

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-07 _____

DOCKET NO. UG-07 _____

DIRECT TESTIMONY OF

ELIZABETH M. ANDREWS

REPRESENTING AVISTA CORPORATION

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I. INTRODUCTION

1
2 **Q. Please state your name, business address, and present position with Avista**
3 **Corporation.**

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

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

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

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

18 A. As Manager of Revenue Requirements, aside from special projects, I am
19 responsible for the preparation of normalized revenue requirement and pro forma studies for the
20 various jurisdictions in which the Company provides utility services. During the last seven years
21 I have assisted in the Company's electric and/or natural gas general rate filings in Washington,
22 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 witnesses in this case.
7 For example, Company witness Mr. Storro will explain the proposed adjustments related to the
8 inclusion of new hydro and thermal generation capital additions. Company witness Mr. Johnson
9 prepared the total system pro forma power supply adjustment. While I provide the revenue
10 requirement impact of the pro forma transmission revenues and expenses adjustment, the Wood
11 Pole Test and Treat expense adjustment, and the transmission capital project adjustment,
12 Company witness Mr. Kinney provides additional operational detail and support regarding these
13 adjustments.

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

15 A. Yes. I am sponsoring Exhibit Nos. ____ (EMA-2) (Electric) and ____ (EMA-3)
16 (Natural Gas), which were prepared under my direction. These Exhibits consist of worksheets,
17 which show actual 2006 operating results, pro forma, and proposed electric and natural gas
18 operating results and rate base for the State of Washington, the Company's calculation of the
19 general revenue requirement, the derivation of the net operating income to gross revenue
20 conversion factor, and the pro forma adjustments proposed in this filing.

21

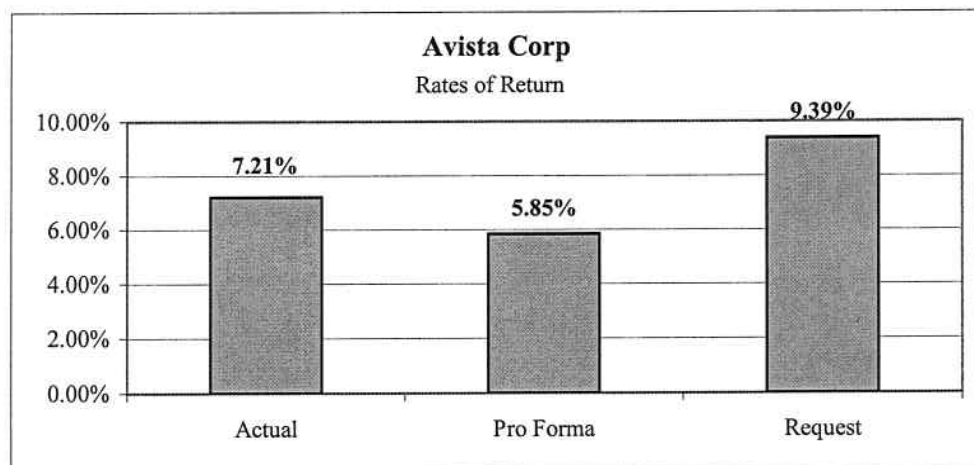
1 A. The test period being used by the Company is the twelve-month period ending
2 December 31, 2006, presented on a pro forma basis. Currently authorized rates are based upon
3 the 2004 test year utilized in UE-050482.

4 **Q. Have there been any changes to electric base rates in the Washington**
5 **jurisdiction since the January 2006 rate change?**

6 A. No. The Company has not changed its base electric rates in Washington since
7 2006.

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 operational factors that have impacted the Company's electric
4 results of operations since the 2004 test year. Net Operating Income ("NOI") has declined
5 approximately \$19.5 million, or 27%, and Total Rate Base has increased approximately \$107
6 million, or 13.5%. During this same time period, the average number of customers has increased
7 approximately 4%. The Company's electric request is driven by changes in various operating
8 cost components, but primarily power supply costs, and plant investment or rate base growth
9 associated with generation, transmission and distribution plant. Production and Transmission
10 expense increases, as explained below, comprise approximately 42% of the overall request. As
11 already noted, net rate base increased approximately \$107 million, primarily due to additional
12 plant investment in generation, both hydro and thermal, and transmission plant. The depreciation
13 recovery, taxes associated with plant, and the return on additional net plant investments offset by
14 the tax benefit of interest, make up approximately 48% of the Company request.

