Exhibit No. ___CT (JH-1CT)
Dockets UE-120436, et al.
Witness: Joanna Huang
REDACTED VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION, d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-120436/UG-120437** ***(consolidated)***
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-110876/UG-110877** ***(consolidated)***

TESTIMONY OF

Joanna Huang

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Electric Results of Operations and Revenue Requirement, PCB Transformer, Incentives, Labor – Non Exec and Exec, Depreciation Study, Gas Inventory and JP Adjustments

September 19, 2012

CONFIDENTIAL PER PROTECTIVE ORDER IN DOCKET UE-120436 ET AL.

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Joanna Huang. My business address is Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My email address is jhuang@utc.wa.gov.

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

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

Q. How long have you been employed by the Commission?

A. 15 years.

Q Would you please state your educational and professional background?

A. I received my B.B.A. degree majoring in Accounting from National Chung-Hsing University, Taiwan, in 1987 and a Master of Accounting degree from Washington State University in 1991. Prior to my employment at the Commission, I was employed by the Washington State Department of Revenue, as an Excise Tax Examiner. I performed desk audits on Business & Occupation tax returns.

I began my employment with the Commission in 1996. My work generally includes financial, accounting and other analyses for general rate case proceedings and other tariff filings by the electric and natural gas utilities regulated by the

Commission. I attended the National Association of Regulated Utility Commissioners Annual Utility School in 1996 and 2001. In addition, I have attended numerous training seminars and conferences regarding utility regulations and operations.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the scope of your testimony?

A. I present and explain Staff's overall revenue requirement recommendation for the electric operations of Avista Corporation (Avista or Company). I incorporate all Staff adjustments to calculate Staff's recommended revenue requirement for the electric operations. I also present Staff's analysis of several individual accounting adjustments for which I am responsible.

Q. Please summarize Staff's revenue requirement analysis for Avista's electric operations.

A. Staff's analysis shows that Avista has a revenue surplus of $1,312,000 on an attrition-adjusted basis. This figure is based on a revenue surplus of $20,378,000 using the Commission's traditional rate base/rate of return analysis, plus 19,066,000 based on Staff's attrition analysis.

Overall, Staff's revenue requirement shows that Avista's electric operations, on a pro forma basis, are earning 8.34 percent return on the rate base shown in Column (f). Based on Staff's recommended 7.22 percent rate of return, Staff's analysis supports a decrease in electric revenues of $20,378,000, which is an overall decrease of 4.49 percent, before attrition shown in Column (g).

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

A. Yes. I prepared Exhibit No. ___ (JH-2) entitled Electric Results of Operations and Revenue Requirement. This is a multi-page exhibit that shows Avista's operating results for the test year ended December 31, 2011, for Washington Electric Operations. The exhibit is organized as follows:

- Results of Operations Summary (Schedule 1.1);
- Schedule of Restating Adjustments (Schedule 1.2);
- Schedule of Pro forma Adjustments (Schedule 1.3);
- Summary of Adjustments Before Attrition Adjustments (Schedule 1.4);
- Revenue Requirement Computation (Schedule 2);
- Revenue Conversion Factor (Schedule 3);
- Pro Forma Capital Structure and Cost of Capital (Schedule 4);

I discuss each of these schedules in my testimony.

In addition, I prepared Exhibit Nos. ___ (JH-3) through ___ (JH-8), which support the individual adjustments I sponsor. I also discuss these exhibits in my testimony.

III. ELECTRIC REVENUE REQUIREMENT

Q. Please explain page one of your Exhibit No. ___ (JH-2), Electric Results of Operations and Revenue Requirement.

A. Page one of my Exhibit No. ___ (JH-2) presents a summary of Staff's analysis of the Company's results of operations for the test year. Page one is labeled Schedule 1.1 and it presents the Results of Operations, Rate Base, and Return on Investment. The Company's Unadjusted Per-Book Results are shown in Column (b), Restated Results are shown in Column (d), and Pro forma Results are shown in Column (f). Staff proposed revenues requirement are shown in Column (g) before attrition adjustment.

Q. Please explain the remaining Schedules in your Exhibit No. ___ (JH-2).

A. Schedule 1.2 covers pages two to four, and this schedule itemizes Staff's Restating Adjustments shown in Column (c) of page one. I use the same adjustment titles as the Company uses in Ms. Andrews' Exhibit No. ___ (EMA-2). Schedule 1.3, on pages five through seven, itemizes Staff's Pro Forma adjustments shown in Column (e) on page 1.

Schedule 1.4 is page 8 of my exhibit, and it is labeled Summary of Adjustments. This schedule shows the difference in revenue requirement for each contested adjustment between the Company and Staff.

The remaining Schedules in my Exhibit No. ___ (JH-2) are Staff's calculation of the Revenue Requirement (Schedule 2.0) before attrition adjustments, the conversion factor (Schedule 3.0), and the derivation of Staff's overall proposed rate of return (Schedule 4.0).

