Exhibit No. ___ (EJK-1T)
Dockets UE-120436, et al.
Witness: Edward J. Keating

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

Edward J. Keating

STAFF OF
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Gas Revenue Requirement, Miscellaneous Restating, Restate Debt Interest, Cost of Short-Term Debt

September 19, 2012

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LIST OF EXHIBITS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Edward J. Keating. My business address is 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504.

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. I have been employed by the Commission since February 2010.

Q. Would you please state your educational and professional background?

A. I graduated from Saint Martin's University in Lacey, Washington with a Bachelor of Arts degree in Accounting. Before joining the Commission in February 2010, my relevant professional experience consisted of 12 years in a variety of fields, including management, accounting/auditing, and the treasury side of banking.

During my employment at the Commission, I have performed accounting and financial analysis of regulated utility companies. I have completed coursework in "Utility Ratemaking: The Fundamentals and the Frontier" and "Regulatory Approaches to Accommodate Renewable energy, Demand-Side Resources, and Energy Efficiency Programs" offered by New Mexico State University.

I have presented testimony before the Commission in Docket UE-101217 regarding the sale of Puget Sound Energy, Inc. ("PSE" or the "Company") property to Jefferson County Public Utility District No. 1. I have also presented Staff recommendations to the Commission in open public meetings

II. SCOPE OF TESTIMONY

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

A. My testimony presents the results of Staff's analysis of Avista Corporation's ("Avista" or "Company") Washington Gas Results of Operations, restated for known and measurable changes shown in my Exhibit No. ___ (EJK-2). My testimony identifies Company proposed Gas adjustments that are contested by Staff. I am responsible for two of the contested Gas adjustments.

Staff's analysis of the Company's Gas Results of Operations shows a need for a revenue requirement increase of $1,134,000 compared to Avista's proposed revenue requirement of $7,413,000 before their attrition adjustment. Staff Witness Kathryn Breda performed an attrition analysis for Avista's gas operations and determined that an attrition allowance in the amount of $2,837,000 was needed compared to Avista's proposed attrition allowance of $2,675,000. The combination of Staff's Results of Operation analysis and Ms. Breda's attrition analysis show the need for a gross revenue requirement increase of $3,972,000 compared to Avista's proposed gross revenue requirement of $10,088,000. Ms. Breda discusses the attrition allowance in further detail in her Exhibit No. ___ (KHB-1T) and Exhibit No. ___ (KHB-10).

In addition, I present my review of 18 ratemaking adjustments proposed by Avista related to the Company's electric and natural gas revenue requirements determination.

Q. What are the primary items that lead Staff to identify a $1,134,000 gas revenue deficiency compared to the Company's analysis showing a $7,413,000 gas revenue deficiency?

A. Adjustments, 1.03 - Gas Inventory & JP Restating, 3.06 - Restating 2011 Capital and Staff's proposed Weighted Cost of Capital combine to reduce the company's revenue requirement by approximately $4.6 million. The detail behind the differences is shown on Page 5, Column Q of my Exhibit No. ___ (EJK-2).

Q. Please identify the exhibits you have prepared in support of your testimony.

A. I have prepared Exhibit Nos. ___ (EJK-2) through ___ (EJK-7). Exhibit No. ___ (EJK-2) is Staff's revenue requirement model for gas. This exhibit produces a final revenue requirement number that reflects Staff's test year results of operations ending December 31, 2011. Included in Exhibit No. ___ (EJK-2) are:

- 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 (Schedule 1.4);

- Revenue Requirement Computation (Schedule 2.);
- Revenue Conversion Factor (Schedule 3.);
- Pro forma Capital Structure and Cost of Capital (Schedule 4.);

The Summary of Adjustments in Schedule 1.4 compares the Company's adjusted numbers and Staff's adjusted numbers based on the Company's proposed cost of capital. The impact of Staff's cost of capital is shown separately near the end of column Q.

My remaining exhibits support my calculations of contested adjustments as follows:

- Exhibit No. ___ (EJK-3), Cost of Short-Term Debt;
- Exhibit No. ___ (EJK-4), Electric - Interest Adjustment
- Exhibit No. ___ (EJK-5), Gas - Interest Adjustment
- Exhibit No. ___ (EJK-6), Electric - Miscellaneous Restating Adjustment
- Exhibit No. ___ (EJK-7), Gas - Miscellaneous Restating Adjustment

III. SUMMARY OF TESTIMONY

Q. Please summarize Staff's revenue requirement analysis for Avista's Gas Operations.

A. Staff's revenue requirement analysis shows Avista has a revenue deficiency from its Washington natural gas operations of $1,134,000. A 0.8 percent increase in revenues would eliminate this deficiency and allow Avista an opportunity to earn Staff's recommended rate of return of 7.22 percent.

