing to the actual incentive compensation expense paid for**
 21 **2008. Do you agree with this adjustment?**

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

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

8
9 Averages are used to determine a representative dollar amount to be used when
10 the test period is not “normal.” The Company has provided no support for the
11 proposition that the 2008 incentives are not “normal,” or why the prior six years
12 are more representative than the test year.
13

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

1 **Larkin Table 2 - Total O&M Incentive Expense**

2

| | |
|--------------------|--------------|
| 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 |

3

4

5

6

7

8

9

10

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

14 A. No, I do not. First, in regards to Staff's argument, I did explain starting at page
 15 30, line 8, why the Company used a 6-year average, as follows:

16 Since annual Company incentive plan payouts can often vary year-to-year, the
 17 Company has chosen to propose an average of annual pay outs. Often where there
 18 are revenues or expenses that can vary significantly from year-to-year and
 19 therefore uncertain as to the appropriate level, the Commission has utilized or
 20 approved averages to properly reflect a fair and reasonable level of revenue or
 21 expense to be included in customers' rates. ...Utilizing a 6-year average, using
 22 years 2003 through 2008, includes common incentive plans that are comparable
 23 from year-to-year, and is consistent with other average methods utilized by this
 24 Commission. (Emphasis added)
 25

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

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

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

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

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

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

15 The Incentive payout from 1999 to 2006 varied from \$0 to \$5,864,642, according
16 to the Company's response to Staff Data Request #232 -Supplemental. Avista did
17 not pay any incentive payout during two out of the past eight years. It is my
18 opinion that the test year's higher than normal incentive compensation should not
19 be included in the company's results of operations used to determine rates but,
20 rather, a levelized expense should be used instead. I levelized the high and
21 low incentive payouts by averaging the past eight years of incentive payouts.
22

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

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

3 A. I used a 6-year average (2003-2008) in which the incentive plans utilized by the
4 Company were similar, if not identical (the current incentive plan was first utilized in the year
5 2002). This 6-year average was also similar to other examples (i.e. injuries and damages) where
6 a 6-year average was used by the Commission.

7 **Q. What are your thoughts regarding Public Counsel’s statement “due to the**
8 **Country’s economic situation, it is unlikely that incentive expense will increase to the**
9 **Company’s projected level”?**

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

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

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

7 Given the Company's arguments noted above, I believe a 6-year average adjusted for CPI
8 is appropriate, and Staff and Public Counsel's electric revenue requirement reduction of
9 \$592,000 for electric, and \$164,000 for natural gas, should be rejected.

10
11 **C. Employee Pension Benefits**

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

14 A. Yes. The original proposed level of expense included in the Company's direct
15 filing was estimated in late 2008. Since that time, updated information from the Company's
16 actuarial company (Watson Wyatt) has been provided for the actual pension expense planned for
17 2009. Staff proposes to update the Employee Benefits adjustment for pension expense to reflect
18 this information provided by the Company during the discovery process. The Company accepts
19 Staff's proposed adjustment, increasing the Company's revenue requirement for electric by
20 \$551,000 and natural gas by 146,000.

1 **D. Asset Management**

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

7 A. No, I do not. While Mr. Norwood provides testimony regarding Staff and Public
8 Counsel’s use of “known and measureable” and the use of “offsetting factors,” I will discuss
9 specifically the Asset Management adjustment.

10 As explained in Company witness Mr. Kinney’s direct testimony, Avista’s Asset
11 Management program manages key assets of its transmission and distribution systems. Public
12 Counsel’s witness Mr. Larkin recognizes the importance of the program at page 16 of his
13 testimony: “Avista’s Asset Management Program attempts to manage assets in order to provide
14 the best value to customers by minimizing life cycle costs and maximizing system reliability. The
15 Asset Management program is relatively new but consists of well established programs such as
16 vegetation management, wood pole inspections and transformer management, etc.”