Q. What are the components of Staff's rate of return, or weighted cost of capital?

A. The weighted average cost of capital recommended by Staff witness Ken Elgin (*see* direct testimony of Ken L. Elgin, Exhibit No. ___ (KLE-1T)) is 7.22 percent. This is composed of 54 percent debt at 5.7 percent (including short-term debt) and 46 percent equity at 9.0 percent. Staff's recommendation is also presented in Schedule 4.0 on page 11 of my Exhibit No. ___ (JH-2).

Q. Please identify the adjustments each Staff witness is responsible for regarding Avista's electric operations, and which adjustments are contested.

A. The following table provides this information:

(remainder of page intentionally left blank)

Table 1

Electric Adj	Contested Y/N	Subject	Staff Witness
1.01	N	Deferred FIT Rate Base	Foisy
1.02	N	Deferred Debits and Credits	Foisy
1.03	Y	Working Capital	Foisy
1.04	Y	FIT Correction	Breda
2.01	N	Eliminate B & O Taxes	Foisy
2.02	N	Uncollectible Expense	Keating
2.03	N	Regulatory Expense	Keating
2.04	N	Injuries & Damages	Keating
2.05	N	FIT/DFIT/ITC/PTC Expenses	Breda
2.06	N	Eliminate WA Power Cost Defer	Foisy
2.07	N	Nez Pierce Settlement Adjustment	Foisy
2.08	N	Eliminate AR Expenses	Foisy
2.09	N	Office Space Charges to Subsidiaries	Huang
2.10	N	Restate Excise Tax	Foisy
2.11	N	Net Gains/Losses	Keating
2.12	N	Revenue Normalization and Gas Cost Adjustment	Keating
2.13	Y	Miscellaneous Restating	Keating
2.14	Y	PCB Transformer Restating	Huang
2.15	Y	Restate Incentives	Huang
2.16	Y	Colsrip CS2 Maintenance	Breda
2.17	N	Restate Debt	Keating
3.00	Y	Pro Forma Power Supply	Buckley/Mickelson
3.01	N	Pro Forma Transmission Rev/Exp	Buckley/Breda
3.02	Y	Pro Forma Labor Non-Exec	Huang
3.03	Y	Pro Forma Labor Exec	Huang
3.04	N	Pro Forma Employee Benefits	Huang
3.05	N	Pro Forma Insurance	Keating
3.06	Y	Pro Forma Property Tax	Foisy
3.07	Y	Pro Forma Restating 2011 Capital	Breda
4.00	Y	Attrition Capital Adds 2012	Breda
4.01	Y	Attrition Capital Adds 2013	Breda
4.02	Y	Attrition DSM	Breda
4.03	Y	Attrition Other	Breda
4.04	Y	Pro Forma Retail Revenue Credit	Breda/Buckley
4.05	Y	Depreciation Study	Huang
4.06	Y	Pro Forma O&M Offsets	Breda

Q. In addition to incorporating the adjustments of other Staff witnesses, how many specific adjustments are you responsible for?

A. I am also responsible for eight ratemaking adjustments proposed by Avista.

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

A. Staff does not contest the following four electric and natural gas adjustments proposed by Avista, which I reviewed:

- Adjustments 2.09, Electric and Gas - Office Space Charges to Subsidiaries
- Adjustment 3.04, Electric and Adjustment 3.02, Gas - Pro Forma Employee Benefits

Q. Which Company adjustments have you reviewed that are contested by Staff?

A. Staff contests the following ten adjustments proposed by Avista:

- Adjustment 2.14, Electric - PCB Transformer Restating
- Adjustment 2.15, Electric and Adjustment 2.12, Gas - Restating Incentives
- Adjustment 3.02, Electric and Adjustment 3.00, Gas - Pro Forma Labor-Non Executive
- Adjustment 3.03, Electric and Adjustment 3.01, Gas - Pro Forma Labor-Executive
- Adjustment 4.05, Electric and Adjustment 4.02, Gas - Depreciation Study
- Adjustment 1.03, Gas - Gas Inventory and JP Restating

Q. You testified earlier about your exhibits other than Exhibit No. ___ (JH-2). Please identify those other exhibits.

A. I prepared the following exhibits in support of my testimony on the contested adjustments I address:

- Exhibit No. ___ (JH-3), PCB Transformer Restating
- Exhibit No. ___ (JH-4), Restating Incentives
- Exhibit No. ___ (JH-5), Pro Forma Labor-Non Executive
- Exhibit No. ___ (JH-6C), Pro Forma Labor- Executive
- Exhibit No. ___ (JH-7), Depreciation Study
- Exhibit No. ___ (JH-8), Gas Inventory and JP Restating

IV. DISCUSSION

A. Adjustment 2.14, Electric - PCB Transformer Restating

Q. Please summarize the Company's PCB Transformer Restating Adjustment.

A. In 2007, Avista initiated a field testing program to perform a comprehensive and accelerated identification of its PCB-tainted transformers. "PCB" means polychlorinated biphenyl, and it is a substance that was once commonly used in transformers. According to Avista, its past experience indicated that 10% of yet unidentified transformers would contain PCBs. Avista completed the field testing in 2011, but did not identify any transformers that contained PCBs.