15 The net increase to all other operating categories, such as distribution expenses, customer
16 service, taxes and administrative and general, total the remaining 10%. I will provide additional
17 detail regarding these items later, but the chart below shows this initial comparison:

18

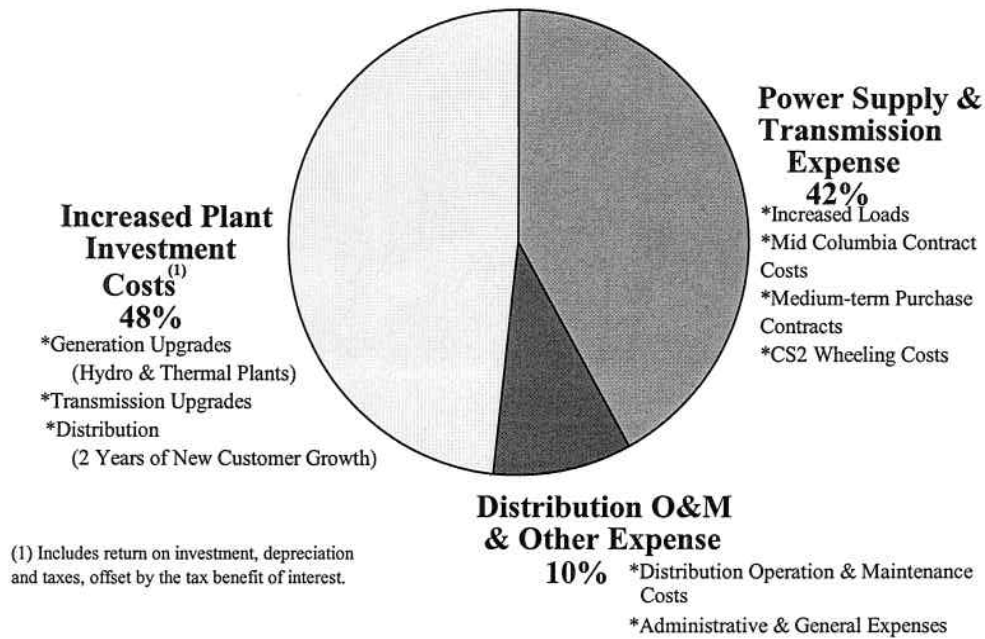
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Primary Electric Revenue Requirement Factors



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

A. Net power supply expense is the sum of fuel expense and purchased power costs less wholesale revenues, or sales for resale. Net power supply expense has increased by approximately \$33.8 million (Washington allocation) from the level currently in base rates. This increase is driven primarily by wholesale electric and natural gas costs to serve increasing load requirements. Retail loads for 2008 are 105 aMW (System) higher than 2004 retail loads that were used to develop current retail rates. The marginal cost of power to serve this load is substantially higher than Avista's current embedded resource costs reflected in current rates. Mr. Johnson explains the power supply revenues and expenses included in net power supply costs. Some of those factors include the changes to long-term contracts, thermal fuel expense and transmission expense.

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 over the last two years since the
4 last Washington electric increase. For example, wages and benefits have increased over the last
5 two years, as well as other administrative and general expenses. However, the primary increase
6 in this area is due to operation and maintenance expenses of the distribution system.

7 We are utilizing a 2006 test year since that is the most recent normalized financial
8 information the Company has available, however, new general electric rates resulting from this
9 filing will not go into effect until early in 2008. Accordingly, the Company has included a
10 number of pro forma adjustments to capture some of the measurable cost changes that the
11 Company will experience from the 2006 test year.

12 **Q. What were the major components of the \$107 million increase in Total Rate**
13 **Base?**

14 A. Looking at the changes to “gross” plant in service shows that gross plant increased
15 \$154 million, or a little over 10% as compared to what is currently included in rates. To continue
16 to meet the energy and reliability needs of our customers, the Company has invested additional
17 amounts in thermal and hydro generating facilities, as well as additional transmission investment.
18 This combined with other production plant additions, make up approximately \$90 million or
19 58% of the increases in gross plant.¹

¹ Also included in the 58% of gross plant additions is the \$37 million of Washington’s share of the purchase of the Rathdrum CT project in September 2005, previously leased by the Company. Company witness Mr. Malquist discusses the 2005 purchase of the Rathdrum CT and termination of the lease. The Rathdrum CT is fully reflected in the Company’s 2006 test period results.