17 It is important to understand, however, that Avista has not based its adjustment on
18 “merely budgeted costs” as suggested by Public Counsel witness Mr. Larkin at page 16. Instead
19 it is founded on sound, historical experience, administered by employees in the Company with
20 many years of utility experience. This knowledge and experiences is combined with the Asset
21 Management program’s comprehensive “Asset Management Model,” which combines
22 technology and information in a manner that integrates data from a myriad of sources into a

1 comprehensive plan that maximizes the value of these capital assets. Mr. Kinney, in his rebuttal
2 testimony, elaborates on this. The foundation for this plan involves determining the future
3 failure rates and impacts to the environment, reliability, safety, customers, costs, labor, spare
4 parts, time, and other consequences. The failure rate model then becomes the baseline to
5 compare all other options, to assure the most efficient use of Company resources.

6 **Q. Are there “offsetting factors,” however, that need to be addressed?**

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

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

21 Staff and Public Counsel have not otherwise identified any particular expenses that have
22 been imprudently incurred to date as part of this program. I believe the Asset Management

1 expenses included in the Company's case should be accepted, and Staff and Public Counsel's
2 electric revenue requirement reduction of \$3,028,000 for electric, and \$92,000 for natural gas,
3 should be rejected.

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

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

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

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

1 **The total deductions or “offsets” described above total \$231,000. Removing these**
2 **“offsets” reduces the amount to \$886,000 of the electric revenue requirement**
3 **increase requested for this component.**
4

5 2.) Vegetation Management-Transmission – The Company has an obligation to spend the
6 transmission vegetation expenses included in the Company’s case, as discussed further in
7 Company witness Mr. Kinney’s rebuttal testimony, because these expenses are required
8 by the North American Electric Reliability Corporation (NERC), and therefore should be
9 included in their entirety. **This portion amounts to \$251,000 (electric) of the revenue**
10 **requirement increase requested for this component.** There are no offsetting amounts.
11

12 3.) Vegetation Management-Distribution – The Company is currently required, by
13 Commission Order in Docket UE-050482, to spend approximately \$2.8 million per year
14 for electric and natural gas vegetation management (includes distribution and
15 transmission expenses), report this to the Commission annually within the Company’s
16 Commission Basis Report, and maintain a one-way balancing account to track any funds
17 under-spent (below the \$2.8 million). In the event any dollars for vegetation management
18 are not spent in any given year, that unspent balance will be accounted for and spent in
19 subsequent year(s) or credited back to customers. The Company maintains that there is
20 no additional benefit that can be quantified in the form of savings in this case for
21 vegetation management activities. To provide customers continued certainty that funds
22 collected in rates on a pro forma basis will be dedicated to Avista’s vegetation
23 management program, however, the Company would request the Commission increase
24 the required spend level from the current \$2.8 million to that requested in this case,
25 approximately \$5.7 million (includes transmission and electric and gas distribution).
26 **This portion amounts to \$1,611,000 of the revenue requirement increase requested**
27 **for this component above the test period (\$1,519,000 electric and \$92,000 natural**
28 **gas).**
29

30 4.) Wood Pole - The Company is currently required, by Commission Order in Docket UE-
31 070804, to track the level of spending for wood pole capital and expenses annually, as
32 compared to the estimates provided in 2007 in Docket UE-070804, and report actual
33 versus estimated amounts, describing any discrepancies, as part of the Company’s annual
34 Commission Basis Report. The Company, therefore, already has an obligation to spend,
35 and report to the Commission, the level of 2010 expenses pro formed into this case of
36 approximately \$.9 million (system). This can be seen in the Company’s 2008
37 Commission Basis Report (2010 estimated total column). This level adds \$207,000
38 (system) in expense above the test period. **This portion amounts to \$141,000 (electric)**
39 **of the revenue requirement increase requested for this component.**
40

41 To summarize, as shown in Table 4 below, taking into consideration all components of
42 the Asset Management program reduced by the estimated offsets (\$231,000) described above,

1 would provide an alternative revenue requirement adjustment of \$2,797,000 electric and \$92,000
 2 for natural gas. Supporting information for these alternate adjustments are provided at Exhibit
 3 No.__(EMA-8), page 13.

