

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION,

Complainant,

v.

AVISTA CORPORATION d/b/a AVISTA UTILITIES,

Respondent.

DOCKET NOS. UE-080416 AND UG-080417

DIRECT TESTIMONY OF MICHAEL J. MAJOROS, JR. (MJM-1CT)

ON BEHALF OF

PUBLIC COUNSEL

AND THE

INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

September 19, 2008

**REVISED 1/23/2009**

**NON-CONFIDENTIAL VERSION**

DIRECT TESTIMONY OF MICHAEL J. MAJOROS, JR. (MJM-1T)  
DOCKET NOS. UE-080416 AND UG-080417

**REVISED 1/23/2009**  
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**MICHAEL J. MAJOROS, JR EXHIBIT LIST**

Exhibit No. ____ (MJM-2)	Summary of Qualifications and Experience
Exhibit No. ____ (MJM-3)	Appearances as an Expert Witness
Exhibit No. ____ (MJM-4C)	Calculation of General Revenue Requirement
Exhibit No. ____ (MJM-5)	Avista's response to Public Counsel Data Request PC-074
Exhibit No. ____ (MJM-6)	Consolidated Tax Adjustment
Exhibit No. ____ (MJM-7)	<i>The Process of Ratemaking</i> , Leonard Saul Goodman, 1998 Public Utilities Reports, page 165-166.



1       **Q:    Have you prepared a summary of your qualifications and experience?**

2       A:    Yes, Exhibit No.\_\_\_\_ (MJM-2) is a summary of my qualifications and experience.  
3           Exhibit No.\_\_\_\_ (MJM-3) contains a tabulation of my appearances as an expert  
4           witness before state and federal regulatory agencies.

5       **Q:    For whom are you appearing in this proceeding?**

6       A:    I am appearing on behalf of the Public Counsel Section of the Washington State  
7           Attorney General’s Office (Public Counsel) and the Industrial Customers of  
8           Northwest Utilities (ICNU).

9       **Q:    Do you have any specific experience in the public utility field?**

10      A:    Yes, I have been in the field of public utility regulation since the late 1970s. My  
11           testimony has encompassed numerous complex revenue requirement issues.  
12           Furthermore, I and other members of my firm specialize in the field of public  
13           utility depreciation. We have appeared as expert witnesses on this subject before  
14           the regulatory commissions of almost every state in the country.

15      **Q:    Does your experience specifically include electric and gas utilities?**

16      A:    Yes, I have appeared as an expert in several electric and gas utility proceedings.

17                   **II.    SUBJECT AND PURPOSE OF TESTIMONY**

18      **Q:    What is the subject of your testimony?**

19      A:    This case involves Avista Corporation’s (Avista or the Company) 2008 general  
20           rate case filing. My testimony addresses the Company’s revenue requirement.

21      **Q:    What is the purpose of your testimony?**

22      A:    I have reviewed the Company’s filing. Based upon my findings and the input of  
23           others, I am recommending monetary adjustments to the Company’s filed request.



1 for electric rate relief beyond the original \$36.6 million.<sup>3</sup> Therefore, my  
2 recommendations will use the original filing as a starting point.

3 **IV. AVISTA'S RATIONALIZATION OF INCREASE**

4 **Q: How does the Company rationalize its requested electric revenue increase?**

5 A: The \$36.6 million electric revenue increase is driven by the following factors:<sup>4</sup>

- 6 1. 36 percent is related to increased net plant investment of  
7 approximately \$55 million (less that related to the hydro  
8 relicensing discussed below), including return on investment,  
9 depreciation and taxes, offset by the tax benefit of interest;
- 10 2. 30 percent is related to hydro relicensing and compliance issues  
11 including the intangible and production net rate base and expenses  
12 associated with the Spokane River Relicensing, and the Montana  
13 Riverbed Lease Settlement lease expense;
- 14 3. 21 percent is related to increased production and transmission  
15 expense, including increased loads, Mid Columbia Purchase  
16 expenses and Colstrip and Kettle Falls thermal fuel expenses; and
- 17 4. 13 percent is related to increased distribution and other expenses,  
18 including distribution operation and maintenance costs and  
19 administrative and general expenses.

20 **Q: How does the Company rationalize its requested gas revenue increase?**

21 A: Although changes in various operating cost components contribute to the

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<sup>3</sup> *Id.*, p. 2:17-18.

<sup>4</sup> Direct Testimony of Elizabeth M. Andrews, Exhibit No. \_\_\_\_ (EMA-1T), pp. 6:7 - 3:16.

1 increase, Avista's \$6.6 million gas revenue increase request is primarily driven by  
2 the addition of the Jackson Prairie expansion project, which is planned for  
3 completion in the fourth quarter of 2008.<sup>5</sup>

4 **Q: What are the results of your investigation of the Company's rate request?**

5 A: We have propounded numerous data requests related to the Company's rate  
6 request, as well as reviewed those propounded by other intervenors. As a result of  
7 this investigation, and in combination with the recommendations of Public  
8 Counsel witness Charles King, I recommend that the Company's base rates be  
9 increased by \$24.477 million for electric, as shown on Exhibit No.\_\_\_\_ (MJM-9)  
10 Schedule 1(E), and by \$0. 3.341 million for natural gas as shown on Exhibit  
11 No.\_\_\_\_(MJM-9) Schedule 1(G), which together amounts to \$27.82 million  
12 overall.

13 **V. PROPOSED ADJUSTMENTS**

14 **Q: Do you have individual adjustments to the Company's filed cost of service?**

15 A: Yes. I will discuss each adjustment below. My discussions will cite to any  
16 exhibits necessary for an understanding of the adjustments. However, all of the  
17 actual adjustments are incorporated as Schedules to Exhibit No.\_\_\_\_ (MJM-9).  
18 My adjustment explanations contain two designations: (E) electric and (G) gas.

19 **A. Adjustment No. 1(E) and (G) – Reclassify SFAS No. 143 Regulatory Liability**

20 **Q: Please explain this adjustment.**

21 A: In this case, there is an important issue related to Avista's collections for future  
22 cost of removal. As of December 31, 2007, the Company had a \$209.4 million

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<sup>5</sup> *Id.*, pp. 29:30 – 21:1.



1 over-collection for future cost of removal, which it recognized as a regulatory  
2 liability for Generally Accepted Accounting Principles (GAAP) reporting  
3 purposes.<sup>6</sup>

4 **Q: Please explain the regulatory liability issue.**

5 A: The Financial Accounting Standards Board's (FASB) Statement of Financial  
6 Accounting Standard No. 143 (SFAS No. 143) addresses asset retirement  
7 obligations associated with long-lived plant. SFAS No. 143 was implemented by  
8 the Federal Energy Regulatory Commission's (FERC) in Order No. 631. Both  
9 SFAS No. 143 and FERC Order No. 631 identify and highlight utilities' prior  
10 excess collections for future cost of removal.

11 When a company has a legal asset retirement obligation, SFAS No. 143  
12 requires capitalization of the discounted fair value of the liability and depreciation  
13 as a component of the original asset cost. If it is determined, upon  
14 implementation that a regulated utility has already collected too much  
15 depreciation relating to the asset retirement obligation, the utility must report the  
16 excess as a regulatory liability.<sup>7</sup> If a utility does not have a legal obligation to  
17 incur asset retirement costs for which it has previously collected money in the  
18 form of future cost of removal embedded in depreciation rates, SFAS No. 143 and  
19 the SEC still require reporting the excess as a regulatory liability.<sup>8</sup> In other  
20 words, if a regulated utility has collected for future cost of removal in its

---

<sup>6</sup> Avista's Response to Public Counsel Data Request No. 232.

