

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-080416

DOCKET NO. UG-080417

DIRECT TESTIMONY OF

ELIZABETH M. ANDREWS

REPRESENTING AVISTA CORPORATION

REVISED 1/28/09

1	<u>CONTENTS</u>		
2	<u>Section</u>		<u>Page</u>
3	I	Introduction	2
4	II	Combined Revenue Requirement Summary	4
5	III	Electric Section	5
6		Revenue Requirement	10
7		Standard Commission Basis Adjustments	11
8		Pro Forma Adjustments	19
9	IV	Natural Gas Section	28
10		Revenue Requirement	30
11		Standard Commission Basis Adjustments	31
12		Pro Forma Adjustments	37
13	V	Allocation Procedures	42
14			
15		Exhibit No. ____ (EMA-2) – Electric Revenue Requirement and	
16		Results of Operations	(pgs 1-9)
17		Exhibit No. ____ (EMA-3) – Gas Revenue Requirement and	
18		Results of Operations	(pgs 1-8)

I. INTRODUCTION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

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

A. My name is Elizabeth M. Andrews. I am employed by Avista Corporation as Manager of Revenue Requirements in the State and Federal Regulation Department. My business address is 1411 East Mission, Spokane, Washington.

Q. Would you please describe your education and business experience?

A. I am a 1990 graduate of Eastern Washington University with a Bachelor of Arts Degree in Business Administration, majoring in Accounting. That same year, I passed the November Certified Public Accountant exam, earning my CPA License in August 1991. I worked for Lemaster & Daniels, CPAs from 1990 to 1993, before joining the Company in August 1993. I served in various positions within the sections of the Finance Department, including General Ledger Accountant and Systems Support Analyst until 2000. In 2000, I was hired into the State and Federal Regulation Department as a Regulatory Analyst until my promotion to Manager of Revenue Requirements in early 2007. I have also attended several utility accounting, ratemaking and leadership courses.

Q. As Manager of Revenue Requirements, what are your responsibilities?

A. As Manager of Revenue Requirements, aside from special projects, I am responsible for the preparation of normalized revenue requirement and pro forma studies for the various jurisdictions in which the Company provides utility services. During the last eight years I have assisted or lead the Company's electric and/or natural gas general rate filings in Washington, Idaho and Oregon.

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

2 A. My testimony and exhibits in this proceeding will generally cover accounting and
3 financial data in support of the Company's need for the proposed increase in rates. I will explain
4 pro forma operating results including expense and rate base adjustments made to actual
5 operating results and rate base.

6 I incorporate the Washington share of the proposed adjustments of several witnesses in
7 this case. For example, Company witnesses Mr. DeFelice sponsors and describes the Company's
8 pro forma 2007 and 2008 capital additions adjustments and Mr. Howard discusses the Spokane
9 River Relicensing efforts by the Company. Other Company witnesses, for example Mr.
10 Vermillion, explains other issues impacting the Company, like the Clark Fork River dissolved
11 gas issue, the Montana Riverbed lease expense, and the Colstrip mercury emissions O&M
12 expense, while Mr. Kinney discusses the transmission net expenses, Asset Management program
13 expenses, and the transmission capital expenditures included in Mr. DeFelice's pro forma capital
14 adjustments. Lastly, Company witnesses Mr. Johnson, prepared the total system pro forma
15 power supply adjustment, while Ms. Knox sponsors the revenue normalization and pro forma
16 production property adjustments.

17 **Q. Are you sponsoring any exhibits to be introduced in this proceeding?**

18 A. Yes. I am sponsoring Exhibit Nos. ____ (EMA-2) (Electric) and ____ (EMA-3)
19 (Natural Gas), which were prepared under my direction. These Exhibits consist of worksheets,
20 which show actual 2007 operating results, pro forma, and proposed electric and natural gas
21 operating results and rate base for the State of Washington, the Company's calculation of the

1 general revenue requirement, the derivation of the net operating income to gross revenue
2 conversion factor, and the pro forma adjustments proposed in this filing.

3
4 **II. COMBINED REVENUE REQUIREMENT SUMMARY**

5 **Q. Would you please summarize the results of the Company's pro forma study**
6 **for both the electric and natural gas operating systems for the Washington jurisdiction?**

7 A. Yes. After taking into account all standard Commission Basis adjustments, as
8 well as additional pro forma and normalizing adjustments, the pro forma electric and natural gas
9 rates of return ("ROR") for the Company's Washington jurisdictional operations are 6.04% and
10 6.06%, respectively. Both return levels are below the Company's requested rate of return of
11 8.43%. The incremental revenue requirement necessary to give the Company an opportunity to
12 earn its requested ROR is \$36,617,000 for the electric operations and \$6,587,000 for the natural
13 gas operations. The overall electric increase is 10.29%, while the overall natural gas increase is
14 3.33%.

15 **Q. What are the Company's rates of return that were last authorized by this**
16 **Commission for its electric and gas operations in Washington?**

17 A. The Company's currently authorized rate of return for its Washington operations
18 is 8.2 %, effective January 1, 2008 for both our electric and natural gas systems.

1 **III. ELECTRIC SECTION**

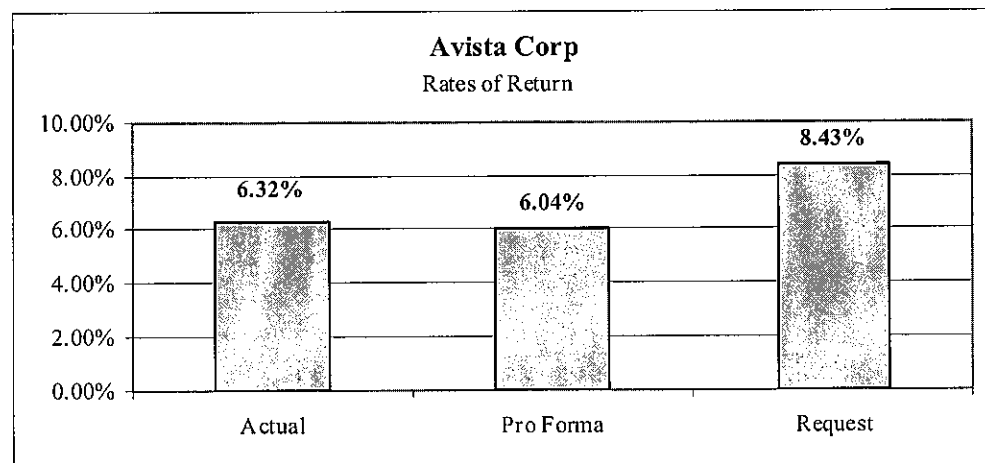
2 **Changes Since the 2006 Test Period**

3 **Q. On what test period is the Company basing its need for additional electric**
4 **revenue?**

5 A. The test period being used by the Company is the twelve-month period ending
6 December 31, 2007, presented on a pro forma basis. Currently authorized rates are based upon
7 the 2006 test year utilized in UE-070804.

8 **Q. By way of summary, could you please explain the different rates of return**
9 **that you will be presenting in your testimony?**

10 A. Yes. Basically, there are three different rates of return that will be discussed. The
11 actual ROR earned by the Company during the test period, the Pro Forma ROR determined in my
12 Exhibit No. ___(EMA-2), and the requested ROR. For convenience of comparison, please refer
13 to the following graph:



1 **Q. What are the primary factors driving the Company’s need for an electric**
2 **increase?**

3 A. There are numerous factors that have impacted the Company’s electric results of
4 operations since the 2006 test year. Net Operating Income (“NOI”) has declined approximately
5 \$16.1 million, or 22%, and total rate base has increased approximately \$55 million, or 6.10%.
6 The Company’s electric request is driven by changes in various operating cost components, but
7 primarily by the various hydro relicensing efforts impacting the Utility and the capital spending
8 requirement in plant investment or rate base growth associated with generation, transmission,
9 distribution, and general plant expenditures during 2007 and 2008.