4 **Table 4 - Summary of Asset Management Program Costs – Alternative Revenue**
 5 **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 - Distribuion Electric | \$ 1,519,000 | \$ - | \$ 1,519,000 |
| Wood Pole | \$ 141,000 | \$ - | \$ 141,000 |
| | \$ 3,028,000 | \$ (231,000) | \$ 2,797,000 |
| Vegetation Management - Distribuion Gas | \$ 92,000 | \$ - | \$ 92,000 |

12
 13 **E. Information Services**

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

19 **A. No.** At the time of the Company's filing, these Information Services (IS) costs had
 20 been determined to be expenditures that the Company would start to incur sometime during
 21 2009, and was expected to continue at the annualized level during the rate period (2010) forward.
 22 At that time no known efficiencies could be determined for these IS Department expenses
 23 because these costs, as explained in the Company's direct filing, were for increased labor to

1 support existing applications, and for increased non-labor dollars costs such as increased
2 software maintenance and licensing fees, and new and replacement software and hardware for
3 existing business applications.

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

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

12 A. No, the Company has revised its Washington IS expense downward, reducing its
13 original revenue requirement request by \$717,000 electric and \$182,000 natural gas.

14 During the discovery process the Company, identified that one of the projects previously
15 requested by the Company for its Work Management System has now been postponed to 2010.
16 Company witness Mr. Kensok discusses this project and the reasons for its delay in his rebuttal
17 testimony, and explains that this project is now planned as a capital project in 2010. Accordingly,
18 the Company will not experience costs associated with this project that will be expensed until
19 2011. Therefore the Company will postpone its request for recovery of these costs until a future
20 rate case.

21 In addition, Mr. Kensok discusses in his rebuttal testimony each requested expense item
22 and explains that based on updated information, although there are minimal efficiencies, to be

1 conservative (err on the side of over-stating benefits) the Company has included “offsets” to its
2 request.

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

6

7 **F. Colstrip Mercury Emissions O&M Expense**

8 **Q. The Company has proposed to revise its “Colstrip Mercury Emission O&M**
9 **Expense” adjustment. Can you please explain this?**

10 A. Yes. As explained in Company witness Mr. Storro’s direct testimony, the
11 Company and the owners of Colstrip Units #3 and #4 are required to mitigate the mercury
12 emissions from these projects. The proforma period adjustment for this expense (related
13 specifically to the expected annual chemical costs to be incurred) for 2010 was originally
14 estimated to be approximately \$3 million (system). However, based on updated information
15 these chemical costs are now expected to be approximately 50% less. The Company has revised
16 its mercury abatement expenses required for its Colstrip to approximately \$1.5 million (System).
17 This reduces the Company’s original requested electric revenue requirement by \$978,000.
18 Supporting information for this revised adjustment is provided at Exhibit No.__(EMA-8), page
19 10.

20 **Q. What is the position of Staff and Public Counsel regarding the Company’s**
21 **original adjustment?**

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

4

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

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

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

13 **Q. Do you agree with these adjustments?**

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

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

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

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

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

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

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

1 A. Yes, it is. Historically, prior to 2008, the Company had allocated approximately
2 33% of its D&O insurance expense to its subsidiary operations, mainly Avista Energy. However,
3 after the sale of Avista Energy in 2007, the Company's 2008 D&O insurance premium dropped
4 related to the sale of Avista Energy. After giving effect to this, the remaining D&O insurance
5 premium expense for 2008 then was not materially different than the 66% expensed to the Utility
6 operations in 2007. The 2009 premium has since dropped even further than that of 2008, as
7 reflected in this case. (For example, the D&O insurance expense for 2007 allocated first to the
8 Utility and then to Washington electric operations was approximately \$787,000. For the revised
9 amount included in this case for the 2009 premium, 98% was allocated to the Utility and then to
10 Washington electric operations of approximately \$721,000. A decrease of 8%.)