<sup>7</sup> SFAS No. 143.

<sup>8</sup> *Id.*, ¶ B.73.

1 depreciation rates, but does not, and never had, a legal obligation to spend the  
2 money, it must segregate these excesses and report them as a regulatory liability.<sup>9</sup>

3 FERC identified such amounts as “non-legal” asset retirement obligations,  
4 meaning that utilities do not have an actual legal obligation to incur these costs in  
5 the future. However, even though current GAAP and SEC accounting rules  
6 require reporting these excess collections as regulatory liabilities, FERC Order  
7 No. 631 does not have the same requirement. FERC Order No. 631 merely  
8 requires separate identification and reporting within account No. 108-  
9 Accumulated Depreciation. Consequently, even though SFAS No. 143 and the  
10 SEC require that excess collections amounts be reported as a regulatory liability,  
11 Avista continues to include these amounts in accumulated depreciation for  
12 regulatory accounting and ratemaking purposes.

13 **Q: How does GAAP define a regulatory liability?**

14 A: SFAS No. 71 – Accounting for the Effects of Certain Types of Regulation -  
15 defines regulatory liabilities from a GAAP perspective. I have summarized  
16 paragraph 11 below. It provides the GAAP definition of a regulatory liability.  
17 Please note paragraphs 11 and 11.b.

18 **SFAS No. 71 – Regulatory Liabilities**<sup>10</sup>

19 11. Rate actions of a regulator can impose a  
20 liability on a regulated enterprise. Such liabilities are  
21 usually obligations to the enterprise’s customers. The  
22 following are the usual ways in which liabilities can be  
23 imposed and the resulting accounting:  
24

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<sup>9</sup> *Id.*, ¶ B.73.

<sup>10</sup> SFAS No. 71, ¶ 11. Only the first sentence of each subparagraph is included.

1 a. A regulator may require refunds to  
2 customers . . . .

3  
4 b. A regulator can provide current rates intended to  
5 recover costs that are expected to be incurred in the future  
6 with the understanding that if those costs are not incurred  
7 future rates will be reduced by corresponding amounts. If  
8 current rates are intended to recover such costs and the  
9 regulator requires the enterprise to remain accountable for  
10 any amounts charged pursuant to such rates and not yet  
11 expended for the intended purpose, the enterprise shall not  
12 recognize as revenues amounts charged pursuant to such  
13 rates. Those amounts shall be recognized as liabilities and  
14 taken to income only when associated costs are incurred.

15  
16 c. A regulator can require that a gain or other  
17 reduction of net allowable costs be given to customers over  
18 future periods . . . .

19  
20 **Q: What ratemaking implications are raised by the identification of the \$209.4**  
21 **million regulatory liability?**

22 A: It is the manifestation and quantification of a past intergenerational inequity,  
23 because prior ratepayers were charged for cost of removal that has not occurred.

24 **Q: What do you recommend?**

25 A: The Commission must specifically recognize that Avista has a \$209.4 million  
26 regulatory liability for these amounts.<sup>11</sup> Avista should reclassify this from  
27 accumulated depreciation to Account 254-Other Regulatory Liabilities for  
28 regulatory accounting, reporting and ratemaking purposes. This will result in  
29 equivalent GAAP and regulatory accumulated depreciation and regulatory

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<sup>11</sup> Avista's Response to Public Counsel Data Request No. 232.

1 liability amounts for “non-legal” cost of removal.<sup>12</sup> Regardless of being included  
2 in accumulated depreciation, these amounts are dollars *already* collected from  
3 ratepayers for future cost of removal. There is no reason that the utility should be  
4 entitled to keep these dollars if it turns out they are never spent on future costs of  
5 removal. The funds represent a refundable liability to ratepayers until spent on  
6 their intended purpose. Now that SFAS No. 143 has identified them, they should  
7 be recognized as the regulatory liability they are.

8 Furthermore, \$209.4 million is a substantial amount. By definition, the  
9 Company has collected, but not spent, \$209.4 million for cost of removal, and it  
10 does not have a legal obligation to incur the related cost of removal. Therefore,  
11 the Commission must protect this amount in Uniform System of Accounts  
12 (USOA) account 254-Other Regulatory Liabilities. Without that protection,  
13 current and future ratepayers face the strong possibility of losing substantial  
14 prepaid funds they have submitted to the Company for future cost of removal.

15 **Q: Why is it necessary for the UTC to protect the \$209.4 million as a regulatory**  
16 **liability?**

17 A: Avista, and virtually all other utilities, consider amounts in accumulated  
18 depreciation, even excessive amounts, to be *their* money, i.e. capital recovery  
19 with no refund obligation. It is certainly fair and reasonable for any Commission  
20 to recognize excessive cost of removal collections as a refundable regulatory

---

<sup>12</sup> The phrase “non-legal” emanates from the FERC’s Order No. 631. It is used to distinguish legally required asset retirement obligations from those which lead to the cost of removal regulatory liability discussed above. Importantly, the phrase “non-legal” should not be construed to imply any “illegality.”

1 liability until the utility spends them on their intended purpose. The FERC rule to  
2 which Avista adheres is insufficient.

3 **Q: Why is FERC Order No. 631 insufficient?**

4 A: The FERC has recognized and identified the amounts involved and requires  
5 separate accounting for those amounts.<sup>13</sup> However, the FERC has deferred  
6 recognition of the regulatory liability to the states. Consequently, until the  
7 Commission provides it, there is no *regulatory* recognition of the liability.  
8 Accordingly, there is no provision for a refund to ratepayers if Avista does not  
9 spend the cost of removal amounts they have collected for the intended purpose.  
10 In fact, it is highly likely that Avista has actually already spent that money for  
11 things other than cost of removal.<sup>14</sup>

12 In other words, nothing holds Avista directly accountable for these excess  
13 collections from a regulatory standpoint. Regardless of the transparency provided  
14 by FERC, Avista failed to mention the regulatory liability in this rate case. This  
15 is wrong and unfair to ratepayers who have paid these excess costs in rates.  
16 Experience indicates that it is highly unlikely that these amounts will be spent for  
17 cost of removal in the magnitude they have been collected. Furthermore, even if  
18 it was highly probable that Avista would spend all this money for cost of removal,  
19 it is fair and reasonable for the Commission to recognize the ratepayers' security  
20 interest in these monies until spent on their intended purpose. Otherwise, the  
21 money is at risk.

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<sup>13</sup> FERC Docket No. RM02-7-000, Order No. 631, ¶ 38.

<sup>14</sup> This is the obvious result since what Avista reports as a regulatory liability is the excess of what they have collected versus what they have spent for non-legal cost of removal.

1           **Q:    Have any other Commissions recognized non-legal asset retirement**  
2                   **obligations as regulatory liabilities?**

3           A:    Yes.  Recently, in Application No. 04-12-014, involving Southern California  
4                   Edison Company, the California Public Utilities Commission specifically  
5                   recognized that Company’s non-legal asset retirement obligations collections as a  
6                   regulatory liability.<sup>15</sup>

7           **Q:    Is the \$209.4 million all related to Washington utility plant?**

8           A:    No, that is the system amount.  I have not attempted to allocate it to Washington,  
9                   Idaho and Oregon because for my adjustments I do not believe that is necessary.  
10                  The entire amount should be protected for Avista’s ratepayers.  However, based  
11                  on the allocations Avista has used for other expenses, the Washington jurisdiction  
12                  clearly would receive the majority.

13          **Q:    Do you have an exhibit showing your recommended reclassification?**

14          A:    Yes, on page 9 of Exhibit No.\_\_\_\_ (MJM-9) , Adjustments No. 1(E) and 1(G) on  
15                  Schedule 5, show the reclassification of the SFAS No. 143 Regulatory Liability.