In this case, Avista proposes to remove from test year expenses its costs to field test PCB transformers from 2007 through 2010, in the amount of $1,278,065.[1] In addition, Avista proposes to amortize these costs over the three-year period 2013

[1] See my Exhibit No. ___ (JH-3), at 10. Avista's response to Public Counsel Data Request 81, section (b): "The Company intended to remove only the 2007 through 2010 costs as prior period costs."

through 2015.[2] The net effect of removing of $1,278,065 in expense, and amortizing it in the amount of $426,021 over three years, increases Washington operating income by $554,000.

Q. Should the Commission accept this adjustment?

A. No. The Commission should reject this adjustment because the Company incurred this expense from 2007 through 2010, and thus it is not a test year expense. Such prior period expenses are not allowed in rates.[3] In addition, Avista should have expensed the costs it incurred to field test the transformers in the year Avista incurred the expense.

Staff's Adjustment 2.14 removes $1,278,065 from the test year expense. The effect of this adjustment increases Washington Electric net operating income by $831,000.

Q. Please explain the Company's accounting for these costs.

A. Avista initially capitalized the costs it incurred in its attempt to find PCB-tainted transformers, as part of an overall asset management program. From 2007 through 2010, Avista recorded these costs as Cost of Removal (COR) in a capital account, FERC Account 108. During the test period 2011, Avista moved these costs from Account 108 to an expense account, FERC Account 595, Distribution Maintenance expense, apparently expecting to recover these expenses through rates.

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[2] Direct Testimony of Avista witness Elizabeth Andrews, Exhibit No. ___ (EMA-1T), at 25, lines 14-15.
[3] WAC 480-07-510(3)(e)(ii).

Q. Why should Avista have expensed these PCB transformer field testing costs in 2007 through 2010 as they were incurred, rather than capitalize them?

A. Avista should have expensed these costs because they were for identification only. As such, these are not costs of removal. In Avista's Response to Staff Data Request 150, Attachment A, Avista admits that: "In 2007 a comprehensive field testing program for PCBs was initiated and incorrectly coded as COR. Since testing was for identification only, it should be expensed." I include this response on page 2 of my Exhibit No. ___ (JH-3).

Q. Please summarize the correct ratemaking treatment of these costs.

A. Avista improperly recorded these costs to a plant account. Avista should have booked these costs to an expense account and expensed the costs in the year the costs were incurred. The Commission should recognize the correct accounting for these costs and reject the Company's adjustment.

B. Adjustment 2.15, Electric and Adjustment 2.12, Gas - Restating Incentives

Q. What types of incentive payments are addressed in this adjustment?

A. This adjustment addresses two types of incentive payments Avista pays to certain employees. First, as part of its compensation plans, Avista pays its employees incentive amounts if the Company meets certain targets for Operating and Maintenance (O&M) costs. Avista pays these incentive amounts to both non-officers (which can be union or non-union employees) and officers.

Second, this adjustment addresses the incentives Avista pays for meeting earnings per share (EPS) targets. Avista's adjustment excludes these EPS-related incentives and Staff's adjustment does the same. For that reason, I will not discuss these EPS-related incentives further.

Q. Please explain how the Company proposes to treat the incentive payments for achieving O&M targets.

A. First, the Company adjusted the incentive payments it paid in the prior six years (2006-2011) by using Consumer Price Index (CPI) to inflate these prior year incentive payments to compare with the 2011 level. Second, the Company adjusted the test year actual incentive payments to the six year average amount.

Q. Should the Commission accept the Company's adjustment for O&M-related incentives?

A. The Commission should accept only the technique of using an average of prior O&M-related incentive payments. The Commission should reject the Company's adjustment using the CPI to inflate prior year incentive payments and the Company's inclusion of 2010 incentive payments in its calculation of the six-year average.

Q. How does Staff's adjustment differ from the Company's adjustment?

A. I make three changes to the Company's calculation of the O&M incentive payments. First, I did not adjust prior year incentive payments using the CPI. Second, I use a six-year average of incentive payments (2005 to 2009 plus 2011) rather than the

2006-2011 period Avista used. Third, I remove [redacted] percent of the Executive O&M portion of the incentive payments, to reflect an appropriate level of incentives paid to executives.

I discuss the reasons underlying the third change in detail later in my testimony, in my discussion of Adjustment 3.03, Electric and Adjustment 3.01, Gas – Pro Forma Labor – Executive.

Q. Why did Avista use the Customer Price Index to adjust prior year incentive payments?

A. The Company believes the historical years' incentives should be based on a similar level of salary as was used in the test period to have an "apples to apples" comparison.[4]

Q. Why should the Commission exclude the Company's CPI compounding adjustment?

A. Avista's use of the CPI in this context is inappropriate because incentive compensation is related to an employee's salary levels at the time of payout.[5] The Company's target level of incentive is determined by applying job level targets against specific year salaries.[6] If any one year's incentive is inflated by the CPI, that specific year's incentive then has lost its correlation to a specific year's salary. The resulting comparison is meaningless.

[4] Direct Testimony of Elizabeth M. Andrews, Exhibit No. ___ (EMA-1T), at 69, lines 12-16.
[5] Avista's response to Public Counsel Data Request 287, section (b).
[6] Avista's response to Public Counsel Data Request 276, section (f).