Q. What capital structure and capital cost rates did you use in determining Avista's revenue requirement for its gas operations?

A. I used the capital structure and cost recommended by Staff witness Ken Elgin (*see* direct Testimony of Ken L. Elgin, Exhibit No. ___ (KLE-1T). I summarize Staff's recommended capital structure, cost rates and overall weighted cost of capital on page 8 of my Exhibit No. ___ (EJK-2) on Schedule 4 for Avista's gas operations.

IV. DISCUSSION

A. Overview

Q. Please identify the areas that you will discuss in this section of your testimony.

A. I testify to Staff's recommended revenue requirement for Avista's Washington gas operations as shown on page 1 of Exhibit No. ___ (EJK-2), Gas-Results of Operations. This exhibit shows actual and pro forma results of operations together with the impact of Staff's recommended revenue requirement for Avista's gas operations.

In addition to my own recommended adjustments, Exhibit No. ___ (EJK-2) incorporates all gas service-related adjustments of other Staff witnesses.

Q. Please give a brief overview of your Exhibit No. ___ (EJK-2).

A. Exhibit No. ___ (EJK-2) is an eight-page exhibit showing Staff's analysis of the Company's results of operations for the test year. Page one, labeled Schedule 1.1, presents the Results of Operations, Rate Base, and Rate of Return. The Company's Unadjusted Results are shown in Column (b), Restated Results are shown in Column (d), and Pro forma Results are shown in Column (f), with pro forma test year results adjusted for Staff's proposed revenues shown in Column (h).

Pages 2 through 3 are labeled Schedule 1.2, and provide the detail for the restating amounts shown in Column (c) on page 1. Page 4 is labeled Schedule 1.3, and provides the detail for the pro forma amounts shown in Column (f) on page 1.

B. Adjustments

Q. Please list Staff's contested adjustments that are included in your Exhibit No. ___ (EJK-2).

A. The following list identifies the Company's gas adjustments that were contested by Staff and the individual Staff witnesses responsible for each such adjustment. I include these contested adjustments in my Exhibit No. ___ (EJK-2), and these are the adjustments that result in Staff's recommended revenue requirement.

Joanna Huang;

- Adjustment 1.03, Gas - Gas Inventory & JP Restating
- Adjustment 2.12, Gas - Restating Incentive Adjustment
- Adjustment 3.00, Gas - Pro Forma Labor Non-Exec

- Adjustment 3.01, Gas - Pro Forma Labor Exec
- Adjustment 4.02, Gas - Depreciation Study

Mike Foisy;

- Adjustment 3.04, Gas - Pro Forma Property Tax

Kathryn Breda;

- Adjustment 3.06, Gas - Restating 2011 Capital
- Adjustment 4.00, Gas - Planned Capital Additions 2012
- Adjustment 4.01, Gas - Planned Capital Additions 2013 AMA
- Adjustment 4.03, Gas - O&M Offsets

In addition to the contested Company adjustments listed above, Staff is sponsoring its own adjustments, which are also included in my Exhibit No. ___ (EJK-2) and are used in determining Staff's revenue requirement. Listed below are these additional adjustments, with the name of the Staff witness responsible for the adjustment;

Mike Foisy

- Adjustment 1.05, Gas - Working Capital

Kathryn Breda

- Adjustment 1.04, Gas - Adjust FIT
- Adjustment 2.14, Gas - Non-Recurring Expense

Page 5 of my Exhibit No. ___ (EJK-2) entitled Schedule 1.4, compares each of the above adjustments to the Company's figures, and their corresponding impact on revenue requirement. For the detail behind these adjustments, please see the testimony or exhibits of the individual Staff witness responsible for the adjustment.