16          **Q:    Does this adjustment have any revenue requirement effect?**

17          A:    No, it is merely a revenue neutral reclassification of a rate base reduction from  
18                  one account to another.

19          **B.    Adjustment Nos. 2(E) and (G) – Federal Income Taxes**

20          **Q:    Have you adjusted Avista’s federal income tax calculations?**

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<sup>15</sup> Southern California Edison 2006 GRC, Application No. 04-12-014, Decision 06-05-016, issued May 11, 2006, p. 204:16.7.1.

1           A:     Yes, I have reduced Avista's federal income tax expense to reflect Avista's  
2                   effective corporate tax rate. Page 10 of Exhibit No.\_\_\_\_ (MJM-9), Schedule 5  
3                   shows my adjustment. These adjustments reduce the revenue requirements for  
4                   electric and gas by \$0.758 million and \$0.685 million, respectively.

5           **Q:     Explain the tax rate adjustment.**

6           A:     My tax rate adjustment reduces Avista's federal statutory tax rate from 35.00  
7                   percent to its 34.00 percent average effective federal tax rate for the years 2005 to  
8                   2006.

9           **Q:     What is the basis for this adjustment?**

10          A:     I examined Avista's corporate federal income tax returns and calculations for  
11                   2005 and 2006.<sup>16</sup> I determined that Avista has several subsidiary companies, some  
12                   of which incurred tax losses, thus reducing Avista Corporation's effective federal  
13                   statutory income tax rate. However, Avista did not use the lower rate in its filing.  
14                   Instead, Avista used a 35 percent statutory tax rate. The result is that Avista's  
15                   ratepayers pay taxes to Avista Corporation at a higher rate than Avista  
16                   Corporation pays to the federal government. Avista's approach causes ratepayers  
17                   to subsidize Avista's non-regulated subsidiaries. I have reduced Avista's federal  
18                   income tax expense claim to eliminate that subsidy. This is typically identified as  
19                   a Consolidated Tax Adjustment (CTA).

20          **Q.     Did you adjust the numbers Avista provided to make your adjustment?**

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<sup>16</sup> See Avista's Response to Public Counsel Data Request No. 46. Per the response, the 2007 return is not available. No reason was given as to why.

1           A.     Yes, I made two adjustments. First, I eliminated Avista Energy from the  
2                   calculation because Avista effectively sold that subsidiary in 2007. I also  
3                   adjusted the numbers to isolate the effects of the depreciation normalization  
4                   requirements specified in the tax code.

5           **Q.     Why did you make the second adjustment?**

6           A.     Utilities typically respond to CTAs with Private Letter Rulings from the IRS  
7                   saying that such adjustments would violate the Tax Code and the utility might  
8                   lose its accelerated depreciation tax benefits as a result. I do not agree with that  
9                   position for several reasons; nevertheless, it is a common argument.

10                   In this case, however, Avista has provided a Private Letter Ruling issued  
11                   on January 8, 2008, that seems to say there are at least three ways to make a CTA  
12                   without violating the Code.<sup>17</sup> I have attached that private letter ruling as Exhibit  
13                   No. \_\_\_\_ (MJM-5). In each of the three methods, the tax liability of the utility or  
14                   affiliated group is adjusted to remove the benefits of accelerated depreciation and  
15                   investment tax credits (ITC) claimed with respect to public utility property.

16                   Avista's investment tax credits are negligible, but it does benefit from  
17                   accelerated tax depreciation. Hence, I reduced Avista's taxable income by that  
18                   benefit in 2005 and 2006 in order to reduce the allocation of losses to it for the  
19                   purposes of my CTA.

20           **Q.     Is the approach precisely what the Private Letter Ruling requires?**

21           A.     I have attempted to adjust the numbers in conformity with the IRS's requirements.  
22                   Furthermore, I have requested the exact calculation from Avista but did not have

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<sup>17</sup> Avista's Response to Public Counsel Data Request No. 74.



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1 its response at the time I filed this testimony.<sup>18</sup> If necessary, I will update this  
2 calculation upon reviewing Avista's response.

3 **C. Adjustment Nos. 3(E) and (G) – Depreciation Expense**

4 **Q: Please explain Adjustment Nos. 3(E) and (G).**

5 A: These adjustments implement Mr. King's depreciation rate recommendations.  
6 They appear on page 11 of Exhibit No. \_\_\_\_ (MJM-9), Schedule 5. This  
7 incorporates the effect of the cost of removal issue. Mr. King's depreciation  
8 expense recommendations result in incremental revenue requirement reductions  
9 of \$3.3 million for electric and \$1.3 million for gas.

10 **[Begin Confidential]**

11 **D. Adjustment No. 4(E) – Coeur d'Alene Tribe Settlement**

12 **Q: Please explain Adjustment No. 4(E).**

13 A: This adjustment, shown on page 12 of Exhibit No. \_\_\_\_ (MJM-9), Schedule 5,  
14 relates to Avista's inclusion of certain amounts related to its settlement with the  
15 Coeur d'Alene Tribe (CDA Tribe). The expense portion of the adjustment results  
16 in a \$0.5 million reduction to electric revenue requirement. The adjustment also  
17 includes a \$15.1 million reduction to electric rate base.

18 **Q: What are the circumstances behind the settlement?**

19 A: Avista has operated the Post Falls Hydroelectric Project (HED), located  
20 downstream from the Coeur d'Alene Lake (Lake) since at least 1907. From the  
21 beginning, the Company received complaints that the water level of the Lake,  
22 which it controlled, was flooding agricultural lands. In 1973, the Coeur d'Alene

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<sup>18</sup> Avista's Response to Public Counsel Data Request No. 295.

1 Tribe asserted an ownership interest in the Lake during FERC hearings on the  
2 licensing of the Spokane River Project. After several FERC decisions and  
3 appeals, FERC decided in 1988 that it did not have the necessary jurisdiction to  
4 resolve the issue. In 1992, the CDA Tribe filed suit for title to the Lake. The  
5 Company and the CDA Tribe agreed to mediation, which resulted in a Settlement  
6 – the cost of which the Company is trying to recover in this rate case. Mr.  
7 Pessemier’s testimony and Exhibit No.\_\_(TEP-3) provides a comprehensive  
8 summary of this history and the resulting settlement.

9 **Q: How is the settlement structured?**

10 A: Avista agreed to pay \$39 million for past trespass damages and usage charges  
11 (§10(e) charges) for the lake. Avista also agreed to pay §10(e) usage charges on a  
12 going-forward basis. The payments are structured as follows:

13 **Past Trespass and Past 10(e) Damages<sup>19</sup>**

- 14 1. Year 1: \$25 million  
15 2. Year 2: \$10 million  
16 3. Year 3: \$4 million

17 **Future 10(e) Usage Payments**

- 18 1. Years 1-20: \$400,000 per year  
19 2. Years 21-50: \$700,000 per year

20 Other aspects of the settlement cover rights of way and issues relating to the  
21 relicensing of the Post Falls HED.<sup>20</sup>

<sup>19</sup> Exhibit No.\_\_(TEP-3), p. 10.

<sup>20</sup> *Id.*, p. 11.

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1       **Q:    What does Avista propose for the past trespass and §10(e) damages**  
2       **amounts?**

3       A:    Avista proposes to defer and amortize the first two payments of \$25 million and  
4       \$10 million, along with the 2008 \$400,000 §10(e) payment and a return on the  
5       balance, over the remaining life of the Post Falls Project.<sup>21</sup> The Company has  
6       included one year's worth of the amortization and the 2009 annual \$400,000  
7       §10(e) payment in the revenue requirement in this case. It has also increased rate  
8       base by the average remaining balance of the deferral.<sup>22</sup> Avista does not propose  
9       any recovery of the 2010 \$4 million payment in its filing.