11 **Q. What is directors and officers' liability insurance?**

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

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

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

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

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

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

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

13 (D&O) Liability Insurance financially protects corporate directors and officers
14 when legal claims are brought against them while performing their corporate
15 duties. D&O insurances is a necessary cost of doing business.
16

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

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

23 This insurance protects officers and directors when decisions that they have made
24 are challenged in court and/or have been determined to be business decisions
25 detrimental to the Company's shareholders. The benefit is limited. As the

1 plaintiffs are usually the Company's shareholders, the benefit from any settlements
2 from this insurance flows through to them. Ratepayers typically do not receive
3 any proceeds from settlements in litigation involving the directors and officers of
4 the Company, so they should not be solely responsible for the cost of protecting
5 officers and directors from their own decisions.
6

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

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

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

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

22 A. Based on my arguments above, I believe the revenue requirement reduction
23 proposed by Staff and Public Counsel should be rejected. However, if the Commission were to
24 decide that some level of sharing of director compensation is appropriate, then the Company
25 would propose a 90% customer / 10% shareholder percentage split. This is the average split

1 utilized by the Company for officer compensation, and may be appropriate for these types of
2 expenditures. Based on the 2009 premium included in the Company's revised revenue
3 requirement, this would equate to a revenue requirement reduction of \$72,000 electric and
4 \$20,000 for natural gas.

5

6 **H. Directors' Fees and Board Meeting Expenses**

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

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

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

16 A. Staff and Public Counsel both proposed the same adjustment, to remove 50% of
17 the board meeting fees included in the Company's case. Washington electric fees expensed in
18 the Company's case was \$45,000 electric and \$13,000 gas. Public Counsel therefore removed
19 50%, or \$23,000 for electric and \$6,000 for natural gas. However, when Staff removed this
20 adjustment they inadvertently removed 100% of the fees in error. Therefore, Public Counsel's
21 reduction to the Company's revenue requirement was \$24,000 for electric and \$6,000 for natural

1 gas, while Staff's reduction to the Company's revenue requirement was \$47,000 for electric and
2 \$13,000 for natural gas.

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

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

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

13 Typically, individuals serving on a Board of Directors do not do so on a full-time
14 basis. Some may be retired individuals or participate in addition to their existing
15 full-time careers. Ratepayers should not be expected to fully fund compensation
16 for directors who are working part-time on behalf of the Company's shareholders.
17 The duties of the Board of Directors are mainly to protect stockholders interests."
18

19 This argument does not demonstrate that such expenses are unnecessary or imprudent.
20 He has not shown that overall director compensation levels are out of line with industry averages.
21 Avista's Directors are paid based on market value for their services as provided. Moreover, the
22 recruitment and retention of qualified directors who provide overall guidance for the utility
23 inures to the benefit of customers, who count on it to provide safe, reliable, and efficient service.
24 A publicly-traded utility simply cannot operate effectively – or at all – without a board of

1 directors. As such, it is a necessary cost of doing business. Therefore, neither of the adjustments
2 as proposed by Staff or Public Counsel has merit and should be rejected in their entirety.

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

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

12
13 **I. Property Taxes**

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

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

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

12

13 **J. Customer Deposits**

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

18 A. Yes. Both Staff and Public Counsel propose to reduce the Company's rate base for
19 the average-of-monthly average balance of customer deposits held by the Company in the test year,
20 amounting to \$2,473,000 of electric and of \$1,353,000 natural gas rate base, and to include as
21 interest expense an amount for interest paid to customers for deposits held by the Company. Both
22 propose these adjustments, arguing that customer deposits provide a form of financing (supplied by

1 customers) and that by including the interest paid to customers as an operating expense, the
2 Company is made whole. Staff witness Mr. Kermode in his direct testimony starting at page 17,
3 line 22, goes so far as to say that “The effect of the rate base reduction is to recognize that a
4 portion of rate base is funded by the customer deposits, which cost less than the Company’s overall
5 cost of capital.”