Q. Please give an example of a similar situation where it is appropriate to use the average of historical expenses without using the CPI to determine the test year level of expenses.

A. A typical example is Injuries and Damages Restating Adjustment 2.04. These expenses are payments the Company makes for injury and damages claims that are not covered by insurance. This adjustment uses the average of the six-year rolling average of the historical expenses, without using the CPI to determine the test year level of expenses level for ratemaking purposes.[7]

Q. Please list Avista's historical actual O&M-related incentives (i.e., without using the CPI) for the last 10 years.

A. This information is shown in the following table.[8]

Table 2

	Incentives including Payroll Taxes Based on YE Accruals Under Approved Plan						
	Officer				Non - Officer	Total Incentive Accrual	Total O&M Incentive
	Corp EPS	Utility EPS	O&M	Total	O&M	Total	
2002		60,536	242,144	302,680	2,749,916	3,052,596	2,992,060
2003	367,751	185,733	280,789	834,272	2,673,057	3,507,329	2,953,846
2004		457,770	225,330	683,099	3,086,293	3,769,392	3,311,623
2005	-	909,032	610,634	1,519,666	4,977,202	6,496,868	5,587,836
2006	822,163	1,096,217	528,800	2,447,180	3,876,843	6,324,024	4,405,643
2007	-	-	352,548	352,548	2,902,511	3,255,059	3,255,059
2008	147,798	997,637	311,028	1,456,462	2,545,340	4,001,803	2,856,368
2009	-	1,523,995	570,632	2,094,627	4,488,749	6,583,376	5,059,381
2010	252,466	1,081,635	1,006,427	2,340,528	8,364,606	10,705,134	9,371,033
2011	215,069	1,191,455	526,587	1,933,110	2,901,617	4,834,727	3,428,204

Data Sources: Avista witness Elizabeth Andrews' electric workpaper for Restate Incentive Adjustments, page 2.15-2 and workpaper from UE-110877.

[7] Direct Testimony of Elizabeth M. Andrews, Exhibit No. ___ (EMA-1T), at 20.
[8] Data source is Avista witness Elizabeth Andrews' workpaper for Adjustment 2.15, at 3 and prior rate case workpapers for the incentive adjustment.

Q. Why did you reject the Company's six-year average based on 2006 to 2011 in favor of a six-year average based on 2005-2009 plus 2011 to adjust test year incentive payment level?

A. As the above table clearly shows, in 2010, Avista paid nearly twice the amount of incentives ($9,371,033) than the next highest annual incentive level payout ($5,587,836), which was in 2005. Because the 2010 amount is so far in excess of the next highest annual bonus payment level over the last 10 years, it is not representative of normal levels, and it distorts the average.

Q. Have you prepared an exhibit that shows your Restating Incentives Adjustment?

A. Yes. My Exhibit No.___ (JH-4) shows the impact of excluding the Company's CPI adjustment, removing the 2010 level of incentive payments from the six-year average and adding the amounts for 2005, and removing [redacted] percent of the Executive O & M portion of the incentive from 2005 to 2011. As I indicated earlier, I explain my reasons for removing [redacted] percent of the Executive O&M portion later when I explain Adjustment 3.03E, Electric and Adjustment 3.01, Gas – Pro Forma Labor – Executive.

C. Adjustment 3.02, Electric and Adjustment 3.00, Gas - Pro Forma Labor - Non Executive

Q. What types of expenses are addressed in the Pro Forma Labor - Non Executive Adjustment?

A. The Pro Forma Labor-Non Executive adjustment relates to the wages Avista pays to its union and non-union employees, but it does not include executive compensation.

Q. Please describe Staff's Pro Forma Labor-Non Executive adjustment.

A. For the 2011 and 2012 parts of this adjustment, Staff accepts the Company's amounts. However, Staff includes no increases for union and non-union employee wages after March 2013, which is during the rate year. Avista included increases after March 2013 for these employees.

The effect of Staff's adjustment reduces electric and natural gas net operating income by $974,000 and $271,000, respectively. My Exhibit No. ___ (JH-5) shows the impact of net operating income electric and natural gas.

Q. Is it appropriate for the Company to include 2013 rate year levels of wages in a pro forma wage adjustment?

A. No. The Commission explained in its Order 11 in Puget Sound Energy rate case Dockets UE-090704 and UG-090705, that wage increases nine months beyond the end of the test year for union contractual increase and before the beginning of the rate year for non-union wage increase "are too remote from the end of the test year to be included without risk of violating the matching principle."[9]

In this case, Avista's 2013 contractual union increases will not be effective until March 27, 2013, fifteen months beyond the end of test year and twenty one

[9] *Utilities and Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order 11 (April 2, 2010) at 34, paragraph 88.

months beyond the mid-point of the 2011 test year. For the 2013 non-union wage, the effective date of the increase is March 1, 2013, which is fourteen months beyond the end of test year and twenty months beyond the mid-point of the 2011 test year.

In addition, this is not a proper pro forma adjustment because it does not account for potentially offsetting factors, such as productivity increases or other expense savings. In fact, the Company has not conducted any productivity studies in the past five years, nor is it aware of studies conducted on its behalf.[10]

Wages affect many expense accounts. Staff witness Ms. Breda captures wage increases as one of the elements in her attrition study.