10       **Q:    Do you agree with this treatment of the settlement?**

11       A:    No, I do not. First, Avista admitted to trespass, which is not prudent.  
12       Furthermore, Avista's proposal would require current customers to pay for past  
13       misconduct as well as usage costs that should have been paid in the past. It would  
14       render the ratemaking process in Washington a guarantee rather than opportunity  
15       for a fair rate of return, and it would require ratepayers to bear losses caused by  
16       past management mistakes, such as trespassing, not paying usage charges, and  
17       failure to conduct title searches and surveys. This is the very definition of  
18       retroactive ratemaking, which is generally precluded.

19       **Q:    What is retroactive ratemaking?**

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<sup>21</sup> Exhibit No. \_\_\_\_ (EMA-1T), p. 24:10-13.

<sup>22</sup> *Id.*, p. 24:13-15 and Andrews' workpapers, section PF 10.

1 A: Retroactive ratemaking refers to an improper recovery of costs that were properly  
2 recoverable in a past period or periods.<sup>23</sup> I have attached as Exhibit No. \_\_\_\_  
3 (MJM-7) an excerpt from a 1998 PUR Text discussing the issue.<sup>24</sup> It states in part:

4 “Retroactive ratemaking” refers to an  
5 improper recovery of costs that were properly  
6 recoverable in a past period or periods. In the  
7 absence of express statutory direction, it is unlawful  
8 for an agency to alter the past legal consequences of  
9 past actions, 1/ such as awarding damages for past  
10 illegal conduct.

11 The Indiana commission usefully  
12 summarized the three basic functions served by the  
13 rule against retroactive ratemaking:3/

14 a) protecting the public by ensuring  
15 that current customers pay for their own service and  
16 not for past deficits:

17 b) preventing utilities from using  
18 future rates to protect the financial investment of  
19 their stockholders, i.e., providing a guaranty, rather  
20 than opportunity, for a fair rate of return: and

21 c) requiring utilities to bear losses  
22 and enjoy gains that depend on their own  
23 managerial efficiency.

24 1/ Bowen v. Georgetown Univ.Hosp., 488  
25 U.S.204 (1988): American Min.Congress v. U.S.  
26 Environmental Protection Agency, 965 F.2d 759,  
27 769 (9<sup>th</sup> Cir. 1992)

28 3/ Re Northern Indiana Pub.Svc.Co., 157  
29 PUR4th 206,228 (Ind. URC, 1991)

30 **Q: What do you recommend?**

31 A: Avista’s requested deferral is unjust and unreasonable and not necessary for the  
32 provision of safe, reliable, and efficient utility service. The Commission should  
33 deny the deferral and not charge any of the past damages to current or future  
34 ratepayers.

<sup>23</sup> *The Process of Ratemaking*, Leonard Saul Goodman, 1998 Public Utilities Reports, p. 165.

<sup>24</sup> *Id.*, pp. 165-166.

**REVISED 01/23/2009**

1 **Q: What if the Company alleges that fairness requires it be allowed to recover**  
2 **those past damages?**

3 A: As I noted earlier, Avista has accumulated a \$209.4 million regulatory liability for  
4 future cost of removal. This is money the Company has collected over and above  
5 what it has needed to remove retired assets. The liability to ratepayers has grown  
6 over the years, continues to grow and will do so until the cost of removal  
7 component of Avista's depreciation rates is reduced or eliminated. Given the  
8 circumstances, it is unfair to allow Avista to keep that money. In the event the  
9 Commission decides to award some or all of the past damages to Avista's  
10 shareholders, the Commission should require that Avista use the regulatory  
11 liability associated with the future cost of removal to offset any of the cost of the  
12 CDA Tribes settlement charged to ratepayers. ~~[End Confidential]~~

13 **E. Adjustment Nos. 5(E) and 4(G) – Non-Executive Compensation**

14 **Q: Please explain Adjustment Nos. 5(E) and 4(G).**

15 A: Adjustment Nos. 5(E) and 4(G) reduce the Company's pro forma adjustment for  
16 2009 non-executive labor expense. These adjustments are shown on page 13 of  
17 Exhibit No.\_\_(MJM-9), Schedule 5.

18 **Q: Why have you reduced this expense?**

19 A: Avista calculated its 2009 pro forma non-executive wages by increasing 2007  
20 amounts by 3.5 percent for union and 3.32 percent for administrative personnel to  
21 reach a 2008 level. The company then increased union wages by 3.5 percent and  
22 administrative wages by 3.8 percent to reach estimated 2009 levels.

1                   In Avista's response to UTC Staff Data Request No. 80, the Company  
2                   acknowledged that the 2009 administrative increase was an estimate, and  
3                   provided some of the materials it is using to project the final increase. Using the  
4                   2009 projected increases for the utility industry provided in Attachment B to that  
5                   response indicates that a more reasonable projected increase for 2009 is 3.75  
6                   percent, instead of the 3.8 percent Avista has used.

7                   **Q: Why have you made this minimal change?**

8                   A: I have made this change because I am not objecting to the increase to 2009 levels.  
9                   Ordinarily I would object to Avista's increase to 2009 levels on the grounds that it  
10                  is beyond the test year. Because the rates resulting from this proceeding will not  
11                  be in effect until 2009, I have not challenged the increase of wages to a 2009  
12                  level. However, that estimated increase should be conservative. These  
13                  adjustments result in an \$8,159 reduction to electric revenue requirement and a  
14                  \$2,125 reduction to gas revenue requirement.

15                  **F. Adjustment Nos. 6(E) and 5(G) –Executive Compensation**

16                  **Q: Please explain Adjustment Nos. 6(E) and 5(G).**

17                  A: Adjustment Nos. 6(E) and 5(G) reduce the Company's pro forma adjustment for  
18                  2009 executive labor expense.

19                  **Q: Do you have any concerns about executive compensation in general?**

20                  A: Yes. In addition to general concerns over increased executive compensation  
21                  levels and the widening gap between what is paid to executives versus non-  
22                  executives, I have specific concerns with the manner in which Avista determines  
23                  the compensation it pays its executives. Recently there has been increased

1 scrutiny regarding the use of paid consultants to assist in setting executive pay  
2 levels.<sup>25</sup> Avista relies upon Towers Perrin to assist in this task. Avista’s  
3 executive compensation levels are influenced heavily by Towers Perrin  
4 compensation studies. Not only are the studies circular, Avista uses an  
5 inappropriate proxy group in setting its compensation levels.

6 **Q: Has the UTC addressed the subject of executive compensation and the use of**  
7 **compensation consultants?**

8 A: Yes, the Commission has addressed the issue several times. In its Order in  
9 PacifiCorp’s 2005 rate case, the Commission provided its overall strategy  
10 regarding executive compensation, stating as a conclusion of law:

11 In determining the reasonableness of executive  
12 compensation, the Commission will consider compensation  
13 as a whole, not limited to whether executive incentive  
14 compensation is paid in stock or whether compensation is  
15 similar in level or benefits to that of other comparable  
16 companies.<sup>26</sup>

17 In its Final Order for PacifiCorp’s 2006 rate case, the Commission noted  
18 the “increasing attention to and criticism of excessive levels of executive  
19 compensation and bloated severance packages” and acknowledged the ongoing  
20 investigation into that matter and the use of compensation consultants by  
21 Congress.<sup>27</sup> As such, the Commission stated, “Therefore, we are inclined to be  
22 wary of studies by consultants that potentially are self-serving and may not

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<sup>25</sup> *Executive Pay: Conflicts of Interest Among Compensation Consultants*, United States House of Representatives, Committee on Oversight and Government Reform, December 2007, Executive Summary.