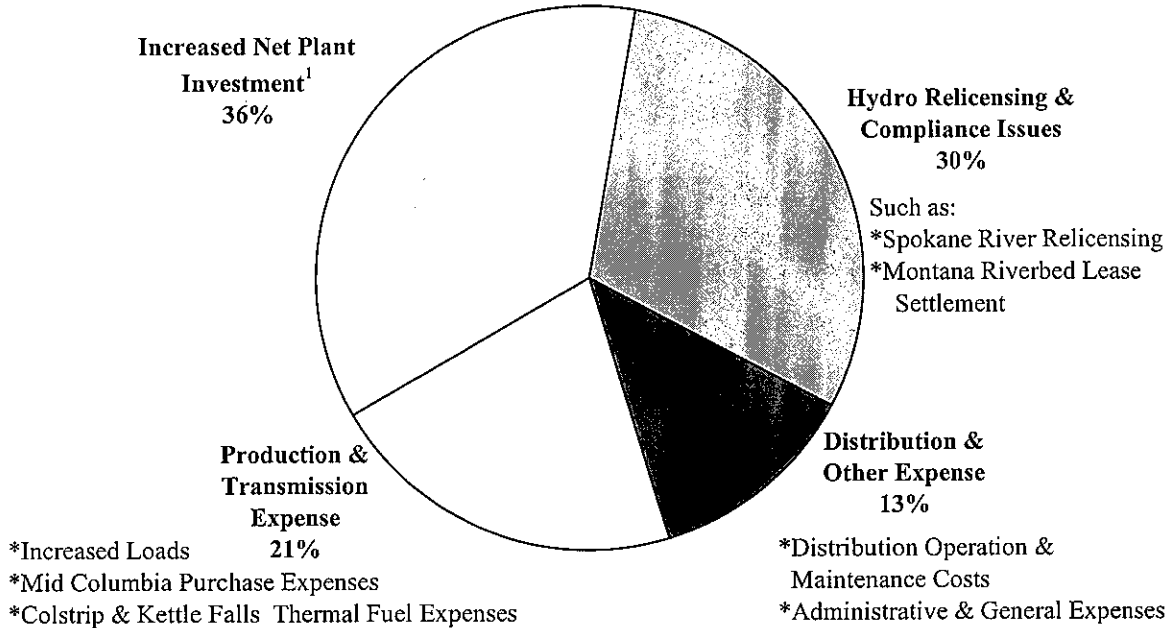
10 The hydro relicensing and compliance efforts pro formed into this case make up
11 approximately 30% of the overall request, and include, the intangible and production net rate
12 base and expenses associated with the Spokane River relicensing, and other hydro compliance
13 related issues, for example the Montana Riverbed Settlement lease expense. As already noted,
14 net rate base increased approximately \$55 million. While some of these rate base dollars have
15 been included in the relicensing issues percentage noted above, the remaining rate base amount
16 makes up approximately 36% of the Company request, and is primarily due to additional
17 production and distribution plant additions, plus transmission and general plant additions,
18 including the depreciation recovery, taxes associated with plant, and the return on additional net
19 plant investments offset by the tax benefit of interest.

20 The remaining cost categories, Production and Transmission expense, and Distribution
21 O&M and Other expense, which includes increases to all other operating categories, such as

1 distribution expenses, customer service, taxes and administrative and general, total
 2 approximately 21% and 13%, respectively, of the overall request.

3 I will provide additional detail regarding these items later, but the chart below shows
 4 this initial comparison:

5 **Primary Electric Revenue Requirement Factors**



15 ¹Includes return on investment, depreciation and taxes, offset by the tax benefit of interest.

16 **Q. Please describe the impact of increased net power supply expense?**

17 A. As discussed by Mr. Johnson, the Washington share of the 2009 pro forma power
 18 supply revenues and expense adjustment increases net expense approximately \$9.8 million. The
 19 primary factors impacting this increase in net power supply expense is the cost of serving
 20 additional retail load, thermal fuel costs and increased Mid Columbia purchased hydro generation
 21 costs. Forecasted retail loads in the 2009 pro forma period are 27.3 aMW higher than 2007
 22 weather adjusted retail loads.

1 **Q. Could you please identify the main components of the “Other” segment**
2 **shown in the chart above?**

3 A. Yes. A number of expense items have increased since 2006, which have been
4 included in this case. For example, wages and benefits have increased, as well as other
5 administrative and general expenses.

6 We are utilizing a 2007 test year since that is the most recent normalized financial
7 information the Company has available, however, new general electric rates resulting from this
8 filing will not go into effect until early in 2009. Accordingly, the Company has included a
9 number of pro forma adjustments to capture some of the measurable cost changes that the
10 Company will experience from the 2007 test year.

11 **Q. What were the major components of the \$55 million increase in total rate**
12 **base?**

13 A. Looking at the changes to “gross” plant in service shows that gross plant increased
14 almost \$169 million (Washington), or just under 11%, as compared to what is currently included
15 in rates. Included in this “gross” plant total is \$50.6 million pro forma capital recorded in
16 intangible and production plant associated with the Spokane River relicensing and compliance
17 issues, or approximately 30% of the total change to “gross” plant.

18 To continue to meet the energy and reliability needs of our customers, the Company has
19 invested additional amounts in production investment, as well as additional transmission
20 investment. Excluding the relicensing compliance issues, mentioned separately above, the
21 production and transmission investment totaled approximately \$36 million or 21% of the
22 increase in total gross plant. The specific pro forma capital expenditures undertaken by the

1 Company to improve operating efficiency and reliability are discussed further by Mr. Vermillion
2 regarding production assets, and Mr. Kinney regarding transmission assets.

3 **Q. What other rate base additions are included in Total Rate Base?**

4 A. Distribution gross plant increased \$63.3 million or 12.6% above the current level
5 included in rates, while general gross plant increased \$19 million or 23.7%.

6 Later in my testimony, I will address each of the relicensing and compliance issues pro
7 forma adjustments, and the additional net rate base adjustments labeled “Pro Forma Capital
8 Additions 2007” and “Pro Forma Capital Additions 2008” included in Exhibit No. ____(EMA-2),
9 pages 8 and 9, which explains the detail behind the normalizing and pro forma net operating
10 income and rate base adjustments.

11 The figures listed above are “gross” plant investment changes. Again, taking into account
12 increases to Accumulated Depreciation and Amortization and Deferred Federal Income Tax
13 offsets, produces the net \$55 million, or 6.1% increase to Total Rate Base. Depreciation
14 expense, which has largely followed the 11% growth in gross plant-in-service, has increased \$8.6
15 million.

16 **Q. Company witness Mr. DeFelice sponsors the pro forma capital adjustments**
17 **included in this case. Could you please briefly describe the conclusions drawn by Mr.**
18 **DeFelice on the reasons for increased capital investment?**

19 A. As described in Mr. DeFelice’s testimony, the Company is facing high levels of
20 capital investment in its electric and gas system infrastructure to address customer growth,
21 replacement and maintenance of Avista’s aging system, and increased reliability and safety
22 requirements. As soon as this new plant is placed in service, the Company must start

1 depreciating the new plant and incur other costs related to the investment. However, the
2 Company does not begin to recover the cost of the new plant or a return on that investment in
3 rates until the next rate case after it makes the investment. Unless this new investment is
4 reflected in retail rates in a timely manner, it has a negative impact on Avista's earnings,
5 particularly because the new plant is typically far more costly to install than the cost of similar
6 plant that was embedded in rates decades earlier.

7

8 **Revenue Requirement**

9 **Q. Would you please explain what is shown in Exhibit No. ____ (EMA-2)?**

10 A. Yes. Exhibit No. ____ (EMA-2) shows actual and pro forma electric operating
11 results and rate base for the test period for the State of Washington. Column (b) of page 1 of
12 Exhibit No. ____ (EMA-2) shows 2007 operating results and components of the average-of-
13 monthly-average rate base as recorded; column (c) is the total of all adjustments to net operating
14 income and rate base; and column (d) is pro forma results of operations, all under existing rates.
15 Column (e) shows the revenue increase required which would allow the Company to earn a
16 8.43% rate of return. Column (f) reflects pro forma electric operating results with the requested
17 increase of \$36,617,000. The restating adjustments shown in columns c through x, of pages 4
18 through 7 of Exhibit No. ____ (EMA-2), are consistent with the treatment reflected in the prior
19 Commission Order in Docket No. UE-070804 and current regulatory principles.

20 **Q. Would you please explain page 2 of Exhibit No. ____ (EMA-2)?**

21 A. Yes. Page 2 shows the calculation of the \$36,617,000 revenue requirement at the
22 requested 8.43% rate of return.