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

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

15 **Q. Does the Company agree with these argument?**

16 A. No, the Company does not. It agrees with neither the adjustment itself nor the
17 way in which they have computed the adjustment. Both Staff and Public Counsel imply that
18 customer deposits, which accrue interest at a short-term interest rate adjusted annually by the
19 Washington Commission, is actually a form of financing for the Company’s utility operations
20 and should be used as a rate base reduction, effectively applying the full authorized rate of return
21 against the rate base adjustment made for customer deposits. Generally speaking, the Company

1 finances its utility operations through various long-term financings, both debt and equity. The
2 suggestion that customer deposit balances are yet another financing vehicle is unsupported.

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

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

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

15 B. Deposits

16 (1) Deposit Requirements. The Company may require a deposit under any of the
17 following circumstances: provided, that during the winter period no deposit may be
18 required of a customer who, in accordance with WAC 480-100-072 (4)(a), has
19 notified the Company of inability to pay a security deposit and has satisfied the
20 remaining requirements to qualify for a payment plan.

21 (a) Where the applicant has failed to establish a satisfactory credit history or
22 otherwise demonstrate that it is a satisfactory credit risk, in the manner
23 prescribed above;

24 (b) When, within the last 12 months an applicant's or customer's similar
25 class of service has been disconnected for failure to pay amounts owing, to
26 any gas or electric utility;

27 (c) There is an unpaid, overdue balance owing to any gas or electric utility
28 for similar class of service;

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

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

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

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

13
14 12. ESTABLISHMENT OF CREDIT/DEPOSITS: - continued

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

17 (a) For each calendar year, at the rate for the one-year Treasury Constant
18 Maturity calculated by the U.S. Treasury, as published in the Federal
19 Reserve's Statistical Release H. 15 on January 15 of that year. If January
20 15 falls on a nonbusiness day, the utility will use the rate posted on the
21 next following business day; and

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

24 It should be evident from the language of the above quoted rule that Customer Deposits

25 are simply a tool for the management of accounts receivable write-offs – not a financing vehicle.

26 In addition, they are very short-term in nature, and the Company has no control over the timing

27 and amount of deposits that will be made. What is appropriate, is that Customers currently

28 receive a short-term interest rate and that amount is credited to the customers who have made the

29 deposit, consistent with the purpose of the deposit rules.

30
31 **K. Injuries and Damages**

32 **Q. Public Counsel, through witness Mr. Larkin, at page 29, has proposed an**
33 **adjustment to reduce rate base for “injuries and damages.” Do you agree with Public**
34 **Counsel’s reasoning for this adjustment?**

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

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

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

17 A. No, I do not. Public Counsel's adjustment has two errors. First, Public Counsel
18 used a trial balance that was provided in response to a data request by the Company to determine
19 the reserve amount (FERC Account 228200 was used.) However, Public Counsel simply failed
20 to include the reserve contra-account that the Company uses to track all payments made for
21 claims (FERC Account No. 228210.). By not including this account, Public Counsel overstated
22 the electric reserve by \$7.4 million (\$7.6 million used by Public Counsel, versus the actual net

1 reserve amount of only \$165,000). In addition, Public Counsel overstated the natural gas reserve
2 by \$1.1 million (\$1.2 million used by Public Counsel versus the actual net reserve amount of
3 \$87,000). Second, Public Counsel used the system reserve and allocated 100% to Washington,
4 when approximately 35% of this reserve should have been allocated to the Company's Idaho
5 jurisdiction. To be clear, if one were to accept Public Counsel's proposal to reduce the
6 Company's gross rate base by the injuries and damages net reserve, correctly accounting for this
7 amount would have required a reduction to gross rate base of approximately \$165,000 electric
8 and \$87,000 natural gas, not the \$7.6 million electric and \$1.2 million gross rate base adjustment
9 removed by Public Counsel. Supporting information for the average reserve balances for
10 Washington electric and natural gas are provided at Exhibit No.__(EMA-8), page 14 and 15.