<sup>26</sup> PacifiCorp GRC, Docket No. UE-050684, Order 04 at ¶ 350 (emphasis added).

<sup>27</sup> Final Order UE-061546 and UE-060817, ¶174.

1 provide objective information that is useful to us.”<sup>28</sup> Both of these Orders  
2 indicate that the “everyone else is doing it” argument is not persuasive when it  
3 comes to executive compensation.

4 **Q: Do you think Avista’s overall executive compensation levels are excessive?**

5 A: Yes. As I will discuss in detail below, Avista’s executive compensation is pegged  
6 to the compensation paid to similar executives at much larger companies. This  
7 alone would cause Avista’s executive compensation to be excessive. In addition,  
8 the increase in total compensation received by the top executives is greater than  
9 that received by other employees.

10 **Q: What are the Towers Perrin compensation studies you mentioned above?**

11 A: Towers Perrin conducts annual compensation surveys and maintains a database of  
12 compensation information from which it can then prepare specialized reports.  
13 The surveys address all types of compensation, from base salary to incentive  
14 payments. These studies are then used by subscribing companies, such as Avista,  
15 to set compensation levels.

16 **Q: How does Avista use these studies to set compensation levels?**

17 A: Avista’s March 31, 2008 Proxy Statement states:

18 When determining the types and amounts of compensation  
19 to be paid to executives of the Company, the Compensation  
20 Committee and management consider it important to  
21 provide an overall plan that reflects compensation paid to  
22 similarly situated executives of our peer companies.... To  
23 achieve this end, the Compensation Committee establishes  
24 base salaries, short-term annual incentives, and long-term  
25 incentive levels generally targeted to be near the median of  
26 the competitive data. However, the Compensation

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<sup>28</sup> Final Order UE-061546 and UE-060817, ¶175.



1 Committee exercises its discretion to set any one or more of  
2 the components at levels higher or lower than the  
3 median....<sup>29</sup>  
4

5 The Compensation Committee annually compares each  
6 element of total direct compensation, which includes base  
7 salary, annual cash incentives, and the annualized value of  
8 long-term incentive grants, against the specific peer group  
9 of publicly-traded companies within the energy/utility  
10 industry.<sup>30</sup>  
11

12 **Q: Do you see a problem with the use of compensation studies?**

13 A: Yes. These types of studies are circular in nature. The data included is from  
14 companies that choose to participate, both in providing their data and in paying  
15 for access to the database. A company that does not set compensation levels  
16 based on industry data would not have any incentive to participate. If each  
17 participant sets its compensation levels at the 50<sup>th</sup> percentile or higher, such as  
18 Avista does, the average will ratchet up each year. Compensation set in this  
19 manner becomes artificial, in that it is not based on business factors specific to  
20 Avista, only on what is being paid to the next company down the road. If a  
21 company such as Avista bases its compensation on data from larger companies,  
22 the database becomes even more skewed.

23 **Q: What did Avista select as its peer group?**

24 A: The peer group selected was comprised of utility companies that had revenues  
25 between \$1 billion and \$3 billion.<sup>31</sup>

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<sup>29</sup> Avista Corporation Proxy Statement, March 31, 2008 Schedule 14A, p. 12.

<sup>30</sup> Avista Corporation Proxy Statement. March 31, 2008 Schedule 14A, pp. 12-13.

<sup>31</sup> Avista Corporation Proxy Statement. March 31, 2008 Schedule 14A, p. 13.



1 compensation studies such as the one by Towers Perrin to set compensation  
2 levels. The use of an inappropriate peer group merely adds to those problems.

3 **Q: Why is the use of larger companies in the proxy group a problem?**

4 A: Because the peer group companies are so much larger, they are not truly  
5 comparable to Avista. Executive pay should be tied somewhat to the size and  
6 complexity of a company. If Avista sets its executive pay to be comparable with  
7 that of larger companies, Avista will naturally end up paying its executives more  
8 than what is a correct market rate for a company of its size.

9 **Q: What do you recommend regarding Avista's use of compensation studies?**

10 A: I do not recommend setting executive compensation based on what is being done  
11 at other companies. As I have discussed above, I believe the sort of compensation  
12 studies Avista relies upon are circular in nature, and can lead to compensation  
13 levels that would otherwise not occur if normal economic factors were at play.  
14 Because Avista has relied upon compensation levels at much larger companies in  
15 determining the compensation for its own executives, in my opinion Avista's  
16 compensation levels are suspect.

17 **Q: Are ratepayers being charged for all of the compensation paid to Avista's  
18 executives?**

19 A: No. Some of the compensation components, such as long-term equity incentive  
20 and the portion of the annual cash incentive related to meeting earnings per share

1 are not paid by ratepayers. Also, a small portion of base pay is allocated to  
2 subsidiary operations.<sup>33</sup>

3 **Q: Have you made any reductions to executive compensation based on Avista's**  
4 **use of an inappropriate proxy group?**

5 A: I have not recommended any reductions based on the use of the Towers Perrin  
6 studies because any such adjustment would tend to be arbitrary. However, as I  
7 will discuss below, I have made adjustments to executive base pay based on other  
8 issues. The fact that executive compensation is based on an inappropriate proxy  
9 group underscores the need for, and reasonableness of, my adjustments.

10 **Q: What adjustments to executive base pay are you recommending?**

11 A: I am recommending three separate adjustments to Avista's calculation of March  
12 2009 executive base pay. My adjustments relate to the following: (1) the  
13 percentage split of time between utility and non-utility, (2) the estimated 2008  
14 base pay, and (3) the use of 5 percent as the pay increase for 2009.

15 **Q: Please explain the issue related to the Company's allocation of executive time**  
16 **between utility and non-utility tasks.**

17 A: In calculating the executive compensation to be included in the revenue  
18 requirement, Avista allocated a portion of that pay to non-utility operations  
19 because "executives routinely charge a portion of their time to non-utility  
20 operations, commensurate with the amount of time spent on such activities."<sup>34</sup>

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<sup>33</sup> Exhibit No. \_\_\_\_ (EMA-1T), p. 21:22-21:4.

<sup>34</sup> Exhibit No. \_\_\_\_ (EMA-1T), p. 20:20-21.

1 According to Ms. Andrews, the executive salary allocations were set at their  
2 expected pro forma test period utility/non-utility percentage splits.<sup>35</sup>

3 **Q: How are the salary allocations derived?**

4 A: Public Counsel Data Request No. 290 asked how executives classify their utility  
5 versus non-utility time, whether the classifications are based on time sheets (i.e.,  
6 they keep track of how much time is spent on each task) or a percentage split  
7 selected at the beginning of a time frame and adhered to during that period.

8 Avista responded as follows:

9 Executives classify their time between utility and non-  
10 utility operations based on a percentage split that is  
11 estimated each year as upcoming budgets are finalized.  
12 Individual time spent on non-utility activities is estimated  
13 by each executive, and the percentage split is updated in  
14 timekeeping and stays constant throughout the year unless  
15 there is a significant change or event requiring the  
16 allocation to change (i.e. allocations were revised upon the  
17 completion of the sale of Avista Energy in 2007).<sup>36</sup>

18  
19 In other words, the classification is merely an estimate.

20 **Q: Do you agree with the percentage splits used by Avista?**

21 A: No. The actual percentage splits used for the calculation in this case were  
22 provided in Avista's Response to UTC Staff Data Request No. 69. Avista's  
23 Confidential Response to UTC Staff Data Request No. 14C provided executive  
24 salaries by month for 2006 and 2007, along with the amounts charged to utility  
25 versus non-utility. As can be seen in the summary table below, the actual

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<sup>35</sup> Exhibit No. \_\_\_\_ (EMA-1T), pp. 20-21: 21-1.