1 **Q. Would you now please explain page 3 of Exhibit No. ____ (EMA-2)?**

2 A. Yes. Page 3 shows the derivation of the net operating income to gross revenue
3 conversion factor. The conversion factor takes into account uncollectible accounts receivable,
4 Commission fees and Washington State excise taxes. Federal income taxes are reflected at 35%.

5 **Q. Now turning to pages 4 through 9 of your Exhibit No. ____ (EMA-2), would**
6 **you please explain what those pages show?**

7 A. Page 4 begins with actual operating results and rate base for the 2007 test period
8 in column (b). Individual normalizing adjustments that are standard components of our annual
9 reporting to the Commission begin in column (c) on page 4 and continue through column (x) on
10 page 7. Individual pro forma and additional normalizing adjustments begin in column (PF1) on
11 page 7 and continue through column (PF13) on page 9. The final column on page 9 is the total
12 pro forma operating results and rate base for the test period.

13

14 **Standard Commission Basis Adjustments**

15 **Q. Would you please explain each of these adjustments, the reason for the**
16 **adjustment and its effect on test period State of Washington net operating income and/or**
17 **rate base?**

18 A. Yes, but before I begin, I will note that in addition to the explanation of
19 adjustments provided herein, the Company has also provided workpapers outlining additional
20 details related to each of the adjustments.

21 The first adjustment, column (c) on page 4, entitled **Deferred FIT Rate Base**, reflects the
22 rate base reduction for Washington's portion of deferred taxes. The adjustment reflects the

1 deferred tax balances arising from accelerated tax depreciation (Accelerated Cost Recovery
2 System, or ACRS, and Modified Accelerated Cost Recovery, or MACRS), bond refinancing
3 premiums, and contributions in aid of construction. These amounts are reflected on the average
4 of monthly average balance basis. The effect on Washington rate base is a reduction of
5 \$139,033,000.

6 The adjustment in column (d), **Deferred Gain on Office Building**, reflects the rate base
7 reduction for Washington's portion of the net of tax, unamortized gain on the sale of the
8 Company's general office facility. The facility was sold in December 1986 and leased back by
9 the Company. Although the Company repurchased the building in November 2005, the
10 Company opted to continue to amortize the deferred gain over the remaining amortization period
11 scheduled to end in 2011. This accounting treatment was approved in Order No. 01 in Docket
12 No. U-071805. This adjustment reflects the average of monthly averages amount of the deferred
13 gain for the 2009 rate period. The effect on Washington rate base is a reduction of \$210,000.

14 The adjustment in column (e), **Colstrip 3 AFUDC Elimination**, is a reallocation of rate
15 base and depreciation expense between jurisdictions. In Cause Nos. U-81-15 and U-82-10, the
16 WUTC allowed the Company a return on a portion of Colstrip Unit 3 construction work in
17 progress ("CWIP"). A much smaller amount of Colstrip Unit 3 CWIP was allowed in rate base
18 in Case U-1008-144 by the Idaho Public Utilities Commission ("IPUC"). The Company
19 eliminated the AFUDC associated with the portion of CWIP allowed in rate base in each
20 jurisdiction. Since production facilities are allocated on the Production/Transmission formula,
21 the allocation of AFUDC is reversed and a direct assignment is made. The rate base adjustment
22 reflects the average of monthly averages amount for 2007. The effect on Washington net

1 operating income is an increase of \$225,000. The effect of the reallocation on Washington rate
2 base is a decrease of \$2,342,000.

3 The adjustment in column (f), **Colstrip Common AFUDC**, is also associated with the
4 Colstrip plants in Montana, and increases rate base. Differing amounts of Colstrip common
5 facilities were excluded from rate base by this Commission and the IPUC until Colstrip Unit 4
6 was placed in service. The Company was allowed to accrue AFUDC on the Colstrip common
7 facilities during the time that they were excluded from rate base. It is necessary to directly assign
8 the AFUDC because of the differing amounts of common facilities excluded from rate base by
9 this Commission and the IPUC. In September 1988, an entry was made to comply with a Federal
10 Energy Regulatory Commission ("FERC") Audit Exception, which transferred Colstrip common
11 AFUDC from the plant accounts to account 186. These amounts reflect a direct assignment of
12 rate base for the appropriate average of monthly averages amounts of Colstrip common AFUDC
13 to the Washington and Idaho jurisdictions. Amortization expense associated with the Colstrip
14 common AFUDC is charged directly to the Washington and Idaho jurisdictions through Account
15 406 and is a component of the actual results of operations. The rate base adjustment reflects the
16 average of monthly averages amount for 2006. The effect on Washington rate base is an increase
17 of \$460,000.

18 The adjustment in column (g), **Kettle Falls Disallowance**, decreases rate base. The
19 amounts reflect the Kettle Falls generating plant disallowance ordered by this Commission in
20 Cause No. U-83-26. The disallowed investment and related depreciation, FIT expense,
21 accumulated depreciation and accumulated deferred FIT are removed from actual results of
22 operations. The rate base adjustment and the accumulated deferred FIT reflects the average of

1 monthly averages amount for the 2006 period. The effect on Washington net operating income is
2 a decrease of \$56,000. The effect on Washington rate base is a decrease of \$913,000.

3 The adjustment in column (h), **Customer Advances**, decreases rate base for moneys
4 advanced by customers for line extensions, as they will most likely be recorded as contributions
5 in aid of construction at some future time. The effect on Washington rate base is a decrease of
6 \$258,000.

7 **Q. Please turn to page 5 and explain the adjustments shown there.**

8 A. Page 5 starts with the adjustment in column (i), **Depreciation True-up**, which
9 reflects a decrease in depreciation expense due to the utilization of new depreciation rates
10 effective January 1, 2008 as approved in Docket No. UE-070804. This adjustment increases
11 Washington net operating income by \$212,000.

12 The adjustment in column (j), **Settlement Exchange Power**, reflects the rate base
13 associated with the recovery of 64.1% of the Company's investment in Settlement Exchange
14 Power. The 64.1% recovery level was approved by the Commission's second Supplemental
15 Order in Cause No. U-86-99 dated February 24, 1987. Amortization expense and deferred FIT
16 expense recorded during the test period are reflected in results of operations. The rate base
17 adjustment and accumulated deferred FIT reflects the average of monthly averages amount for
18 the 2009 rate period. The effect on Washington rate base is an increase of \$20,432,000.

19 The next column marked by a dash, entitled **Subtotal Actual** represents actual operating
20 results and rate base plus the standard rate base adjustments that are included in Commission
21 Basis reporting.

1 The adjustment in column (k), **Eliminate B & O Taxes**, eliminates the revenues and
2 expenses associated with local business and occupation (B & O) taxes, which the Company is
3 allowed to pass through to its Washington customers. The adjustment eliminates any timing
4 mismatch that exists between the revenues and expenses by eliminating the revenues and
5 expenses in their entirety. B & O taxes are passed through on a separate schedule, which is not
6 part of this proceeding. The effect of this adjustment is to decrease Washington net operating
7 income by \$19,000.

8 The adjustment in column (l), **Property Tax**, restates the 2007 test period accrued levels
9 of property taxes to the most current information available and eliminates any adjustments
10 related to the prior year. The effect of this particular adjustment is to increase Washington net
11 operating income by \$831,000.

12 The adjustment in column (m), **Uncollectible Expense**, restates the accrued expense to
13 the actual level of net write-offs for the test period. The effect of this adjustment is to increase
14 Washington net operating income by \$70,000.

15 The adjustment in column (n), **Regulatory Expense**, restates recorded 2007 regulatory
16 expense to reflect the WUTC assessment rates applied to revenues for the test period and the
17 actual levels of FERC fees paid during the test period. The effect of this adjustment is to
18 decrease Washington net operating income by \$12,000.

19 **Q. Please turn to page 6 and explain the adjustments shown there.**

20 A. The adjustment in column (o), **Injuries and Damages**, is a restating adjustment
21 that replaces the accrual with actuals to obtain the six-year rolling average of injuries and
22 damages payments not covered by insurance. As a result of the Commission's Order in Docket

1 No. U-88-2380-T, the Company changed to the reserve method of accounting for injuries and
2 damages not covered by insurance. The effect of this adjustment is to increase Washington net
3 operating income by \$8,000.