Q. Please state what specific adjustments you are responsible for.

A. I reviewed the following Company adjustments:

- Adjustment 2.02, Electric and Adjustment, 2.03 Gas - Uncollectible Expense
- Adjustment 2.03, Electric and Adjustment, 2.04 Gas - Regulatory Expense
- Adjustment 2.04, Electric and Adjustment 2.05, Gas - Injuries & Damages
- Adjustment 2.11, Electric and Adjustment 2.07, Gas - Net Gains/Losses
- Adjustment 2.12, Electric and Adjustment, 2.01 Gas, - Revenue Normalization and Gas Cost Adjustment
- Adjustment 2.13, Electric and Adjustment 2.11, Gas - Miscellaneous Restating
- Adjustment 2.17, Electric and Adjustment 2.13, Gas - Restate Debt Interest
- Adjustment 3.05, Electric and Adjustment 3.03, Gas - Pro Forma Insurance
- Adjustment 3.05, Gas - Pro Forma Atmospheric Testing
- Electric and Gas, Cost of Short-Term Debt

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

A. Of the above 18 adjustments I reviewed, Staff does not contest the following:

- Adjustment 2.02, Electric and Adjustment, 2.03 Gas - Uncollectible Expense
- Adjustment 2.03, Electric and Adjustment, 2.04 Gas - Regulatory Expense
- Adjustment 2.04, Electric and Adjustment 2.05, Gas - Injuries & Damages
- Adjustment 2.11, Electric and Adjustment 2.07, Gas - Net Gains/Losses

- Adjustment 2.12, Electric and Adjustment, 2.01 Gas, - Revenue Normalization and Gas Cost Adjustment
- Adjustment 3.05, Electric and Adjustment 3.03, Gas - Pro Forma Insurance
- Adjustment 3.05, Gas - Pro Forma Atmospheric Testing

Q. Which Company adjustments that you reviewed are contested?

A. I am contesting the following adjustments:

- Adjustment 2.13, Electric and Adjustment 2.11, Gas - Miscellaneous Restating
- Adjustment 2.17, Electric and Adjustment 2.13, Gas - Restate Debt Interest
- Total Company, Cost of Short-Term Debt

C. Contested Adjustments

1. Cost of Short-Term Debt

Q. What does Avista propose as its cost of short-term debt?

A. Avista proposes a short-term debt cost of 3.91 percent, as shown in Mr. Thies' Exhibit No. ___ (MTT-2), at 4.

Q. Is that an appropriate figure for short-term debt costs?

A. No, the appropriate figure is 2.14 percent, as shown in my Exhibit No. ___ (EJK-3).

Q. Please explain how you arrived at 2.14 percent as the appropriate cost for Avista's short-term debt.

A. First, I use a flat 1.15 percent average monthly forecasted borrowing rate, shown in my Exhibit No. ___ (EJK-3), line 7. Avista used the 1.50 to 1.88 percent range as shown in Mr. Thies' Exhibit No. ___ (MTT-2), page 4.

Second, I use a flat $39,178 per month for the fee the Company pays for its short-term debt credit facility, shown on line 10 of my Exhibit No. ___ (EJK-3). Avista used the average of $41,667, as shown in Mr. Thies' Exhibit No. ___ (MTT-2), at 4.

Third, I use an average amount of short-term debt of $105 million, shown on line 3 of my Exhibit No. ___ (EJK-3). Avista used an average of $48.7 million, as shown in Mr. Thies' Exhibit No. ___ (MTT-2), Page 4. Although the amount of short-term debt does not change the overall cost of debt, I note it simply because it is a large difference from Avista's case.

Q. Please explain why you used 1.15 percent as the Company's average monthly forecasted borrowing rate.

A. I arrived at my 1.15 percent flat rate by projecting LIBOR at 0.25 percent for the rate year and then adding the same LIBOR margin of 0.875 percent used by the Company, plus an additional 2.5 basis points for slippage. LIBOR, which is the London Interbank Offered Rate, has a strong correlation to the Fed Funds Target rate which Federal Reserve Officials have said will likely remain at 0.0 to 0.25 percent through late 2014.[1] Therefore, a 0.25 percent LIBOR rate for 2012 is appropriate.

In addition, as evidenced by Avista's response to Staff Data Request 124, Attachment A, the Company's average actual borrowing rate for the first quarter of 2012 was 1.14 percent, which is very close to the figure I recommend.

The Company used a LIBOR forecast from Thomson One plus a margin of 0.875 percent over forecasted LIBOR, to arrive at its monthly forecasted borrowing rate. The resulting range of 1.50 to 1.88 percent is too high. For example, forecasted LIBOR rates ranged from 0.5 percent in the first quarter of 2012 to 0.875 percent in the fourth quarter of 2012. As of July 1, 2012, the actual one month LIBOR is at 0.24575 percent. These figures do not support the Company's range.