<sup>36</sup> Avista's Response to Public Counsel Data Request No. 290.

1 percentage charged to non-utility for several executives in 2007 was far more than  
 2 is assumed in the Company's calculation of their pay in this case.

3 **Table 2**

4 **Comparison of Utility / Non-Utility Percentage Splits**

	Per Avista 2009 Pay Calculation <sup>37</sup>				Actual 2007 <sup>38</sup>			
	Utility		Non-WA	Non-Utility	Utility		Non-WA	Non-Utility
	920	557	Other	417	920	557	Other	417
Feltes	90%			10%	75%			25%
Meyer	100%			0%	97%			3%
Malquist	90%			10%	82%			18%
Durkin	90%			10%	75%			25%
Burmeister- Smith	90%			10%	75%			25%
Kensok	100%			0%	100%			0%
Kopczynski	59%		40%	1%	59%		40%	1%
Morris 1/	90%			10%	75%			25%
Norwood	99%			1%	99%			1%
Vermillion	0%	69%	30%	1%	0%	69%	30%	1%
Wilson	90%			10%	75%			25%
Woodworth	99%			1%	99%			1%

1/ Used Ely 2007 split as proxy for Morris as CEO.

5  
 6 The primary difference appears to be an assumption that executives who charged  
 7 25 percent of their time to non-utility operations in 2007 will charge only 10  
 8 percent of their time to those tasks in 2009.

9 **Q: Do you think that the change from 25 percent to 10 percent of time spent on**  
 10 **non-utility activities is related to the sale of Avista Energy?**

11 **A:** No. According to Avista's Response to Public Counsel Data Request No. 290,  
 12 the time change was made during the year, after the sale of Avista Energy.

<sup>37</sup> Avista's Response to UTC Staff Data Request No. 69.

<sup>38</sup> Avista's Confidential Response to UTC Staff Data Request No. 14.

1 Looking at the amounts charged to non-utility by month, I was able to determine  
2 that the only allocations that changed in July 2007 (the time of the sale) were for  
3 Mr. Malquist (from 25 percent to 10 percent) and Mr. Meyer (from 5 percent to 0  
4 percent).<sup>39</sup>

5 **Q: Several executives charge little or no time to non-utility operations. Do you**  
6 **believe this is appropriate?**

7 A: It depends on the job of the executive in question. For instance, the executives  
8 charging 1 percent of their time to non-utility operations all have positions that  
9 appear to justify that allocation – they are the VPs of Transmission and  
10 Distribution, State and Federal Regulation, Power Resources, and Customer  
11 Solutions. In my opinion, the focus of these positions would be entirely on the  
12 provision of safe, reliable and efficient electric and gas service.

13 On the other hand, the time for the remaining executives should include  
14 not just time spent on unregulated subsidiaries, but time spent on activities  
15 designed to benefit shareholders. In any investor-owned utility one would expect  
16 the top executives to spend at least some of their time on activities that provide no  
17 direct benefit to ratepayers. These activities may include preparing shareholder  
18 reports and meetings, monitoring stock performance, and cost reduction efforts  
19 where there is no accompanying reduction in rates. Other activities might be  
20 designed to increase shareholder value, such as the sale of subsidiaries, or the  
21 formation of a holding company. In fact, a portion of the executives' incentive

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<sup>39</sup> See Avista's Response to Public Counsel Data Request No. 14.

1 pay is determined by earnings per share, which indicates that shareholder-related  
2 activities are an important part of their role.

3 **Q: What do you recommend?**

4 A: I recommend that the minimum amount charged to non-utility operations should  
5 be 25 percent, with the exception of the positions I discussed above. For the five  
6 executives whose non-utility percentage changed from 25 percent in 2007, to 10  
7 percent in 2008/2009, this means a return to the 2007 percentage split. For the  
8 three remaining executives, this results in an increase over 2007 levels.

9 **Q: Please explain your other adjustments to Avista's calculation of 2009 pro**  
10 **forma executive pay.**

11 A: Avista calculated its 2009 executive pay by taking the actual 2007 salaries of its  
12 2009 executive team, increasing them by 3.5 percent for 2008 (with the exception  
13 of Mr. Morris who received a 50 percent increase) and then increasing the 2008  
14 amounts by 5 percent for 2009. I disagree with both the calculated 2008 amounts  
15 and the use of 5 percent for the 2009 increase.

16 **Q: Why do you disagree with Avista's use of 3.5 percent increase 2007 salaries**  
17 **to a 2008 level?**

18 A: I disagree because the actual 2008 executive salaries are available for use. These  
19 salaries were provided in Avista's Response to UTC Staff Data Request No. 67.  
20 Use of the actual 2008 salaries leads to a \$35,150 decrease in 2008 executive pay  
21 versus simply increasing 2007 salaries by 3.5 percent. This is due to Avista's  
22 assumption that Mr. Morris would receive a 50 percent salary increase in 2008.  
23 In reality, Mr. Morris's salary increase was closer to 34 percent. Absent this



1 difference, the actual 2008 executive pay was actually \$39,850 more than what  
2 Avista calculated using the 3.5 increase.

3 **Q: Why do you disagree with Avista's use of a 5 percent increase to estimate**  
4 **2009 salaries?**

5 A: I disagree with the use of 5 percent because: 1) it is not supported, and 2) it is  
6 much higher than what is being proposed for non-executives.

7 **Q: Please explain.**

8 A: The Board of Directors has not approved the 2009 salary increase for Avista's  
9 executives. From 2005 to 2006, the executive team received a 4.1 percent  
10 increase in total base salary.<sup>40</sup> From 2006 to 2007, the total increase in base  
11 salary was 4.45 percent.<sup>41</sup> The change between 2007 and 2008 is only 4.5  
12 percent, excluding Mr. Morris whose position change led to an abnormal salary  
13 increase. Avista's response to WUTC Data Request No. 80 provides a survey  
14 which indicates that the estimated 2009 increase for executives in the utility  
15 industry is only 4 percent. Finally, the 5 percent increase used for executive pay  
16 is quite a bit higher than the 3.8 percent used to increase administrative non-  
17 executive pay. As I have discussed above, I believe even that 3.8 percent increase  
18 is overstated. I believe executive pay increases, at least as far as ratepayers are  
19 concerned, should not exceed those proposed for the non-executive administrative  
20 staff.

21 **Q: What do you recommend?**

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<sup>40</sup> See Avista's Response to UTC Staff Data Request No. 67, Attachment A.

<sup>41</sup> *Id.*, Attachment B.



1 XXXXX<sup>42</sup> XXXXXXXXXXX<sup>43</sup>. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

2 XXXXXXXXXXXXXXXXXXXXXXXX.<sup>44</sup> [End Confidential] The executive plan  
3 appears to have an earnings per share component; however, Avista has removed  
4 its calculation of that portion in the incentive amount it charges to ratepayers in  
5 this case.

6 **Q: Do you take issue with Avista including expenses relating to this program in**  
7 **its revenue requirement?**

8 A: Not in theory because the portion included in rates is determined on customer-  
9 related objectives. However, Avista has made an adjustment which substantially  
10 increases the amount it seeks to charge ratepayers, over its actual 2007 amount,  
11 and I object to this adjustment. Avista adjusted its 2007 test year incentive  
12 compensation expense to the actual 2007 incentive paid in 2008, and then further  
13 adjusted the incentive expense to a six year average. This had the effect of  
14 increasing the 2007 incentive amount included in Washington jurisdiction rates by  
15 \$461,454.<sup>45</sup>

16 **Q: Does Avista explain why it made the adjustment to increase incentive**  
17 **expense?**

18 A: No. Ms. Andrews discusses the adjustment at pages 25 through 28 of her  
19 testimony, but she gives no reason for moving to a six-year average. Instead she  
20 discusses other areas where averages are used and mentions that Settlement in the

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<sup>42</sup> [Begin Confidential] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX [End Confidential]

<sup>43</sup> [Begin Confidential] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX [End Confidential]

<sup>44</sup> Avista's Confidential Response to UTC Staff Data Request No. 13.