4 The adjustment in column (p), **FIT**, adjusts the FIT calculated at 35% within Results of
5 Operations by removing the effect of certain Schedule M items, matching the jurisdictional
6 allocation of other Schedule M items to related Results of Operations allocations and to adjust
7 the production tax credits for pro forma qualified generation. The FIT adjustment decreases
8 Washington net operating income by \$83,000. This adjustment also reflects the proper level of
9 deferred tax expense for the test period decreasing Washington net operating income by \$66,000.
10 Therefore, the net effect of this adjustment all based upon a Federal tax rate of 35% is to increase
11 Washington net operating income by \$149,000.

12 The adjustment in column (q), **Eliminate WA ERM Surcharge & Deferrals**, removes
13 the effects of the financial accounting for the Energy Recovery Mechanism (ERM.) The ERM
14 normalizes and defers certain net power supply and transmission revenues and costs pursuant to
15 the deferral and recovery mechanism authorized in Docket No. UE-060181. The adjustment
16 removes the ERM surcharge revenue as well as the deferral and amortization amounts and
17 certain directly assigned power costs and net transmission costs associated with the ERM. The
18 effect of this adjustment is to decrease Washington net operating income by \$10,623,000.

19 The adjustment in column (r), **Nez Perce Settlement Adjustment**, reflects an increase in
20 Production operating expenses. An agreement was entered into between the Company and the
21 Nez Perce Tribe to settle certain issues regarding earlier owned and operated hydroelectric
22 generating facilities of the Company. This adjustment directly assigns the Nez Perce Settlement

1 expenses to the Washington and Idaho jurisdictions. This is necessary due to differing regulatory
2 treatment in Idaho Case No. WWP-E-98-11 and Washington Docket No. UE-991606. This
3 restating adjustment is consistent with Docket No. UE-011595. The effect of this adjustment is
4 to decrease Washington net operating income by \$6,000.

5 The adjustment in column (s), **Eliminate A/R Expenses**, A/R representing Accounts
6 Receivable, removes expenses associated with the sale of customer accounts receivable. The
7 effect of this adjustment is to increase Washington net operating income by \$593,000.

8 The adjustment in column (t), **Office Space Charged to Subs**, removes a portion of the
9 office space costs (building lease and O&M costs, common area costs, copier expense and annual
10 office furniture rental) using the relationship of labor hours charged to subsidiary activities by
11 employee compared to total labor hours by employee. These percentages are applied to the
12 employees' office space (expressed in square feet) and multiplied by office space costs/per
13 square foot. This restating adjustment is made as a result of the Commission's Third
14 Supplemental Order in Docket No. U-88-2380-T and is consistent with Docket No. UE-070804.
15 The effect of this adjustment is to increase Washington net operating income by \$6,000.

16 The adjustment in column (u), **Restate Excise Taxes**, removes the effect of a one-month
17 lag between collection and payment of taxes. The effect of this adjustment is to increase
18 Washington net operating income by \$32,000.

19 **Q. Please continue on page 7 with your explanations of the adjustments.**

20 A. The adjustment in column (v), **Net Gains/Losses**, reflects a ten-year amortization
21 of net gains realized from the sale of real property disposed of between 1999 and 2007. This
22 restating adjustment is made as a result of the Commission's Order in Docket No. UE-050842

1 and is consistent with Docket No. UE-070804. The effect of this adjustment is to increase
2 Washington net operating income by \$68,000.

3 The adjustment in column (w), **Revenue Normalization**, is a 3-fold adjustment taking
4 into account known and measurable changes that include revenue normalization, weather
5 normalization and a recalculation of unbilled revenue. Revenues associated with the Schedule 91
6 Tariff Rider and Schedule 59 Residential Exchange are excluded from pro forma revenues, and
7 the related amortization expense is eliminated as well. Ms. Knox is sponsoring this adjustment.
8 The effect of this particular adjustment is to increase Washington net operating income by
9 \$18,145,000.

10 The adjustment in column (x), **Restate Debt Interest**, restates debt interest using the
11 Company's pro forma weighted average cost of debt, as outlined in the testimony and exhibits of
12 Company witness Mr. Malquist, and applied to Washington's pro forma level of rate base,
13 produces a pro forma level of tax deductible interest expense. The Federal income tax effect of
14 the restated level of interest for the test period decreases Washington net operating income by
15 \$2,612,000.

16 **Q. Please continue on page 7 with your explanations of the adjustments.**

17 A. The adjustment in column (y), on page 7, entitled **Restated Total**, subtotals all the
18 preceding columns (b) through column (x), exclusive of the previously discussed subtotal
19 column. These totals represent actual operating results and rate base plus the standard
20 normalizing adjustments that the Company includes in its annual Commission Basis reports
21 except power supply.

22

1 **Pro Forma Adjustments**

2 **Q. Please explain the significance of the 13 columns subsequent to column (y)**
3 **that begin at page 7 in your Exhibit No. ____ (EMA-2).**

4 A. Certainly. The adjustments subsequent to column (y) are pro forma adjustments
5 that recognize the jurisdictional impacts of items that will impact the pro forma operating period
6 levels for known and measurable changes. They encompass revenue and expense items as well
7 as additional capital projects. These adjustments bring the operating results and rate base to the
8 final pro forma level for the rate year.

9 **Q. Please continue with your explanation of the adjustments starting on page 7,**
10 **subsequent to column (y).**

11 A. The adjustment in column (PF1), **Pro Forma Power Supply**, was made under the
12 direction of Mr. Johnson and is explained in detail in his testimony. This adjustment includes
13 pro forma power supply related revenue and expenses to reflect the twelve-month period January
14 1, 2009 through December 31, 2009. Mr. Johnson's testimony outlines the system level of pro
15 forma power supply details that are included in this adjustment. This adjustment calculates the
16 Washington jurisdictional share of those figures, and also eliminates an offsetting direct
17 assignment of certain power supply costs included in the base Results of Operations. The net
18 effect of the power supply adjustments decreases Washington net operating income by
19 \$6,408,000.

20 The adjustment in column (PF2), **Pro Forma Production Property Adjustment**, adjusts
21 production and transmission revenues, expenses, and rate base by a factor that is the ratio of 2007
22 Washington test year retail load divided by 2009 Washington pro forma rate year retail load. The

1 adjustment is made to avoid the over-recovery of production and transmission costs, since the
2 revenue requirement associated with those costs is being spread to test year retail load. Ms.
3 Knox sponsors this adjustment which was calculated using the same methodology employed in
4 our last general rate case, Docket No. UE-070804. The effect of this adjustment on Washington
5 net operating income is an increase of \$3,776,000. The effect on Washington rate base is a
6 decrease of \$17,504,000.

7 **Q. Please turn to page 8 and explain the adjustments shown there.**

8 A. The adjustment in column (PF3), **Pro Forma Labor-Non-Exec**, reflects known
9 and measurable changes to test period union and non-union wages and salaries, excluding
10 executive salaries, which are handled separately in PF4. Test period wages and salaries are
11 restated as if the wage and salary increases through March 2009 were in place during the entire
12 pro forma test period. The methodology behind this adjustment is consistent with Docket Nos.
13 UE-011595, UE-050842 and UE-070804. The effect of this adjustment on Washington net
14 operating income is a decrease of \$1,522,000.

15 The adjustment in column (PF4), **Pro Forma Labor-Executive**, reflects known and
16 measurable changes to executive compensation, restating their salaries as if wage and salary
17 increases through March 2009 were in place for the entire pro forma test period. This adjustment
18 takes into account changes in executive staffing made during 2007 and includes compensation
19 for the planned executive team in 2009 only. Compensation costs for non-utility operations are
20 excluded as executives routinely charge a portion of their time to non-utility operations,
21 commensurate with the amount of time spent on such activities. The current executives' salary

1 allocations are set at their expected pro forma test period utility/non-utility percentage splits. The
2 impact of this adjustment on Washington net operating income is a decrease of \$160,000.

3 **Q. Can you please provide additional details regarding the determination of**
4 **officer compensation?**

5 A. Yes. At Avista, our compensation philosophy is founded in the belief that our
6 success will be driven by our ability to hire, develop and retain the most competent employees.
7 In an effort to recruit and retain such people, we provide salaries, performance incentives and
8 benefits that are competitive in the marketplace, as benchmarked against other similarly-sized
9 energy companies, in regional and national markets.