D. Adjustment 3.03, Electric and Adjustment 3.01, Gas - Pro Forma Labor – Executive

Q. What types of expenses are at issue in this adjustment?

A. This adjustment includes compensation Avista pays to its 13 officers. These officers' positions and compensation are as follows:[11]

Table 3

Job Title	Estimated 2013 Base Salary
Chairman, President and CEO	$670,000
Sr VP and CFO	$345,000
President of Avista Utilities	$305,000
Sr VP Gen Counsel & CCO	$290,000
Sr VP HR & Corp Sec	$255,000
all other executive officers	$1,834,000
Total	$3,699,000

[10] Avista's response to Public Counsel Data Request 43.
[11] Avista witness Elizabeth Andrews' electronic workpaper for *Pro Forma Labor – Executive Adjustments*, worksheet "PLE-3".

Q. In the last Avista general rate case, Dockets UE-110877 and UG-110876, what did the Commission order Avista to do with respect to executive compensation?

A. The Commission required Avista to provide the following information:

- A description of current executive compensation, including but not limited to, base salary, non-equity incentive compensation, and incentive compensation. This description should state what elements and amounts are included in rates for the Company and what elements and amounts are not recovered through rates.

- A description of how levels of compensation are set. This description should include discussion of the basis for selecting ostensibly comparable utilities that were surveyed, state what those survey results showed, and explain how the results relate to Avista. Avista is also required to state whether executive compensation paid by any Pacific Northwest investor-owned (e.g., Puget Sound Energy, PacifiCorp, et cetera) or publicly-owned utilities (e.g., Seattle City Light, Tacoma Power, Public Utility District No. 1 of Snohomish County, and the Bonneville Power Administration) were considered and if not, explain why not.

- An explanation of why the existing levels of executive compensation are appropriate for recovery in utility rates.[12]

Q. Did Avista respond?

A. Yes. Avista filed its response on February 29, 2012. The response was titled "Compliance Filing - Avista Corporation - Dockets UE-110876 & UG-110877."

Q. What was included in the Avista's response to the Commission's order?

A. Avista included a report entitled "Review of Executive Officer Compensation."

[12] *Utilities and Transp. Comm'n v. Avista Corp.,* Dockets UE-110876 and UG-110877, Commission Order 06, (December 16, 2011) at 19, paragraphs 42-43.

Q. Have you reviewed that report?

A. Yes.

Q. Did you use the data from that report to determine an appropriate level of salary for Avista's 13 executives in this proceeding?

A. Yes. I used information from Confidential Attachment G of the Review of Executive Officer Compensation, which is entitled "Towers Watson Total Direct Compensation Review." That document, including the pages I used, is Avista witness Ms. Feltes' Exhibit No. ___(KSF-2C), Confidential Attachment G, at 185-212.

Q. What types of information are included in Avista's Review of Executive Officer Compensation document, Confidential Attachment G?

A. Attachment G contains a study conducted by Towers Watson for [redacted]

This information is contained in Confidential Attachment G as follows: included following information:

- [redacted] (Exhibit No. ___ (KSF-2C), at 189)

- [redacted] (Exhibit No. ___ (KSF-2C), at 190-204)

- [redacted] (Exhibit No. ___ (KSF-2C), at 205)

[redacted]

- [redacted](Exhibit No. ___ (KSF-2C), at 206-212)

Q. [redacted]

A. [redacted]

Q. [redacted]

A. [redacted] are shown on page 205 of Confidential Attachment G, of Ms. Feltes' Exhibit No. ___(KSF-2C).

[redacted] are shown on page 205 of Confidential Attachment G, of Ms. Feltes' Exhibit No. ___ (KSF-2C).

Q. Please explain how Towers Watson [redacted].

A. [redacted] This is shown on page 205 of Confidential Attachment G, of Ms. Feltes' Exhibit No.__(KSF-2C).

Q. What did Avista do with this information?

A. [redacted] as shown in Avista witness Ms. Feltes' Exhibit No. ___(KSF-2C), at 205.

Q. Is it appropriate to use [redacted] to evaluate Avista's executive compensation?

A. Yes, in general.

Q. Please explain.

A. The Towers Watson report provides a general guideline with which to evaluate Avista's executive compensation. [redacted] Though the Towers Watson report provides a general guideline, it is up to Avista's Compensation Committee to exercise its discretion to set any level of compensation for its 13 officers within the Company.[13]

Q. Based on the Towers Watson study, [redacted]

A. [redacted].[14]

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[13] Avista witness Karen Feltes' Exhibit No. ___ (KSF-2C), at 13 of 212, paragraph entitled "Competitive Analysis".
[14] Avista witness Karen Feltes' Exhibit No. ___ (KSF-2C), at 191.

Q. Is it appropriate for Avista to [redacted]?

A. No.

Q. Please explain.

A. [redacted].[15]

[redacted]

[redacted].

[redacted], [redacted]

[15] Avista witness Karen Feltes' Exhibit No. ___ (KSF-2C), at 191.

[redacted].