Q. Please explain your reasons for using credit facility fees of $39,178 per month.

A. My figure is based on an average of first quarter 2012 actual fees, as shown in Avista's response to Staff Data Request 124, Attachment A. As explained in the Company's response to Staff Data Request No. 214, this lower amount was the result of Avista allocating a portion of the committed line of credit facility fees directly attributable to letters of credit outstanding to their respective cost centers. This allocation is appropriate because Avista uses this credit facility to post collateral for gas hedging. Costs associated with gas hedging which include a portion of credit facility fees are, or should be, captured in the Company's Purchased Gas Adjustment (PGA) and Energy Recovery Mechanism (ERM).

[1] See http://federalreserve.gov/newsevents/press/monetary/20120801a.htm.

By contrast, the Company's projection of $41,667 per month reflects the full credit facility amount of $400 million, multiplied by the credit facility fee of 12.5 basis points, with no allocation.

Q. Why did you use $105 million for the amount of outstanding short-term debt?

A. As Mr. Elgin testifies, an appropriate amount of short-term debt in this rate environment is approximately 4 percent of capital, which equates to $105 million.

2. Adjustment 2.17, Electric and Adjustment 2.13, Gas - Restate Debt Interest

Q. Please explain the adjustment for Restate Debt Interest.

A. The Restate Debt Interest adjustment, also known as interest synchronization, restates the income tax effect of debt interest using the weighted cost of debt times the test period rate base. In this way, the amount of interest that is tax deductible for federal income taxes is synchronized with the amount of debt that is supporting the rate base. This results in a revised level of tax deductible interest expense.

Historically, this adjustment applied the pro forma weighted cost of debt to pro forma rate base, resulting in a single adjustment in a single column for all rate base items. However, in this case the Company presents the Federal income tax effect of the restated level of interest separately in each adjustment that involves rate base. To avoid confusion between the Company and Staff case, Staff presented this adjustment the same way as the Company.

Q. Please describe Staff's Restate Debt Interest adjustment and explain the difference between the Staff and Company adjustments.

A. As seen in my Exhibit Nos. ___ (EJK-4) and ___ (EJK-5), my adjustment reduces income tax expense by $559,000 for Avista's electric operations and $98,000 for Avista's gas operations. The Company's adjustment reduces income tax expense by $126,000 (electric) and $63,000 (gas). The differences between Staff's adjustment and the Company's adjustment are due solely to the fact that Staff uses a different weighted cost of debt than the Company.

3. Adjustment 2.13, Electric and Adjustment 2.11, Gas - Miscellaneous Restating

Q. Please summarize the Company's Miscellaneous Restating adjustment.

A. The Company's Miscellaneous Restating adjustment attempts to identify and remove non-operating or non-utility expenses included in the test period actual results and removes or restates other expenses the Company incorrectly charged between services and/or jurisdictions. The Company's adjustment also includes a 10% reduction in Board of Directors Fees and a 50% reduction in Board of Directors Meeting expenses.

Non-utility expenses can include items such as charitable donations, image advertising, club dues, sporting events and entertainment costs.

The majority of the transactions in the Miscellaneous Restating adjustment are found in FERC Accounts 500-935. The calendar year 2011 internal audit showed approximately 670,000 transactions in these accounts.[2] Realizing the amount of data available to audit, Staff is cognizant of the fact that it must balance time with materiality on this adjustment.

Q. Please describe Staff's Miscellaneous Restating adjustment, and compare it to the Company's.

A. As shown in my Exhibit Nos. ___ (EJK-6) and ___ (EJK-7), my Miscellaneous Restating adjustment removes expenses of $296,000 from electric operations and $89,000 from gas operations respectively. The Company's adjustment removes expenses of $90,000 from electric operations[3] and $25,000[4] for gas operations.

My adjustment decreases revenue requirement by $310,000 (electric) and $93,000 (gas) compared to the Company's decrease in revenue requirements of $95,000 (electric) and $26,000 (gas).

Q. Please explain how you arrived at your numbers.

A. First, I removed costs such as lodging, food, cruises, and dues to Executive Women International because these expenses provide no ratepayer benefit. Staff's adjustment removes 100 percent of the cost of these items, while Avista removed 50 percent of the cost. These items are presented in my Exhibit No. ___ (EJK-6) for electric and my Exhibit No. ___ (EJK-7) for gas.