10 The Compensation Committee of the Board has responsibility for establishing,
11 implementing, and continually monitoring adherence to the Company's compensation
12 philosophy. The Compensation Committee believes that an effective total compensation plan
13 should be structured to focus executives on the achievement of specific business goals set by the
14 Company and to reward executives for achieving such goals.

15 The Compensation Committee compensates senior management through a mix of base
16 salary; short-term performance-based cash incentive compensation; long-term equity incentive
17 compensation – performance shares or restricted stock (100 percent of this compensation is paid
18 by shareholders, and none by customers); and retirement and other benefits.

19 In recent years, the total compensation for Avista's executives (particularly the top five
20 Executive Officers identified in the proxy) has been predominantly funded by Avista's
21 shareholders. As an example, as noted above, none of the long-term equity incentive is paid by
22 customers. In addition, the portion of the annual cash incentive that is related to meeting

1 shareholder targets, such as earnings per share, is also not paid by customers. And finally, a
2 portion of officer salaries is also allocated to subsidiary operations, which further reduces the
3 total compensation paid by customers. With each of these exclusions, currently, approximately
4 29% of the total compensation for the top five officers is paid by Avista's customers.

5 **Q. Please continue with your explanation of the adjustments on page 8.**

6 A. Column (PF5), **Pro Forma Transmission Rev/Exp**, was made under the
7 direction of Mr. Kinney and is explained in detail in his testimony. This adjustment includes pro
8 forma transmission-related revenues and expenses to reflect the twelve-month period January 1,
9 2009 through December 31, 2009. The net effect of the transmission revenue and expense
10 adjustments decreases Washington net operating income by \$487,000.

11 The adjustment in column (PF6), **Pro Forma Capital Additions 2007**, pro forms in the
12 capital cost and expenses associated with adjusting the 2007 average-monthly-average plant
13 related balances to actual end-of-period balances for plant in service at December 31, 2007. The
14 capital costs have been included for December 31, 2007 pro forma period with the associated
15 depreciation expense and property tax, as well as the appropriate accumulated depreciation and
16 deferred income tax rate base offsets. This adjustment was made under the direction of Mr.
17 DeFelice and is described further in his testimony. The production property adjustment is also
18 applied to the production and transmission components of these additions as discussed further by
19 Ms. Knox. This adjustment decreases Washington net operating income by \$346,000 and
20 increases rate base by \$32,809,000.

21 The adjustment in column (PF7), **Pro Forma Capital Additions 2008**, pro forms in the
22 capital cost and expenses associated with pro forming in capital expenditures for 2008. This

1 adjustment includes projects completed during 2008, and thus were normalized to reflect annual
2 amounts, and projects expected to be completed and transferred to plant-in-service by December
3 31, 2008, prior to approval of new retail rates in this case. The capital costs have been included
4 for the appropriate pro forma period with the associated depreciation expense and property tax,
5 as well as the appropriate accumulated depreciation and deferred income tax rate base offsets.
6 This adjustment also reduces the 2007 vintage plant net rate base (including accumulated
7 depreciation and deferred FIT) to an end of period December 31, 2008 adjusted balance. This
8 adjustment was also made under the direction of Mr. DeFelice and is described further in his
9 testimony. The production property adjustment is also applied to the production and
10 transmission components of these additions as discussed further by Ms. Knox. This adjustment
11 decreases Washington net operating income by \$2,044,000 and increases rate base by
12 \$7,292,000.

13 The adjustment in column (PF8), **Pro Forma Asset Management**, pro forms in the
14 O&M expense associated with the Asset Management Program as described further by Company
15 witness Mr. Kinney. This adjustment decreases Washington net operating income by
16 \$1,152,000.

17 **Q. Please turn to page 9 and explain the adjustments shown there.**

18 A. The adjustment in column (PF9), **Pro Forma Spokane River Relicensing**,
19 includes the processing costs associated with the Company's Spokane River relicensing efforts.
20 These costs include actual life-to-date expenditures from April 2001 through December 31, 2007,
21 and 2008 pro forma expenditures through December 31, 2008. Company witness Mr. Howard
22 provides additional details regarding these costs, and explains that the Company anticipates a

1 final license approved by the Federal Energy Regulatory Commission (FERC) by December
2 2008. This adjustment decreases Washington net operating income by \$1,464,000 and increases
3 rate base by \$21,960,000.

4 The adjustment in column (PF10), **Pro Forma Coeur d' Alene Tribe Settlement**,
5 includes cost associated with the Lake Coeur d' Alene Tribe settlement agreement as described
6 further by Company witness Ms. Pessemier. For compensation for trespass, the settlement
7 includes the payment of \$25.0 million in 2008, \$10 million in 2009 and \$4.0 million in 2010 for
8 resolution of the past trespass and §10(e) charges. The future §10(e) payments are \$400,000 flat
9 annual payments for the first 20 years of the license and \$700,000 flat annual payments for the
10 remaining 30 years of the license. The Company is proposing, in this filing, that the first two
11 payments of \$25.0 million and \$10.0 million, together with the 2008 \$400,000 first annual
12 payment be deferred and amortized. The deferred payments including a return on the balance
13 would be amortized over the average remaining life of the Post Falls Project. The pro forma
14 adjustment includes one year amortization of the deferred balance, and the 2009 annual payment
15 of \$400,000. This adjustment decreases Washington net operating income by \$499,000 and
16 increases rate base by \$15,084,000.

17 The adjustment in column (PF11), **Pro Forma Montana Riverbed Lease**, includes costs
18 associated with the Montana Riverbed lease settlement as described further by Company witness
19 Mr. Vermillion. In this settlement, the Company agreed to pay the State of Montana \$4.0 million
20 annually beginning in 2007, with annual inflation adjustments, for a 10-year period for leasing
21 the riverbed under the Noxon Rapids Project and the Montana portion of the Cabinet Gorge
22 Project. The first two annual payments were deferred by Avista as approved in Docket No. UE-

1 072131. The deferred payments including accrued interest are being amortized over the
2 remaining eight years of the agreement. The pro forma adjustment includes one-eighth of the
3 deferred balance amortization and the 2009 annual lease payment. This adjustment decreases
4 Washington net operating income by \$2,222,000 and increases rate base by \$3,299,000.

5 The adjustment in column (PF12), **Pro Forma Colstrip Mercury Emission O&M**,
6 includes additional 2009 O&M costs associated with the mercury control project at Colstrip as
7 further described by Company witness Mr. Vermillion. This adjustment decreases Washington
8 net operating income by \$630,000.

9 The adjustment in column (PF13), **Pro Forma Incentives**, adjusts 2007 test year
10 incentive expense to the actual 2007 incentive expense paid in 2008 for the 2007 incentive plan.
11 The Company's main employee incentive plan uses Customer Satisfaction and Reliability targets
12 as the initial step in issuing incentive payouts. Actual payouts are dictated by utility O&M cost
13 savings. Since the executive plan is slightly different than the main employee incentive plan, this
14 adjustment removes any part of the 2007 executive incentive payout that was "not" based on the
15 Customer Satisfaction and Reliability targets. This pro forma adjustment further adjusts
16 incentive expenses to a 6 year average. The impact of this adjustment on Washington net
17 operating income is a decrease of \$258,000.

18 **Q: Please explain how the Company computed its 6-year average.**

19 A. Actual incentives paid and the associated payroll taxes accrued for years 2002
20 through 2006 were adjusted by the Consumer Price Index (CPI) annual average for the calendar
21 year the incentives were paid, to reflect those costs in 2007 dollars. The computed six-year

1 average of 2002 through 2007 incentives was compared to 2007 test year incentives paid to
2 determine the pro forma adjustment.

3 **Q. Please explain other examples where the use of an average has been used by**
4 **the Company to determine the appropriate level of revenue or expense to include in its**
5 **general rate case filings?**

6 A. A few examples come to mind regarding transmission revenue adjustments. For
7 example, the Company uses a five-year average for OASIS wheeling revenues because these
8 revenues vary year to year depending on electric energy market conditions, Avista has, in the
9 current and previous rate cases, used the most recent five-year average as being representative of
10 future expectations unless there are known events or factors that occurred during the period that
11 would cause the average to not be representative of future expectations.