[redacted].[16] [redacted].[17] [redacted]. [redacted].[18]

Q. What is the appropriate comparison the Commission should use for purposes of evaluating Avista's executive compensation for ratemaking purposes?

A. For ratemaking purposes, the Commission should compare Avista's officer compensation at the [redacted]. As I have explained, [redacted]. Accordingly, the [redacted] is more representative of Avista's circumstances.

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[16] Avista witness Karen Feltes' Exhibit No. ___ (KSF-2C), at 205 footnote.
[17] Avista's response to Public Counsel Data Request 268, section (b).
[18] Avista witness Karen Feltes' Exhibit No. ___ (KSF-2C), at 191.

Q. Please explain how you used the Company's Review of Executive Officer Compensation to determine an appropriate level of salary for Avista's 13 executives.

A. For each of the 13 Avista executives, I compared their base salary and target cash or short-term incentives, with the amount of compensation for companies at the [redacted], as shown in Ms. Feltes' Exhibit No. ___ (KSF-2C), Confidential Attachment G, at 192-204. That comparison shows that for both base salary and short term incentive category combined, Avista pays its executives at a level [redacted].

My Exhibit No.___ (JH-6C), at 9, shows the Staff calculation of [redacted].

Q. Why did you compare Avista's officers' base salary and target cash or short-term incentive category combined, instead of the officers' total compensation?

A. In addition to base salary and short term incentives, Avista's compensation includes long term incentives and supplemental Executive Retirement Plan (SERP) and deferred compensation. However, Avista books these expenses below the line so they are borne by shareholders.[19] My Exhibit No. ___ (JH-6C), at 9, shows that Avista pays its executives at a level [redacted]. For ratemaking purposes, Staff only evaluates two

[19] Direct Testimony of Karen Feltes, Exhibit No. ___ (KSF-1T), at 29, lines 26-29.

categories of compensation, the base salary and target cash (or short term incentives).

Q. Did you apply [redacted] to any other part of executive compensation?

A. Yes. As I described earlier, I removed [redacted] of the compensation Avista paid its executives from Company Adjustment 3.03 Electric and 3.01 Gas, Pro Forma Labor - Executive and Company Adjustment 2.15 Electric and 2.12 Gas, relating to the executive (only) O& M incentive portion of incentive pay.

Q. Did you also review how Avista allocated its executive compensation expenses to utility operations for recovery through rates in this case?

A. Yes.

Q. How did Avista perform that allocation?

A. For the test year 2011, Avista allocated approximately 91 percent of executive compensation to utility operations and approximately 9 percent to non-utility operations. For the rate year 2013, Avista allocates approximately 87 percent to utility operations and 13 percent to non-utility operations.

Q. How did Avista determine its allocation of officers' compensation between utility and non-utility operations?

A. Avista's executive officers estimated the time they spent on non-utility activities based on each officer's historical experience and plans for the future.[20] The result is a percentage for each executive. The Company updates this percentage split between utility and non-utility operations in timekeeping each year, and the percentages stay constant throughout the year, unless situations change.

Q. Does Avista keep time records sufficient to verify the accuracy of these estimates?

A. No. No Avista executive officer puts information in their timekeeping records to indicate the hours they spend on regulated utility matters or matters involving unregulated subsidiaries.[21]

Q. Is Avista's allocation of 87 percent officers' compensation to the non-utility operations for the rate year 2013 appropriate?

A. No.

Q. Please explain.

A. Based on the employee count evidence in the table below, Avista is expanding its non-utility operations while utility operations have maintained the same level of employees since 1997. Avista predicts that during the rate year 2013, it will have

[20] Avista's response to Public Counsel Data Requests 19, 64, 83, 269, section (c) and 270 (C), sections (a) and (c).
[21] Avista's response to Public Counsel Data Requests 64, 83, 269, section (c) and 270 (C), sections (a) and (c).

nearly [redacted] more employees in its non-utility operations than in its utility operations.[22]

Table 4

[redacted]

Having more employees for its non-utility operations will demand more supervision and other resources from Avista's executives.

In addition, some of Avista's corporate level employees, such as the Treasurer, Assistant Corporate Secretary and Assistant Treasurer perform services for the overall corporation, which is comprised of both utility and non-utility operations. Yet, Avista assigns none of their labor dollars to non-utility operations. Avista improperly includes 100 percent of these employees' wages in utility operations.[23]

Q. Please describe the methodology you used to allocate executive compensation between utility and non-utility operations.

A. I developed the three-year average (2009-2011) of revenues and number of employees for utility operations and non-utility operations. The result was 76.36

[22] Avista's response to Public Counsel Data Requests 174 and 22(C).
[23] Avista's response to Public Counsel Data Request 270 (C), sections (b2) and (b5).

percent utility and 23.64 percent non-utility. I used these percentages to allocate executive compensation between utility and non-utility operations.