1 The specific pro forma hydro and thermal generation project upgrades undertaken by the
 2 Company to improve operating efficiency, reliability, and increase generation include Colstrip
 3 Units 3 & 4, Cabinet Gorge Unit 4, and Noxon Rapids Unit 4. Mr. Storro sponsors testimony
 4 that details these project upgrades. The table below includes the four generation project upgrades
 5 that have been included in pro forma period results, listing the estimated gross system costs,
 6 Washington's share, and their expected in-service dates.

Generation Projects ⁽¹⁾	Cost: System / WA (000s)	In-Service Date
Cabinet Gorge Unit 4	\$6,200 / \$4,081	Mar-07
Noxon Rapids Unit 4	\$7,189 / \$4,733	Sep-07
Colstrip Unit 4	\$2,949 / \$1,941	Jun-06
Colstrip Unit 3	\$3,760 / \$2,475	Jun-07
Total	\$20,098 / \$13,230	
⁽¹⁾ The additional generation from the Cabinet Gorge Unit 4 and Colstrip Units 3 & 4 project upgrades has also been included in the AURORA model as discussed by Company witness Mr. Kalich.		

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 12 Later in my testimony, I will address the \$11.8 million net rate base adjustment labeled
 13 "Pro Forma Generation Capital Additions" included in Exhibit No.__(EMA-2), page 9, which
 14 explains the detail behind the normalizing and pro forma net operating income and rate base
 15 adjustments.

16 **Q. Could you please continue by explaining the transmission upgrades included**
 17 **in Total Rate Base?**

18 A. Yes. By itself, the additional transmission investment increased gross
 19 Washington electric plant by \$54.3 million, including projects scheduled to be completed in
 20 2007. The transmission upgrades included are part of a multi-year project to increase transfer
 21 capability and improve reliability on our transmission system. Mr. Kinney is sponsoring
 22 testimony that details the overall transmission project. The total project is broken down into a

1 number of sub-projects that are placed in service at different times. The increase in pro forma
 2 rate base for the specific transmission sub-projects with completion dates through December
 3 2007 are included in the table below, which lists the gross estimated system costs and
 4 Washington's share included in this case.

Transmission Projects	Cost: System / WA (000s)	In-Service Date
West of Hatwai (WoH) Telecom	\$3,207 / \$2,111	* Oct-07
Beacon-Bell #5 230 kV line	\$2,915 / \$1,919	Apr-07
Palouse Reinforcement Project	\$52,392 / \$34,489	* Nov-07
Dry Creek 115 kV Substation	\$2,236 / \$1,472	Nov-06
Boulder Substation	\$3,299 / \$2,172	* Jun-07
Lolo Substation	\$2,044 / \$1,345	Dec-07
Critchfield Substation	\$800 / \$527	Dec-07
Total	\$66,893 / \$44,035	
*These projects include multiple phases with various in service dates in 2006 and 2007. The dates shown are the in service dates for the last phase of the project. See details in Exhibit No. _(SJK-2), page 2.		

11
 12
 13 Later in my testimony, I will address the \$40.3 million net rate base adjustment labeled
 14 "Pro Forma Transmission Capital Additions" included in Exhibit No.__(EMA-2), page 9, which
 15 explains the detail behind the normalizing and pro forma net operating income and rate base
 16 adjustments.

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

18 A. Distribution plant increased \$45.4 million, or 10%, while General and Intangible
 19 plant increased a combined \$19 million.²

20 The figures listed above are "gross" plant investment changes. Again, taking into account
 21 increases to Accumulated Depreciation and Amortization and Deferred Federal Income Tax
 22 offsets, produces the net \$107 million, or 13.5% increase to Total Rate Base. Depreciation

1 expense, which has largely followed an 11% growth in gross plant-in-service, has increased \$5.8
2 million.

3

4 **Revenue Requirement**

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

6 A. Exhibit No. ____ (EMA-2) shows actual and pro forma electric operating results
7 and rate base for the test period for the State of Washington. Column (b) of page 1 of Exhibit
8 No. ____ (EMA-2) shows 2006 operating results and components of the average-of-monthly-
9 average rate base as recorded; column (c) is the total of all adjustments to net operating income
10 and rate base; and column (d) is pro forma results of operations, all under existing rates. Column
11 (e) shows the revenue increase required which would allow the Company to earn a 9.39% rate of
12 return. Column (f) reflects pro forma electric operating results with the requested increase of
13 \$51,139,000. The restating adjustments shown in columns c through y, of pages 4 through 9 of
14 Exhibit No. ____ (EMA-2), are consistent with the treatment reflected in the prior Commission
15 Order in Docket No. UE-050482 and current regulatory principles.