12 A second transmission revenue example includes the adjustment for Dry Gulch revenue.
13 The current methodology used to forecast Dry Gulch revenue is a five-year average of actual
14 revenue. A five-year average is used since the revenue can vary from year to year. The revenue
15 is calculated using a 12-month rolling ratchet based on monthly peak demands. Load peaks are
16 very sensitive to temperatures, which vary from year to year.

17 A third example, regarding injuries and damages expense, includes the restating
18 adjustment described later in my testimony that replaces the amount accrued in the test period
19 with a six-year rolling average of actual payments for injuries and damages not covered by
20 insurance.

21 **Q. Have these average cost calculations been acceptable by parties in Avista's**
22 **previous rate cases?**

1 A. Yes. Both of the 5-year average transmission revenue examples described above,
2 are consistent with the calculations used in previous Avista rate cases, including the most recent
3 Docket Nos. UE-070804. The 6-year average used for injuries and damages is a result of the
4 Commission's Order in Docket No. U-88-2380-T and is consistent with that used in Docket Nos.
5 UE-070804 and UG-070805.

6 **Q. Has the Washington Utilities and Transportation Commission (WUTC) Staff**
7 **proposed the use of an average regarding incentives in any past rate proceedings for**
8 **Avista?**

9 A. Yes, the WUTC proposed a 7-year average of Avista's previous years incentive
10 pay outs (years 2000-2006) during the Company's last general rate proceeding in Docket Nos.
11 UE-070804 and UG-070805. This seven year average of incentives was ultimately included in
12 the all-party Settlement approved by the WUTC in the Dockets noted above.

13 **Q. Please explain why the Company used a 6-year average rather than the 7-**
14 **year average proposed by the WUTC Staff.**

15 A. The 7-year average was agreed to by the Company during settlement negotiations
16 as part of the give and take process of negotiating a fair and reasonable outcome for all parties
17 under those circumstances. However, the Company believes a 6-year average, using years 2002
18 though 2007, is more appropriate. Besides the other examples noted above where a five or six
19 year average has been used, the deciding factor is that the Company changed its incentive plan in
20 2002 to be based on Customer Satisfaction and Reliability targets, and the requirement that O&M
21 savings must occur in order for there to be any pay out. This is significantly different than the

1 plans prior to 2002 based on earnings targets of the Company. Therefore, including years prior
2 to 2002 in the average would not be appropriate, since the prior years would not be comparable.

3 **Q. Please continue your explanation of the adjustment columns on page 9.**

4 A. The last column, Pro Forma Total, reflects total 2007 pro forma results of
5 operations and rate base consisting of 2007 actual results and the total of all adjustments.

6 **Q. Referring back to page 1, line 42, of Exhibit No. ____ (EMA-2), what was the
7 actual and pro forma electric rate of return realized by the Company during the test
8 period?**

9 A. For the State of Washington, the actual test period rate of return was 6.32%. The
10 pro forma rate of return is 6.04% under present rates. Thus, the Company does not, on a pro
11 forma basis for the test period, realize the 8.43% rate of return requested by the Company in this
12 case.

13 **Q. How much additional net operating income would be required for the State
14 of Washington electric operations to allow the Company an opportunity to earn its
15 proposed 8.43% rate of return on a pro forma basis?**

16 A. The net operating income deficiency amounts to \$22,772,000, as shown on line 5,
17 page 2 of Exhibit No. ____ (EMA-2). The resulting revenue requirement is shown on line 7 and
18 amounts to \$36,617,000, or an increase of 10.29% over pro forma general business revenues.

19

20

IV. NATURAL GAS SECTION

21 **Q. On what test period is the Company basing its need for additional natural
22 gas revenue?**

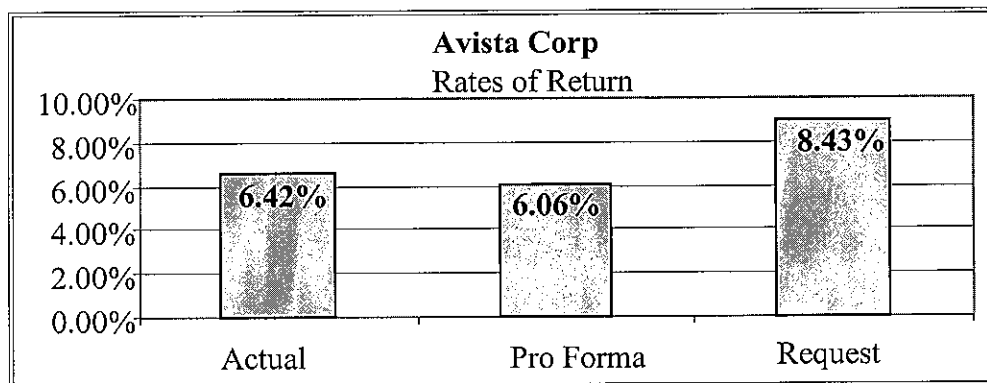
1 A. The test period being used by the Company is the twelve-month period ending
 2 December 31, 2007, presented on a pro forma basis.

3 **Q. When was the last change to base rates in the Washington jurisdiction?**

4 A. The last change to base gas rates in Washington occurred on January 1, 2008 as a
 5 result of a settlement in Docket No. UG-070805.

6 **Q. Could you please explain the different rates of return shown in your natural
 7 gas results presented in your testimony?**

8 A. Yes. As discussed previously in the Electric Section, there are three different
 9 rates of return calculated. The actual ROR earned by the Company during the test period, the Pro
 10 Forma ROR determined in my Exhibit No. ____ (EMA-3), and the requested ROR. For
 11 convenience of comparison, please refer to the following graph depicting these results for the
 12 Natural Gas Section:



13
 14
 15
 16
 17
 18
 19 **Q. What are the primary factors driving the Company's need for additional
 20 natural gas revenues?**

21 A. The Company's natural gas request is driven by changes in various operating cost
 22 components, but primarily the addition of the Jackson Prairie expansion project planned for

1 completion in the fourth quarter of 2008. This causes an increase in the fixed costs of providing
2 gas service to customers. Company witness Mr. Vermillion further discusses the JP Expansion
3 project in his testimony, while I describe the pro forma adjustment included in this case later in
4 my testimony.

5

6 **Revenue Requirement**

7 **Q. Would you please explain what is shown in Exhibit No. ____ (EMA-3)?**

8 A. Exhibit No. ____ (EMA-3) shows actual and pro forma gas operating results and
9 rate base for the test period for the State of Washington. Column (b) of page 1 of Exhibit
10 No. ____ (EMA-3) shows 2007 operating results and components of the average-of-monthly-
11 average rate base as recorded; column (c) is the total of all adjustments to net operating income
12 and rate base; and column (d) is pro forma results of operations, all under existing rates. Column
13 (e) shows the revenue increase required which would allow the Company to earn a 8.43% rate of
14 return. Column (f) reflects pro forma gas operating results with the requested increase of
15 \$6,587,000.

16 **Q. Would you please explain page 2 of Exhibit No. ____ (EMA-3)?**

17 A. Yes. Page 2 shows the calculation of the \$6,587,000 revenue requirement at the
18 requested 8.43% rate of return.

19 **Q. Would you now please explain page 3 of Exhibit No. ____ (EMA-3)?**

20 A. Yes. Page 3 shows the derivation of the net operating income to gross revenue
21 conversion factor. The conversion factor takes into account uncollectible accounts receivable,
22 Commission fees and Washington State excise taxes. Federal income taxes are reflected at 35%.

1 **Q. Now turning to pages 4 through 8 of your Exhibit No. ____ (EMA-3), would**
2 **you please explain what those pages show?**

3 A. Page 4 begins with actual operating results and rate base for the 2007 test period
4 in column (b). Individual normalizing adjustments that are standard components of our annual
5 reporting to the Commission begin in column (c) on page 4 and continue through column (u) on
6 page 6. Individual pro forma and additional normalizing adjustments begin in column (PF1) on
7 page 7 and continue through column (PF6) on page 8. The final column on page 8 is the total pro
8 forma operating results and rate base for the test period. Additional details related to each
9 adjustment described below are provided in accompanying work papers.

10

11 **Standard Commission Basis Adjustments**

12 **Q. Would you please explain each of these adjustments, the reason for the**
13 **adjustment and its effect on test period State of Washington net operating income and/or**
14 **rate base?**

15 A. Yes, but before I begin, I will note that in addition to the explanation of
16 adjustments provided herein, the Company has also provided workpapers outlining additional
17 details related to each of the adjustments. The restating adjustments shown in columns *c* through
18 *u* are consistent with methodologies employed in our prior cases and current regulatory
19 principles.