Q. Has Staff used this type of methodology in previous Avista dockets?

A. Yes. Staff used a similar methodology to calculate this adjustment in Docket UG-920840 and Avista Dockets UE-991606/UG-991607, except for one factor (wages) in the present case because Staff was unable to obtain the information from Avista upon request.[24] The Commission's order in the latter dockets accepted Staff's adjustment based on this procedure: "The allocation derived by Staff witness Joanna Huang following the 'WNG' method, which allocated 52.3 percent of officer salaries to Avista's regulated operations and 47.7 percent to non-regulated, is superior to the allocation proposed by Avista."[25]

Q. Why should the Commission accept Staff's allocation of executive compensation between utility and non-utility operations?

A. Staff's allocations follow the method the Commission approved in Dockets UG-920840 and Dockets UE-991606/UG-991607 and are based on quantifiable business parameters (revenues and employee counts, non-officers wages) which are more reasonable and appropriate compared to Avista's allocations, which are based on unverifiable estimates.

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[24] Avista's response to Staff Data Request 321.
[25] *Utilities and Transp. Comm'n v. Avista Corp.,* Dockets UE-991606 and UG-990607, Third Supplemental Order (September 29, 2000) at 67, paragraph 250.

Q. What is the net effect of Staff's Pro Forma Labor – Executive Adjustments?

A. The net effect of Staff's adjustments increases electric and natural gas net operating income by $442,000 and $127,000, respectively.

E. Adjustment 4.05, Electric and Adjustment 4.02, Gas - Depreciation Study

Q. Did Avista also file a new depreciation study in this case?

A. Yes. Avista includes a new depreciation study prepared by Gannett Fleming Inc. in Mr. DeFelice's Exhibit No. ___ (DBD-6). Subsequently, Avista updated its depreciation expense for transportation assets in FERC Accounts 392000 and 396000.[26]

Q. What is the scope of the depreciation study?

A. The depreciation study contains two phases. Phase one estimates the service life and net salvage characteristics for each depreciable group of assets. Phase two calculates the composite remaining lives and annual depreciation accrual rates by using straight-line remaining life method.

Q. Does Staff contest the Depreciation Study?

A. No.

[26] Avista's response to Staff Data Request 215, REVISED 2 and Supplemental.

Q. Would you please describe Staff's proposed Depreciation Study Adjustment?

A. Staff's Depreciation Study Adjustment reflects the Company's proposed changes in depreciation rates pertaining to both electric and natural gas plant-in-service, using the depreciation study the Company filed. Staff's adjustment used the average monthly average (AMA) of December 31, 2011, test year plant balances to calculate the difference between the existing depreciation rate and the proposed depreciation rates.

The net effect of the difference between the existing depreciation rate and the proposed deprecation rates is an increase to electric net operating income of $1,339,000 and a decrease to natural gas net operating income of $548,000. These adjustments are shown in my Exhibit No. ___ (JH-7). Staff's adjustment also reflects the updated depreciation expense for transportation assets in FERC Accounts 392000 and 396000, as shown in Avista's response to Staff Data Request 215 REVISED 2, column entitled "Grand Total."

Q. How does Staff's proposed Depreciation Study Adjustment differ from Avista's adjustment?

A. As I just explained, to calculate the difference between the existing depreciation rates and the proposed depreciation rates, Staff used the AMA test year plant balances. Avista used end of period (EOP) test year plant balances to calculate the difference between the existing depreciation rates and the proposed depreciation rates in its Adjustment 3.07, Electric and Adjustment 3.06, Gas, both Restating 2011 Capital. It is proposing the same results for the new depreciation study.

Staff's proposal keeps this adjustment on the same basis as Staff's AMA for all plant in 2011.

Q. Have you prepared an exhibit for this adjustment?

A. Yes. It is my Exhibit No. ___ (JH-7). My exhibit reflects impact of using the AMA of December 31, 2011, test year plant balances to calculate the difference between the existing depreciation rate and the proposed depreciation rates for Steam Production Plant, Transmission Plant, Distribution Plant, Common electric Plan and General Common Plant.

F. Adjustment 1.03, Gas - Gas Inventory and JP Restating,

Q. Please explain what "JP" refers to as well as the context of this adjustment.

A. "JP" refers to the Jackson Prairie underground gas storage facility of which Avista is a one-third owner. Large volumes of natural gas are injected into this facility and stored for later use by utility customers. This facility permits Avista to buy and store significant amounts of natural gas during the lower-priced summer months and withdraw natural gas from the reserves in winter months when customers' usage and wholesale natural gas prices are the highest. It also ensures that sufficient natural gas supplies are available throughout the year and provides Avista flexibility in the delivery of gas into its system. In sum, the Jackson Prairie facility helps to stabilize customers' energy costs and mitigate the impacts of price volatility in the wholesale natural gas markets.

On May 1, 2011, Avista and the other owners added storage capacity from 23 billion cubic feet to nearly 25 billion cubic feet. This adjustment is to reflect the increased operating and maintenance expense due to the capacity expansion and JP working gas inventory balance applicable to Washington gas operations.

Q. What is "working gas" and "cushion gas"?

A. "Working gas" is the volume of natural gas in the JP reservoir that is available to be withdrawn during any particular withdrawal season. Conditions permitting, Avista could use the total working capacity more than once during any season.

By contrast, "cushion" or "base" gas is not available to be withdrawn. It is needed to provide pressure and stability to the JP storage facility.