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

17 A. Yes. Page 2 shows the calculation of the \$51,139,000 revenue requirement at the
18 requested 9.39% rate of return.

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

² Included in the \$19 million of General and Intangible gross plant additions is the \$8.7 million of Washington's share of the purchase of the main office building in November 2005, previously leased by the Company. The main office building is fully reflected in the Company's 2006 test period results.

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

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

6 A. Page 4 begins with actual operating results and rate base for the 2006 test period
7 in column (b). Individual normalizing adjustments that are standard components of our annual
8 reporting to the Commission begin in column (c) on page 4 and continue through column (y) on
9 page 8. Individual pro forma and additional normalizing adjustments begin in column (PF1) on
10 page 8 and continue through column (PF9) on page 9. The final column on page 9 is the total pro
11 forma operating results and rate base for the test period.

12

13 **Standard Commission Basis Adjustments**

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

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

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 \$138,495,000.

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. This adjustment reflects the average of monthly averages amount of the deferred
9 gain for the 2008 rate period. The effect on Washington rate base is a reduction of \$295,000.

10 The adjustment in column (e), **Colstrip 3 AFUDC Elimination**, is a reallocation of rate
11 base and depreciation expense between jurisdictions. In Cause Nos. U-81-15 and U-82-10, the
12 WUTC allowed the Company a return on a portion of Colstrip Unit 3 construction work in
13 progress ("CWIP"). A much smaller amount of Colstrip Unit 3 CWIP was allowed in rate base
14 in Case U-1008-144 by the Idaho Public Utilities Commission ("IPUC"). The Company
15 eliminated the AFUDC associated with the portion of CWIP allowed in rate base in each
16 jurisdiction. Since production facilities are allocated on the Production/Transmission formula,
17 the allocation of AFUDC is reversed and a direct assignment is made. The rate base adjustment
18 reflects the average of monthly averages amount for 2006. The effect on Washington net
19 operating income is an increase of \$216,000. The effect of the reallocation on Washington rate
20 base is a decrease of \$2,255,000.

21 The adjustment in column (f), **Colstrip Common AFUDC**, is also associated with the
22 Colstrip plants in Montana, and increases rate base. Differing amounts of Colstrip common

1 facilities were excluded from rate base by this Commission and the IPUC until Colstrip Unit 4
2 was placed in service. The Company was allowed to accrue AFUDC on the Colstrip common
3 facilities during the time that they were excluded from rate base. It is necessary to directly assign
4 the AFUDC because of the differing amounts of common facilities excluded from rate base by
5 this Commission and the IPUC. In September 1988, an entry was made to comply with a Federal
6 Energy Regulatory Commission (“FERC”) Audit Exception, which transferred Colstrip common
7 AFUDC from the plant accounts to account 186. These amounts reflect a direct assignment of
8 rate base for the appropriate average of monthly averages amounts of Colstrip common AFUDC
9 to the Washington and Idaho jurisdictions. Amortization expense associated with the Colstrip
10 common AFUDC is charged directly to the Washington and Idaho jurisdictions through Account
11 406 and is a component of the actual results of operations. The rate base adjustment reflects the
12 average of monthly averages amount for 2006. The effect on Washington rate base is an increase
13 of \$492,000.

14 The adjustment in column (g), **Kettle Falls Disallowance**, decreases rate base. The
15 amounts reflect the Kettle Falls generating plant disallowance ordered by this Commission in
16 Cause No. U-83-26. The disallowed investment and related depreciation, FIT expense,
17 accumulated depreciation and accumulated deferred FIT are removed from actual results of
18 operations. The rate base adjustment and the accumulated deferred FIT reflects the average of
19 monthly averages amount for the 2006 period. The effect on Washington net operating income is
20 a decrease of \$56,000. The effect on Washington rate base is a decrease of \$993,000.

21 The adjustment in column (h), **Customer Advances**, decreases rate base for moneys
22 advanced by customers for line extensions, as they will most likely be recorded as contributions

1 in aid of construction at some future time. The effect on Washington rate base is a decrease of
2 \$267,000.