<sup>45</sup> Andrews Workpaper, p. PF 13.2.

1 last rate case adopted a Staff proposal to use a seven year average for this  
2 expense.<sup>46</sup>

3 **Q: Why did Staff recommend the use of a seven-year average in the last case?**

4 A: The last rate case used a 2006 test year. In that year, the incentive payout was the  
5 second highest since 1999, with only 2005's payment being higher. The Staff  
6 witness was merely trying to adjust the incentive payment to an amount more  
7 reflective of the Company's average experience.<sup>47</sup>

8 **Q: What do you recommend?**

9 A: I recommend including only the actual 2007 payout in the revenue requirement.  
10 As shown in the table below, the 2007 total is closer to the total experienced in  
11 years 2002 through 2004, when adjusted for inflation.

12 Table 3

13 O&M Incentive Payout Adjusted for Inflation<sup>48</sup>

Year	Total Adjusted O&M Incentive
2002	\$ 3,448,470
2003	3,328,567
2004	3,634,931
2005	5,932,377
2006	4,531,125
2007	3,255,059

14  
15 I have reversed the portion of Avista's proforma adjustment that relates to the  
16 move to a six-year average. The annual revenue requirement impact of these  
17 adjustments is a reduction of \$0.4 million for electric and \$0.1 million for gas.

<sup>46</sup> Exhibit No. \_\_\_\_ (EMA-1T), p. 27:9-12.

<sup>47</sup> Docket No. UE-070804, Exhibit No. \_\_\_\_ (DPK-1T), p. 23:4-10.

<sup>48</sup> Andrews Workpaper, p. PF13.4. Amounts include payroll taxes and are adjusted to 2007 dollars.

1       **H.     Adjustment Nos. 8(E) and 7(G) – Advertising Expense**

2       **Q:     Please explain Adjustment Nos. 8(E) and 7(G).**

3       A:     Adjustment Nos. 8(E) and 7(G) remove certain advertising expenses from  
4             Avista’s claim. These adjustments are shown on page 16 of  
5             Exhibit No.\_\_\_\_(MJM-9), Schedule 5, and result in an incremental reduction to  
6             revenue requirement of \$29,173 for electric and \$31,432 for gas.

7       **Q:     Why have you removed these expenses?**

8       A:     Avista has included costs associated with advertising that in my opinion should  
9             not be included in rates. These include costs associated with advertisements done  
10            for charitable and civic purposes, as well as some advertisements that appear to  
11            encourage the use of or switch to natural gas.

12      **Q:     What guided you in your removal of advertising expenses?**

13      A:     Using Avista’s response to Public Counsel’s Data Request No. 119, I removed  
14            any expenses labeled as charitable or civic related. I also removed several sales  
15            and marketing expenses over \$10,000 which were discussed in Avista’s response  
16            to Public Counsel’s Data Request No. 120. Of these expenses, some relate to the  
17            preparation of a website presenting Avista’s legacy. The others appear to be  
18            directed at encouraging homeowners to select or switch to natural gas.

19      **Q:     Why did you choose to remove these specific expenses?**

20      A:     The Washington rule on allowable advertising states the following:<sup>49</sup>

21                   The commission will not allow expenses for promotional or  
22                   political advertising for rate-making purposes. The term  
23                   "promotional advertising" means advertising to encourage

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<sup>49</sup>See WAC 480-100-223 for the electric rule and WAC 480-90-223 for the natural gas rule.

1 any person or business to select or use the service or  
2 additional services of an electric utility, to select or install  
3 any appliance or equipment designed to use the electric  
4 utility's service, or to influence consumers' opinions of the  
5 electric utility.  
6

7 In my opinion any advertising done for a charitable or civic purpose is  
8 intended to influence consumers towards a positive opinion of the utility.

9 I also believe expenses relating to Avista's legacy website are purely for  
10 self-promotion purposes. The other expenses I have removed include a  
11 print advertisement and two television advertisements designed to  
12 encourage the use of natural gas. They clearly fall under the rule quoted  
13 above and should not be charged to ratepayers.

14 **I. Adjustment Nos. 9(E) and 8(G) – Sporting Events**

15 **Q: Please explain Adjustment Nos. 9(E) and 8(G).**

16 A: Adjustment Nos. 9(E) and 8(G) remove amounts related to sporting and other  
17 entertainment events from the Company's revenue requirement claim. These  
18 adjustments are shown on page 17 of Exhibit No.\_\_(MJM-9), Schedule 5.

19 **Q: Why have you made this adjustment?**

20 A: In Avista's Response to UTC Data Request No. 43, the Company acknowledged  
21 that they had included in advertising expense certain costs related to "sponsorship  
22 agreements in support of community partnerships, such as overall support for our  
23 area's colleges and universities" that should have been classified as non-utility.<sup>50</sup>

24 In her Supplemental Direct Testimony, Ms. Andrews removed \$105,365 of  
25 electric expenses related to these costs. An additional \$65,200 should be removed

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<sup>50</sup> Avista's Response to UTC Data Request No. 43

1 from the gas revenue requirement, which was not addressed in Supplemental  
2 Testimony.<sup>51</sup> I have removed these amounts in addition to the other advertising  
3 amounts discussed above. The incremental impact of these adjustments is to  
4 reduce the revenue requirement by \$110,125 for electric and \$68,131 for gas.

5 **J. Adjustment Nos. 10(E) and 9(G) – Dues and Membership Fees**

6 **Q: Please explain Adjustment Nos. 10(E) and 9(G).**

7 A: Adjustment Nos. 10(E) and 9(G) remove certain dues and membership fees from  
8 the Company's revenue requirement claim. These adjustments are shown on page  
9 18 of Exhibit No.\_\_\_\_(MJM-9), Schedule 5 and result in a \$159,214 reduction to  
10 the electric revenue requirement and a \$39,217 reduction to the gas revenue  
11 requirement.

12 **Q: Why have you made this adjustment?**

13 A: Avista included in its revenue requirement claim expenses associated with dues  
14 and membership fees for organizations which are not necessary for the safe and  
15 reliable provision of electric or gas service. This includes dues related to  
16 charitable and civic organizations, as well as fees related to Board of Director's  
17 activities. Using the information found in Avista's response to WUTC Data  
18 Request No. 45, Attachment A. I have removed these types of expenses.

19 **K. Adjustment Nos. 11(E) and 10(G) – Charitable Donations**

20 **Q: Please explain Adjustment Nos. 11(E) and 10(G).**

---

<sup>51</sup> These amounts also include the portion of costs related to athletic events that were not recorded as advertising costs.

1 A: Adjustment Nos. 11(E) and 10(G) remove charitable donations from the  
2 Company's revenue requirement claim. These adjustments are shown on page 19  
3 of Exhibit No.\_\_(MJM-9), Schedule 5 and result in a \$15,670 reduction to the  
4 electric revenue requirement and a \$8,283 reduction to the gas revenue  
5 requirement.

6 **Q: Why have you made this adjustment?**

7 A: Avista included in its revenue requirement certain charitable donations. These  
8 donations are not necessary for the provision of safe, reliable and efficient electric  
9 and natural gas service. While it is commendable that Avista is involved in civic  
10 and charitable activities, ratepayers should not be expected to finance those  
11 activities. As such, I have removed these donations.