Q. Would you please describe the Company's proposed Gas Inventory and JP Restating Adjustment?

A. The Company's Gas Inventory and JP Restating Adjustment has two components. First, the Company restates the test year operating and maintenance expense level to the 2013 level resulting from the May 1, 2011, capacity addition.

Second, the Company restates the AMA of test year $10,772,781 JP working gas inventory balance applicable to Washington gas operations to the AMA $11,422,163 as of December 31, 2013.

Q. Please explain Staff's Gas Inventory and JP Restating Adjustment.

A. First, in contrast to the Company's proposed adjustment, Staff only adjusts test year operating and maintenance expense levels for January through April 2011 resulting from the May 1, 2011, capacity addition. Because the storage expansion was completed May 1, 2011, the test year operating and maintenance expense level already reflects the higher level of operating and maintenance expense from May through December as shown below. Therefore, test year operating and maintenance expense should be adjusted to reflect the additional capacity only for January to April, not the entire twelve months, January through December.

Table 5

JP related O & M	(May-December only)
2011	$ 608,690
2010	384,341
2009	349,171
2008	406,134
2007	405,491
2006	291,847

Second, in contrast to the Company's adjustment, Staff removes from the rate base the working gas inventory that Avista booked in FERC account 164100 for the per books amount of $10,772,781 for Washington operations.[27] Staff witness Michael Foisy explains this in his testimony regarding working capital.

[27] Avista witness Elizabeth Andrews' natural gas workpaper, at 1.03-12.

Q. How did Avista evaluate the average monthly average (AMA) JP working gas inventory balance applicable to Washington gas operations for the rate year January 1 to December 31, 2013?

A. Avista used a synthetic injection and withdrawal schedule and applied a 60-day average of the forward prices based on February 15, 2012, plus adders to the weighted percentage of the three pricing points, (AECO, Sumas and Rockies) to calculate the AMA as of December 31, 2013. This resulted in an AMA balance of $11,422,163, which is the per bookss amount of $10,772,781 plus the inflated amount of $649,382.[28]

Q. Is Avista's calculation of the AMA working gas inventory as of December 31, 2013, appropriate?

A. No. There are four reasons why the Company's adjustment to restate AMA of test year JP working gas inventory to 2013 is inappropriate.

First, the synthetic injection and withdrawal schedule Avista used is an estimate; it may or may not be the schedule the Company will actually use in the rate year 2013. Avista indicates that the actual synthetic injection and withdrawal schedule can differ based on market conditions and variability in actual demand as shown in its workpaper provided in this filing, which is my Exhibit No. ___ (JH-8), at 5.[29]

Second, due to the increased gas supply from the unconventional drilling practice and lower demand for gas for heating, wholesale natural gas commodity

[28] Avista witness Elizabeth Andrews' natural gas workpaper, at 1.03-1.
[29] Avista witness Elizabeth Andrews' natural gas workpaper, at 1.03-7, footnote.

costs have been lower than expected. Since 2009, Avista, Puget Sound Energy, Northwest Natural and Cascade Natural Gas each have been experiencing lower actual gas costs than what is currently embedded in their rates. More than likely, Avista and these other companies will file rate decreases in their PGA filings this fall.

Therefore, applying a 60-day average of the forward prices based on February 15, 2012, plus adders to the weighted percentage of the three pricing points (AECO, Sumas and Rockies) to calculate the AMA as of December 31, 2013, may produce an unreliable estimate.

Third, Avista's weighted percentage of the three pricing points, AECO (0%), Sumas (60%) and Rockies (40%), is yet another Avista prediction that may or may not come true.[30] The actual weighting on AECO, Sumas and Rockies can differ based on market conditions, variability in actual demand, availability of pipeline capacities, and other factors. For example, Avista weighted 100% to Sumas and none to AECO or Rockies in the last general rate case, Docket UG-110877.

Fourth, because Avista's proposed working gas inventory as of December 31, 2013, is purely an estimated amount, there is no mechanism to true-up to actuals.

Q. What is the appropriate amount for the average monthly average (AMA) JP working gas inventory balance that Avista booked in FERC account 164100?

[30] Avista witness Elizabeth Andrews' natural gas workpaper, at 1.03-3 and 6.

A. The appropriate amount is the per books amount of $10,772,781. As I stated earlier, I remove this amount for the reasons Staff witness Michael Foisy discusses in his testimony on Staff's working capital adjustment.

Q. What is the impact of Staff's Gas Inventory and JP Restating Adjustment?

A. Staff's adjustment decreases Washington net operating income by $173,000 related to the operating and maintenance expense and decreases rate base by $10,773,000, which is the amount of JP working gas inventory balance applicable to Washington gas operations which Avista booked in FERC Account 164100 as of December 31, 2011.

Q. Have you prepared an exhibit for this adjustment?

A. Yes. It is my Exhibit No. ___ (JH-8), which shows the calculation of Staff's adjustment for test year operating and maintenance expense levels for January through April 2011 extracted from Avista's budgeted operating and maintenance expense levels for January through April, 2013 of the rate year. This Exhibit also shows Staff's removal of JP working gas inventory from the rate base.

Q. Does this conclude your testimony?

A. Yes.