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

4 A. Page 5 starts with the adjustment in column (i), **PGE Monetization**, which adds
5 the amortization and related rate base reduction associated with the interest component of the
6 PGE Monetization per Docket No. UE-991606. The rate base adjustment and accumulated
7 deferred FIT is the average of monthly averages amount for the 2008 rate period. This
8 adjustment decreases Washington rate base by \$324,000 and increases Washington net operating
9 income by \$866,000.

10 The adjustment in column (j), **Settlement Exchange Power**, reflects the rate base
11 associated with the recovery of 64.1% of the Company's investment in Settlement Exchange
12 Power. The 64.1% recovery level was approved by the Commission's second Supplemental
13 Order in Cause No. U-86-99 dated February 24, 1987. Amortization expense and deferred FIT
14 expense recorded during the test period are reflected in results of operations. The rate base
15 adjustment and accumulated deferred FIT reflects the average of monthly averages amount for
16 the 2008 rate period. The effect on Washington rate base is an increase of \$22,441,000.

17 The next column marked by a dash, entitled **Subtotal Actual** represents actual operating
18 results and rate base plus the standard rate base adjustments that are included in Commission
19 Basis reporting, but not generally calculated in the Company's monthly jurisdictional Results of
20 Operations reports.

21 The adjustment in column (k), **Eliminate B & O Taxes**, eliminates the revenues and
22 expenses associated with local business and occupation (B & O) taxes, which the Company is

1 allowed to pass through to its Washington customers. The adjustment eliminates any timing
2 mismatch that exists between the revenues and expenses by eliminating the revenues and
3 expenses in their entirety. B & O taxes are passed through on a separate schedule, which is not
4 part of this proceeding. The effect of this adjustment is to decrease Washington net operating
5 income by \$21,000.

6 The adjustment in column (l), **Property Tax**, restates the 2006 test period accrued levels
7 of property taxes to the most current information available and eliminates any adjustments
8 related to the prior year. The effect of this particular adjustment is to decrease Washington net
9 operating income by \$12,000.

10 The adjustment in column (m), **Uncollectible Expense**, restates the accrued expense to
11 the actual level of net write-offs for the test period. The effect of this adjustment is to increase
12 Washington net operating income by \$31,000.

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

14 A. The adjustment in column (n), **Regulatory Expense**, restates recorded 2006
15 regulatory expense to reflect the WUTC assessment rates applied to revenues for the test period
16 and the actual levels of FERC fees paid during the test period, and eliminates any adjustments
17 related to the prior year. The effect of this adjustment is to decrease Washington net operating
18 income by \$755,000.

19 The adjustment in column (o), **Injuries and Damages**, is a restating adjustment that
20 replaces the accrual with actuals to obtain the six-year rolling average of injuries and damages
21 payments not covered by insurance. As a result of the Commission's Order in Docket No. U-88-
22 2380-T, the Company changed to the reserve method of accounting for injuries and damages not

1 covered by insurance. The effect of this adjustment is to increase Washington net operating
2 income by \$316,000.

3 The adjustment in column (p), **FIT**, adjusts the FIT calculated at 35% within Results of
4 Operations by removing the effect of certain Schedule M items, matching the jurisdictional
5 allocation of other Schedule M items to related Results of Operations allocations and to adjust
6 the production tax credits for pro forma qualified generation. The FIT adjustment increases
7 Washington net operating income by \$56,000. This adjustment also reflects the proper level of
8 deferred tax expense for the test period decreasing Washington net operating income by \$56,000.
9 Therefore, the net effect of this adjustment all based upon a Federal tax rate of 35% is \$0.0.

10 The adjustment in column (q), **Eliminate WA ERM Surcharge & Deferrals**, removes
11 the effects of the financial accounting for the Energy Recovery Mechanism (ERM.) The ERM
12 normalizes and defers certain net power supply and transmission revenues and costs pursuant to
13 the deferral and recovery mechanism authorized in Docket No. UE-060181. The adjustment
14 removes the ERM surcharge revenue as well as the deferral and amortization amounts and
15 certain directly assigned power costs and net transmission costs associated with the ERM. The
16 effect of this adjustment is to increase Washington net operating income by \$229,000.