20 The first adjustment, column (c) on page 4, entitled **Deferred FIT Rate Base**, reflects the
21 rate base reduction for Washington's portion of deferred taxes. The adjustment reflects the
22 deferred tax balances arising from accelerated tax depreciation (Accelerated Cost Recovery

1 System, or ACRS, and Modified Accelerated Cost Recovery, or MACRS), bond refinancing
2 premiums, and contributions in aid of construction. These amounts are reflected on the average
3 of monthly average balance basis. The effect on Washington rate base is a reduction of
4 \$26,823,000.

5 The adjustment in column (d), **Deferred Gain on Office Building**, reflects the rate base
6 reduction for Washington's portion of the net of tax, unamortized gain on the sale of the
7 Company's general office facility. The facility was sold in December 1986 and leased back by
8 the Company. Although the Company repurchased the building in November 2005, the
9 Company opted to continue to amortize the deferred gain over the remaining amortization period
10 scheduled to end in 2011. This accounting treatment was approved in Order No. 01 in Docket
11 No. U-071805. This adjustment reflects the average of monthly averages amount of the deferred
12 gain for the 2009 rate period. The effect on Washington rate base is a reduction of \$71,000.

13 The adjustment in column (e), **Gas Inventory**, reflects the adjustment to rate base for the
14 average of monthly average value of gas stored at the Company's Jackson Prairie underground
15 storage facility. The effect on Washington rate base is an increase of \$5,607,000.

16 The adjustment in column (f), **Weatherization and DSM Investment**, includes in rate
17 base the balance (net of amortization) of company investments in natural gas demand side
18 management (DSM) and Weatherization consistent with Docket Nos. UG-991607, UG-041515,
19 UG-050483, and UG-070805. Rate base has been restated to the average of monthly averages for
20 the 2009 rate period. The effect of this adjustment is to increase Washington rate base by
21 \$784,000.

1 The adjustment in column (g), entitled **Customer Advances**, decreases rate base for
2 funds advanced by customers for line extensions, as they are generally recorded as contributions
3 in aid of construction at some future time. The effect of this adjustment on Washington rate base
4 is a decrease of \$64,000.

5 The adjustment in column (h), entitled **Depreciation True-up**, reflects a decrease in
6 depreciation expense due to the utilization of new depreciation rates effective January 1, 2008 as
7 approved in Docket No. UG-070805. This adjustment increases Washington net operating
8 income by \$214,000.

9 **Q. Please turn to page 5 and explain the adjustments shown there.**

10 A. The column marked by a dash, and labeled **Subtotal Actual**, is a subtotal of
11 columns (b) through (h) and reflects the standard rate base adjustments that are included in
12 Commission Basis reporting.

13 The first adjustment on page 5 in column (i), entitled **Revenue Normalization & Gas**
14 **Cost Adjustment**, is a 3-fold adjustment taking into account known and measurable changes that
15 include revenue normalization, which reprices customer usage under presently effective rates, as
16 well as weather normalization and an unbilled revenue calculation. Associated gas costs are
17 replaced with gas costs computed using normalized volumes at the currently effective “weighted
18 average cost of gas,” or WACOG rates. Revenues associated with the Schedule 191 Tariff Rider
19 are excluded from pro forma revenues, and the related amortization expense is eliminated as
20 well. Ms. Knox is sponsoring this adjustment. The effect of this particular adjustment is to
21 increase Washington net operating income by \$1,149,000.

1 The adjustment in column (j), **Eliminate B & O Taxes**, eliminates the revenues and
2 expenses associated with local business and occupation taxes, which the Company passes
3 through to customers. The adjustment eliminates any timing mismatch that exists between the
4 revenues and expenses by eliminating the revenues and expenses in their entirety. B & O Taxes
5 are passed through on a separate schedule, which is not part of this proceeding. The effect of this
6 adjustment is to decrease Washington net operating income by \$4,000.

7 The adjustment in column (k), **Property Tax**, restates the 2007 test period accrued levels
8 of property taxes to the most current information available and eliminates any adjustments
9 related to the prior year. The effect of this particular adjustment is to increase Washington net
10 operating income by \$341,000.

11 The adjustment in column (l), **Uncollectible Expense**, restates the accrued expense to the
12 actual level of net write-offs for the test period. The effect of this adjustment is to increase
13 Washington net operating income by \$68,000.

14 The adjustment in column (m), entitled **Regulatory Expense Adjustment**, restates
15 recorded 2007 regulatory expense to reflect the WUTC assessment rates applied to revenues for
16 the test period. The effect of this adjustment is to decrease Washington net operating income by
17 \$8,000.

18 The adjustment in column (n), entitled **Injuries and Damages**, is a restating adjustment
19 that replaces the accrual with actuals to obtain the six-year rolling average of injuries and
20 damages payments not covered by insurance. As a result of the Commission's Order in Docket
21 No. U-88-2380-T, the Company changed to the reserve method of accounting for injuries and

1 damages not covered by insurance. The effect of this adjustment is to decrease Washington net
2 operating income by \$73,000.

3 **Q. Please turn to page 6 and explain the adjustments shown there.**

4 A. The first adjustment on page 6 in column (o), entitled **FIT**, adjusts the FIT
5 calculated at 35% within Results of Operations by removing the effect of certain Schedule M
6 items and matches the jurisdictional allocation of other Schedule M items to related Results of
7 Operations allocations. This adjustment also reflects the proper level of deferred tax expense for
8 the test period. The effect of this adjustment, all based upon a Federal tax rate of 35%, is to
9 decrease Washington net operating income by \$9,000.

10 The adjustment in column (p), **Net Gains/Losses**, reflects a ten-year amortization of net
11 gains realized from the sale of real property disposed of between 1999 and 2007. This restating
12 adjustment is made as a result of the Commission's Order in Docket No. UG-050843 and
13 consistent with UG-070805. The effect of this adjustment is to increase Washington net
14 operating income by \$8,000.

15 The adjustment in column (q), **Eliminate A/R Expenses**, A/R representing Accounts
16 Receivable, removes expenses associated with the sale of customer accounts receivable. The
17 effect of this adjustment is to increase Washington net operating income by \$99,000.

18 The adjustment in column (r), **Office Space Charges to Subs**, removes a portion of the
19 office space costs (building lease and O&M costs, common area costs, copier expense and annual
20 office furniture rental) using the relationship of labor hours charged to subsidiary activities by
21 employee compared to total labor hours by employee. These percentages are applied to the
22 employees' office space (expressed in square feet) and multiplied by office space costs/per

1 square foot. This restating adjustment is made as a result of the Commission's Third
2 Supplemental Order in Docket No. U-88-2380-T and is consistent with Docket No. UG-050483
3 and UG-070805. The effect of this adjustment is to increase Washington net operating income
4 by \$2,000.

5 The adjustment in column (s), **Restate Excise Taxes**, removes the effect of a one-month
6 lag between collection and payment of taxes. The effect of this adjustment is to decrease
7 Washington net operating income by \$15,000.

8 The adjustment in column (t), **O&M Savings**, removes O&M expenses, or future
9 savings, included in the 2007 test period for the reduction of three gas serviceman and other net
10 expenses, due to the gas mobile dispatch project completed in Washington in 2007. The effect of
11 this adjustment is to increase Washington net operating income by \$94,000.

12 The adjustment in column (u), **Restate Debt Interest**, restates debt interest using the
13 Company's pro forma weighted average cost of debt, as outlined in the testimony and exhibits of
14 Mr. Malquist, and applied to Washington's pro forma level of rate base, produces a pro forma
15 level of tax deductible interest expense. The federal income tax effect of the restated level of
16 interest for the test period decreases Washington net operating income by \$342,000.

17 **Q. Please turn to page 7 and explain the adjustments shown there.**

18 A. The first adjustment on page 7, entitled **Restated Total**, subtotals all the
19 preceding columns (b) through column (u), exclusive of the previously discussed subtotal
20 column. These totals represent actual operating results and rate base plus the standard
21 normalizing adjustments that the Company includes in its annual Commission Basis reports.