11 After factoring an adjustment made by Public Counsel for DFIT, the net rate base
12 reduction proposed by Public Counsel was overstated by \$4.79 million for electric service and
13 \$703,000 for natural gas service. The revenue requirement impact of these adjustments is a
14 reduction of \$652,000 for electric and \$104,000 for natural gas. The rate base impact of these
15 adjustments is a reduction of \$4,597,000 for electric and \$790,000 for natural gas. For the
16 reasons discussed above, these adjustments as proposed by Public Counsel should be rejected.

17

18 **L. Dues**

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

21 A. Yes. Avista accepts Public Counsel's adjustment to reduce the amount of dues
22 allocated to the utility for dues paid to the American Gas Association, based on information that

1 was not available to Avista at the time it filed its case. This adjustment reduces the natural gas
2 revenue requirement by \$22,000. In addition, the Company is proposing to correct an error that
3 was found during the discovery process. The Company determined that dues paid to the Edison
4 Electric Institute had been allocated to Washington gas service in error. This proposed
5 adjustment reduces the natural gas revenue requirement by \$44,000 (total impact of both
6 adjustments for natural gas is \$66,000) and increases the electric revenue requirement by
7 \$42,000. Supporting information for these revised adjustments are provided at Exhibit
8 No.__(EMA-8), page 11.

9

10 **M. Capital Additions**

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

14 A. No, we do not. As explained by Company witnesses Mr. DeFelice and Mr.
15 Norwood, the Company's original proposed regulatory treatment of capital investments in utility
16 plant is the best method to match revenues, expenses and rate base for ratemaking purposes. Mr.
17 DeFelice specifically addresses the adjustments related to capital expenditures proposed by Staff
18 and by Public Counsel and why their methods do not fairly state costs and rate base. The
19 adjustments as proposed by Staff, which reduced the Company's electric revenue requirement by
20 \$6,455,000 and rate base by \$14,515,000 and the Company's natural gas revenue requirement by
21 \$1,442,000 and rate base by \$7,328,000, should be rejected. Likewise, the revenue requirement
22 and rate base adjustments as proposed by Public Counsel, which reduced the Company's electric

1 revenue requirement by \$10,807,000 and rate base by \$41,340,000 and the Company's natural
2 gas revenue requirement by \$1,448,000 and rate base by \$7,328,000, should also be rejected.

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

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

11

12 **N. Production Property Adjustment**

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

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

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

3

4 **O. Spokane River Relicensing**

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

8 A. The original adjustment was prepared in late 2008 using an estimated cost of
9 securing the license for its Spokane River hydro projects and an estimated 45 year life. In June
10 2009, the Company completed its relicensing efforts and received its Federal Energy Regulatory
11 Commission (FERC) 50-year license. No parties to the case opposed the Company's Pro Forma
12 Spokane River Relicensing adjustment included in the Company's direct filing. However, the
13 Company proposes to update the adjustment for actual information. The changes proposed by
14 the Company include: 1) Update (i.e., reduce) the final system cost of securing the license from
15 the estimated cost of \$30,011,315 to \$28,729,338, which will reduce the annual amortization
16 expense and rate base; 2) Extend the amortization period from 45 years to 50 years, which will
17 also reduce the annual amortization expense; and 3) Recognize approximately \$363,000 of actual
18 annual labor costs that had been capitalized, which will be recorded as PM&E costs in the future,
19 since the license was received. The net impact of this proposed change increases the revenue
20 requirement by \$194,000 and reduces rate base by \$795,000. Supporting information for this
21 revised adjustment is provided at Exhibit No.__(EMA-8), page 12.

22

1 **P. CDA Tribe Settlement**

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

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

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

16

17 **Q. Lancaster Prudence**

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

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

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

8 **R. Restate Debt**

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

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

17

18 **S. Conversion Factor**

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

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

1 Company has corrected for this in its revised revenue requirement calculations using .62195 for
2 electric and .62209 for natural gas. These corrections were noted, and used by Public Counsel
3 within their proposed revenue requirement calculation proposals. The net revenue requirement
4 impact of these corrections on the Company's revised revenue requirement is a reduction of
5 \$3,000 electric and less than \$1,000 natural gas.

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

7 A. Yes.