In addition, in its response to Staff Data Request No. 365, Avista summarized many other items it discovered had been mis-booked while responding to various

[2] Testimony of Elizabeth M. Andrews, Exhibit No. ___ (EMA-1T), at 79, lines 11-14.
[3] Exhibit No. ___ (EMA-2), at 7, line 24, column 2.13.
[4] Exhibit No. ___(EMA-2), at 7, line 25, column 2.11.

Public Counsel data requests . The net dollar amount of these items increased expenses by $23,951 (electric) and by $2,850 (gas).

Also included in Avista's response to Staff Data Request No. 365, Attachment A, was an adjustment to Board of Director Fees resulting from the Company erroneously eliminating the same expenses twice. This adjustment increased expenses by $28,399 (electric) and by $7,705 (gas).

The remainder of my adjustment came from splitting Directors Fees 50/50 rather than the 90/10 as requested by Avista, which, after taking into account the adjustment to Board of Director Fees identified in Avista's response to Staff Data Request No. 365, Attachment A, decreased allowed expenses by $244,137 (electric) and by $66,240 (gas).

Q. Why did you split Directors Fees 50/50?

A. In *Utilities and transportation Commission v. Avista Corp.,* Docket Nos. UE-090134, UG-090135 and UG-060518, the Commission determined in Order 10 at 58, paragraph 142, that:

> The record supports a finding that the Board of Directors provides services that benefit shareholders to the same extent those activities benefit ratepayers. Therefore, we determine Directors' Fees and Meeting costs should be shared equally between shareholders and ratepayers.

Nothing has changed since the Commission issued that Order requiring Avista to split Directors Fees 50/50. In particular, the Company has not presented any evidence to show that the Board of Directors does not provide services that benefit shareholders to the same extent as ratepayers. Therefore, the Commission should continue to split Board of Directors Fees 50/50.

Q. Do you have any other comments or suggestions regarding this adjustment?

A. Yes. The Company's accounting for these items has been the subject of controversy over the past few rate cases, and the Company has made changes to its accounting procedures and it has trained its employees on these new systems.

The Company completed its Internal Audit of 2011 Avista Utility Expenditures[5] as required by the Settlement Stipulation[6] approved by the Commission in Dockets UE-110876 and UG-110877[7]. That audit showed errors totaling $12,529.90 within the sample groups.[8]

The Internal Audit split the population of FERC Accounts 400-935 consisting of approximately 670,000 transactions into two subsets (A and B). Subset A consisted of Administrative and General expense accounts (FERC Accounts 900-935), and subset B consisted of all remaining transactions not included in Subset A.[9] Avista sampled 208 transactions within Subset A with 21 errors identified. Two of the errors were found by the Company's Rates Department and removed prior to filing the general rate case. 93 transactions were sampled within Subset B, with 1 error identified.

The Internal Audit concluded that the appropriate accounting and allocation of utility expenditures in Subset A was not occurring within the tolerable rate, while Subset B was within the tolerable rate.

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[5] Exhibit No. ___ (EMA-4).
[6] *Utilities and Transportation Commission v. Avista Corp,* Dockets UE-110876 and UG-110877, Settlement Stipulation, at 12, ¶15.
[7] *Utilities and Transp. Commission v. Avista Corp.*, Dockets UE-110876 and UG-110877, Order 6, (December 16, 2011), at 22, ¶67.
[8] Exhibit No. ___ (EMA-4), at 7-8.
[9] Exhibit No. ___ (EMA-4), at 3.

It is noteworthy that the majority of the errors were the result of booking expenditures to the wrong FERC Account or Service, not booking amounts to regulated operations rather than unregulated operations, or vice versa.

For example, the largest dollar amount error of $9,239.40 (out of total errors of $12,529.90 found in the sample groups) was from booking the expense to FERC Account 921 (Office Supplies and Expense) rather than to FERC Account 903 (Customer Records and Collection Expenses). This error had no impact on ratepayers or the Company.

While it is reasonable for the Commission to expect improvement in this area, it is not reasonable to expect perfection. The cost of improvements needs to be weighed against the benefits. This adjustment is important, but more for principle than materiality.

Q. Does this conclude your testimony?

A. Yes.