1 **Pro Forma Adjustments**

2 **Q. Please explain the significance of the 6 columns subsequent to the Restated**
3 **Total column on page 7 of your Exhibit No. ____ (EMA-3).**

4 A. The adjustments starting on page 7 are pro forma adjustments to reflect known
5 and measurable changes between the test period and the pro forma period. In this case, they
6 encompass revenue and expense items, and natural gas capital projects. These adjustments bring
7 the operating results and rate base to the final pro forma level for the test year.

8 **Q. Please continue with your explanation of the adjustments on page 7.**

9 The adjustment in column (PF1), **Pro Forma Labor-Non-Exec**, reflects known and
10 measurable changes to test period union and non-union wages and salaries, excluding executive
11 salaries, which are handled separately in PF2. Test period wages and salaries are restated as if
12 the wage and salary increases through March 2009 were in place during the entire pro forma test
13 period. The methodology behind this adjustment is consistent with Docket No. UG-050483 and
14 UG-070805. The effect of this adjustment on Washington net operating income is a decrease of
15 \$412,000.

16 The adjustment in column (PF2), **Pro Forma Labor-Executive**, reflects known and
17 measurable changes to executive compensation, restating their salaries as if wage and salary
18 increases through March 2009 were in place for the entire pro forma test period. This adjustment
19 takes into account changes in executive staffing made during 2007 and includes compensation
20 for the planned executive team in 2009 only. Compensation costs for non-utility operations are
21 excluded as executives routinely charge a portion of their time to non-utility operations,
22 commensurate with the amount of time spent on such activities. The current executives' salary

1 allocations are set at their expected pro forma test period utility/non-utility percentage splits. The
2 impact of this adjustment on Washington net operating income is a decrease of \$43,000.

3 The adjustment in column (PF3), **Pro Forma JP Storage**, decreases Washington net
4 operating income by \$1,374,000 and increases rate base by \$18,695,000.

5 **Q. Could you please explain the purpose and the breakdown of the Jackson**
6 **Prairie Storage Pro Forma Adjustment components?**

7 A. Yes. The JP Storage adjustment is necessary because the storage capacity and
8 deliverability associated with the Jackson Prairie (JP) Storage facility will increase markedly
9 from the 2007 test year. The increased storage has implications on revenues, expenses, rate base,
10 and inventory levels associated with this filing.

11 **Q. Please describe the capacity portion of the Storage Adjustment.**

12 A. In April of 2007, Avista ended its natural gas storage release contract with
13 Cascade Natural Gas, effectively recouping storage capacity of its JP Storage facility. Similarly,
14 Avista will end its release contract with Terasen Gas in April of 2008. The revenues from these
15 two release contracts have been eliminated from the test period and both were removed from
16 base tariff rates effective January 1, 2008 (as approved in Docket No. UG-070805). The net
17 effect of the elimination of these contracts is a decrease in Washington net operating income of
18 \$1,374,000.

19 **Q. How much 2009 storage will the Company have and how was the JP Storage**
20 **inventory valued?**

21 A. The Company will be able to store approximately 5.2 million Dth during the 2009
22 pro forma period, a significant increase over the 2007 test year. The JP inventory adjustment

1 puts a valuation on the total JP Storage inventory and adjusts the pro forma rate base accordingly.

2 Monthly gas purchases are assumed from April to September, and are based on an
3 estimated daily Dth injection schedule. The cost of the purchased gas is estimated using 60-day
4 historical average (Nov. 16, 2007 to Feb. 14, 2008) forward monthly prices (including fuel cost
5 adders). The acquisition amount/percentage by gas supply basin (AECO, Sumas, Rockies) was
6 estimated using estimated load requirements and available pipeline transportation capacity each
7 day during the injection period. The resulting gas inventory is valued each month using the
8 weighted average cost method.

9 The net effect of the adjustment is to increase gas inventory by \$10.3 million, from \$5.6
10 million to \$15.9 million for the 2009 pro forma period.

11 **Q. Please describe the deliverability portion of the Storage Adjustment.**

12 A. In addition to the recouped storage, a multi-year expansion project at the JP
13 Storage facility is expected to go into service November of 2008. The \$16.2 million
14 deliverability component of the project is 75% assignable to the Washington and Idaho service
15 territories, and is allocated to Washington at 72.09% based on system contract demand.
16 Assuming an in-service date of November 2008 and related depreciation and deferred taxes
17 through the 2009 pro forma period, the Washington portion of rate base is \$8.4 million.
18 Depreciation and property tax expense increase the revenue requirement by \$300,000.

19 Company witness Mr. Vermillion discusses the JP Expansion project in more detail in his
20 direct testimony.

21 **Q. Please continue with your explanation of the adjustments on page 7.**

1 A. The adjustment in column (PF4), **Pro Forma Capital Additions 2007**, pro forms
2 in the capital cost and expenses associated with adjusting the 2007 average-monthly-average
3 plant related balances to actual end-of-period balances for plant in service at December 31, 2007.
4 The capital costs have been included for December 31, 2007 pro forma period with the
5 associated depreciation expense and property tax, as well as the appropriate accumulated
6 depreciation and deferred income tax rate base offsets. This adjustment was made under the
7 direction of Company witness Mr. DeFelice and is described further in his testimony. This
8 adjustment increases Washington net operating income by \$170,000 and increases rate base by
9 \$549,000.

10 The adjustment in column (PF5), **Pro Forma Capital Additions 2008**, pro forms in the
11 capital cost and expenses associated with pro forming in capital expenditures for 2008. This
12 adjustment includes projects completed during 2008, and thus were normalized to reflect annual
13 amounts, and projects expected to be completed and transferred to plant-in-service by December
14 31, 2008. The capital costs have been included for their appropriate pro forma period with the
15 associated depreciation expense and property tax, as well as the appropriate accumulated
16 depreciation and deferred income tax rate base offsets. This adjustment also reduces the 2007
17 vintage plant net rate base (including accumulated depreciation and deferred FIT) to an end of
18 period December 31, 2008 adjusted balance. This adjustment was also made under the direction
19 of Mr. DeFelice and is described further in his testimony. This adjustment decreases Washington
20 net operating income by \$378,000 and increases rate base by \$1,957,000.

21 **Q. Please describe the adjustments on page 8.**

1 A. The adjustment in column (PF6), entitled **Pro Forma Incentives**, adjusts 2007
2 test year incentive expense to the actual 2007 incentive expense paid in 2008 for the 2007
3 incentive plan and removes any part of the 2007 executive incentive payout that was not based on
4 the Customer Satisfaction and Reliability targets (as further explained in the Electric Section).
5 This adjustment also pro forms in a 6 year average (as further explained in the Electric Section).
6 The impact of this adjustment on Washington net operating income is a decrease of \$68,000.

7 The last column on page 8, **Pro Forma Total**, reflects total 2007 pro forma results of
8 operations and rate base consisting of 2007 actual results and the total of all normalizing and pro
9 forma adjustments.

10 **Q. Referring back to page 1, line 43, of Exhibit No. ____ (EMA-3), what was the**
11 **actual and pro forma gas rate of return realized by the Company during the test period?**

12 A. For the State of Washington, the actual test period rate of return was 6.42%. The
13 pro forma rate of return is 6.06% under present rates. Thus, the Company does not, on a pro
14 forma basis for the test period, realize the 8.43% rate of return requested by the Company in this
15 case.

16 **Q. How much additional net operating income would be required for the State**
17 **of Washington gas operations to allow the Company an opportunity to earn its proposed**
18 **8.43% rate of return on a pro forma basis?**

19 A. The net operating income deficiency amounts to \$4,097,000, as shown on line 5,
20 page 2 of Exhibit No. ____ (EMA-3). The resulting revenue requirement is shown on line 7 and
21 amounts to \$6,587,000, or an increase of 3.33% over pro forma general business and
22 transportation revenues.

1
2
3
4
5
6
7
8
9
10

V. ALLOCATION PROCEDURES

Q. Have there been any changes to the Company’s system and jurisdictional procedures since the Company’s last general electric and natural gas cases, Docket Nos. UE-070804 and UG-070805?

A. No. For ratemaking purposes, the Company allocates revenues, expenses and rate base between electric and gas services and between Washington, Idaho, and Oregon jurisdictions where electric and/or gas service is provided. The current methodology was implemented in 1994 and has not changed.

Q. Does that conclude your pre-filed direct testimony?

A. Yes, it does.