12 **L. Adjustment Nos. 12(E) and 11(G) – Directors' Compensation and Other**  
13 **Shareholder-Related Expenses**

14 **Q: Please explain Adjustment Nos. 12(E) and 11(G).**

15 A: Adjustment Nos. 12(E) and 11(G) remove half of the Company's claim for  
16 directors' compensation and other expenses related to shareholder services.  
17 These adjustments are shown on page 20 of Exhibit No.\_\_(MJM-9), Schedule 5.

18 **Q: Why have you made this adjustment?**

19 A: Avista incurs certain costs as a result of its status as a publicly-traded, shareholder  
20 owned company. Included in these costs are directors' fees and expenses, trustee,  
21 registrar, and transfer agent fees and expenses, stockholder meeting expenses,  
22 expenses related to dividend and other financial notices and the printing and  
23 mailing dividend checks, expenses related to the publishing and distributing  
24



1 annual reports to stockholders and expenses related to public notices of financial,  
2 operating and other data required by regulatory statutes. In its filing, Avista has  
3 charged all of these expenses to utility operations.<sup>52</sup> In my opinion, these  
4 expenses serve to benefit shareholders, and therefore, shareholders should bear  
5 the cost.

6 **Q: What do you recommend?**

7 A: I recommend the removal of 100 percent of Avista's expenses related to trustee,  
8 registrar, and transfer agent fees, stockholder meetings, dividend and other  
9 financial notices, the printing and mailing dividend checks, the publishing and  
10 distributing annual reports to stockholders and public notices of financial,  
11 operating and other data required by regulatory statutes. Because I recognize that  
12 Directors play a role in the management of a company, I have split the Directors'  
13 fees and expenses evenly between shareholders and ratepayers. My  
14 recommendations result in incremental revenue requirement reductions of \$0.4  
15 million for electric and \$0.1 million for gas.

16 **M. Adjustment Nos. 13(E) and 12(G) – D&O Insurance**

17 **Q: Please explain Adjustment Nos. 13(E) and 12(G).**

18 A: Adjustment Nos. 13(E) and 12(G) splits the Company's claim for D&O insurance  
19 between ratepayers and shareholders. These adjustments are shown on page 21 of  
20 Exhibit No. \_\_\_\_ (MJM-9), Schedule 5 and result in a \$0.4 million reduction to the  
21 electric revenue requirement and a \$0.1 million reduction to the gas revenue  
22 requirement.

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<sup>52</sup> Avista's Response to Public Counsel Data Request No. 280.

1           **Q:     Why have you made this adjustment?**

2           A:     Avista included in its revenue requirement \$979,840 in expenses related to  
3                 Directors and Officers (D&O) insurance.<sup>53</sup> I have adjusted that amount to share  
4                 this expense on a 50-50 basis with shareholders.

5           **Q:     Why do you feel it is appropriate to share the cost of D&O insurance?**

6           A:     I base my recommendation on information provided in the Revised Direct  
7                 Testimony of William. B. Marcus on behalf of Public Counsel in Avista's last rate  
8                 case, Docket Nos. UE-070804 and UG-070805. In that case, Mr. Marcus pointed  
9                 out that in 2007 Avista settled a suit brought on by shareholders, which resulted in  
10                its insurance company paying those shareholders \$8.5 million. This demonstrates  
11                that D&O insurance benefits shareholders as well as ratepayers – it is used to pay  
12                off shareholders when Company executives make poor decisions. Mr. Marcus  
13                also pointed out that in at least two jurisdictions – California and Arkansas – these  
14                costs are shared between ratepayers and shareholders.

15          **Q:     Do you agree with Avista's statement in its response to Public Counsel Data**  
16          **Request No. 278 that:**

17                    ...**"D&O" coverage is meant to provide insurance for**  
18                    **Directors and Officers who would otherwise remain**  
19                    **personally financially exposed to large damage awards**  
20                    **in the course of discharging their responsibilities for the**  
21                    **Corporation. Without sufficient coverage, no**  
22                    **individual would knowingly risk this type of personal**  
23                    **exposure, by agreeing to serve as a Director or Officer.**  
24                    **Accordingly, without such coverage, no corporation**  
25                    **could attract and retain Directors and Officers to**  
26                    **govern its affairs. As such, premiums paid for such**

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<sup>53</sup> Avista's Response to Public Counsel Data Request No. 278.

1                   **coverage are an important and necessary cost of doing**  
2                   **business.**<sup>54</sup>  
3

4           A:     Yes, I agree that D&O insurance is a necessary business expense. However, the  
5                   need for this insurance is brought on, in part, by the Company's status as a  
6                   publicly traded company. The insurance is there to protect shareholders in that it  
7                   provides a source of funds to provide payment should their investment decline  
8                   due to poor decisions by the Company executives. Therefore, shareholders  
9                   should bear a share of these costs.

10          **N. Adjustment Nos. 14(E) and 13(G) – Interest Synchronization**

11          **Q: Explain your interest synchronization adjustments as shown on Exhibit**  
12                   **No.\_\_\_\_ (MJM-9), Schedule 5, p. 22.**

13          A:     Adjustment Nos. 14(E) and 13(G) adjust the interest expense in the income tax  
14                   calculation to reflect Avista's current composite weighted interest rate.

15          **O. Rate of Return**

16          **Q. Have you accepted Avista's proposed rate of return?**

17          A:     No. I have used the cost of capital to which certain parties have agreed in the  
18                   proposed settlement in this docket. This adjustment is shown in Exhibit  
19                   No.\_\_\_\_(MJM-9), Schedules 2(E) and 2(G). The calculation of the cost of capital  
20                   is shown as Schedule 4 to Exhibit No.\_\_\_\_(MJM-9).  
21

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<sup>54</sup> Avista Response to Public Counsel Data Request No. 278.

1 **VI. Summary**

2 **Q: Please summarize your recommendations.**

3 A: I have made 14 adjustments to the Company's electric revenue requirement  
4 proposal and 13 adjustments to its gas revenue requirement proposal. In  
5 summary:

- 6 • I recommend that the UTC specifically recognize that Avista has a \$209.4  
7 million regulatory liability related to its collection of excess future  
8 removal costs. Avista should be required to reclassify this amount to  
9 Account 254-Other Regulatory Liabilities for regulatory accounting,  
10 reporting, and ratemaking purposes. This adjustment is a revenue neutral  
11 reclassification, however, I recommend it be used to offset **[Begin**  
12 **Confidential]** ~~XX~~  
13 ~~XXXXXXXXXX~~ **[End Confidential]**
- 14 • I have adjusted the Company's federal income tax rate to reflect its  
15 corporate tax rate.
- 16 • I have implemented Mr. King's depreciation adjustments.
- 17 • I have recommended that the portion of **[Begin Confidential]** ~~XXXXXXX~~  
18 ~~XX~~ **[End**  
19 **Confidential]**
- 20 • I have reduced Avista's requests for non-executive compensation,  
21 executive compensation and incentive pay.

- 1                   •       I have eliminated certain expenses relating to advertising, sporting events,  
2                               dues and membership fees, charitable donations, shareholders' services  
3                               and D&O insurance.

4           **Q:    What is the impact of your adjustments?**

5           A:    My adjustments reduce Avista's calculated revenue deficiency by \$12.139 million  
6                   for electric and \$3.247 million for gas. This results in a \$24.477 million electric  
7                   revenue increase and a \$3.341 million gas revenue increase.

8           **Q:    Does this conclude your testimony?**

9           A:    Yes, it does