17 The adjustment in column (r), **Nez Perce Settlement Adjustment**, reflects an increase in
18 Production operating expenses. An agreement was entered into between the Company and the
19 Nez Perce Tribe to settle certain issues regarding earlier owned and operated hydroelectric
20 generating facilities of the Company. This adjustment directly assigns the Nez Perce Settlement
21 expenses to the Washington and Idaho jurisdictions. This is necessary due to differing regulatory
22 treatment in Idaho Case No. WWP-E-98-11 and Washington Docket No. UE-991606. This

1 restating adjustment is consistent with Docket No. UE-011595. The effect of this adjustment is
2 to decrease Washington net operating income by \$12,000.

3 The adjustment in column (s), **Eliminate A/R Expenses**, A/R representing Accounts
4 Receivable, removes expenses associated with the sale of customer accounts receivable. The
5 effect of this adjustment is to increase Washington net operating income by \$1,116,000.

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

7 A. The adjustment in column (t), **Office Space Charged to Subs**, removes a portion
8 of the office space costs (building lease and O&M costs, common area costs, copier expense and
9 annual office furniture rental) using the relationship of labor hours charged to subsidiary
10 activities by employee compared to total labor hours by employee. These percentages are applied
11 to the employees' office space (expressed in square feet) and multiplied by office space costs/per
12 square foot. This restating adjustment is made as a result of the Commission's Third
13 Supplemental Order in Docket No. U-88-2380-T and is consistent with Docket No. UE-050482.
14 The effect of this adjustment is to increase Washington net operating income by \$16,000.

15 The adjustment in column (u), **Restate Excise Taxes**, removes the effect of a one-month
16 lag between collection and payment of taxes. The effect of this adjustment is to decrease
17 Washington net operating income by \$78,000.

18 The adjustment in column (v), **Net Gains/Losses**, reflects a ten-year amortization of net
19 gains realized from the sale of real property disposed of between 1998 and 2006. This restating
20 adjustment is made as a result of the Commission's Order in Docket No. UE-050842. The effect
21 of this adjustment is to increase Washington net operating income by \$57,000.

1 The adjustment in column (w), **Revenue Normalization**, is a 3-fold adjustment taking
2 into account known and measurable changes that include revenue normalization, weather
3 normalization and a recalculation of unbilled revenue. Mr. Hirschhorn is sponsoring this
4 adjustment. The effect of this particular adjustment is to decrease Washington net operating
5 income by \$23,000.

6 The adjustment in column (x), **Incentives and Other**, adjusts 2006 test year incentive
7 expense to the actual 2006 incentive expense paid in 2007 for the 2006 incentive plan. The
8 Company's main employee incentive plan uses Customer Satisfaction and Reliability targets as
9 the initial step in issuing incentive payouts. Actual payouts are dictated by O&M cost savings at
10 the individual department level. Since the executive plan is slightly different than the main
11 employee incentive plan, this adjustment removes any part of the 2006 executive incentive
12 payout that was "not" based on the Customer Satisfaction and Reliability targets. This
13 adjustment also removes other prior period and non-recurring items impacting test period
14 operating income. The impact of this adjustment on Washington net operating income is a
15 decrease of \$336,000.

16 **Q. Please continue on page 8 with your explanations of the adjustments.**

17 A. The adjustment in column (y), **Restate Debt Interest**, restates debt interest using
18 the Company's pro forma weighted average cost of debt, as outlined in the testimony and
19 exhibits of Mr. Malquist, and applied to Washington's pro forma level of rate base, produces a
20 pro forma level of tax deductible interest expense. The Federal income tax effect of the restated
21 level of interest for the test period decreases Washington net operating income by \$1,170,000.

1 The adjustment in column (z) on page 8, entitled **Restated Total**, subtotals all the
2 preceding columns (b) through column (y), exclusive of the previously discussed subtotal
3 column. These totals represent actual operating results and rate base plus the standard
4 normalizing adjustments that the Company includes in its annual Commission Basis reports
5 except power supply.

6

7 **Pro Forma Adjustments**

8 **Q. Please explain the significance of the 9 columns subsequent to column (z) that**
9 **begin at page 8 in your Exhibit No. ____ (EMA-2).**

10 A. Certainly. The adjustments subsequent to column (z) are pro forma adjustments
11 that recognize the jurisdictional impacts of material items that will impact the pro forma
12 operating period levels for known and measurable changes. They encompass revenue and
13 expense items as well as significant capital projects. These adjustments bring the operating
14 results and rate base to the final pro forma level for the rate year.

15 **Q. Please continue with your explanation of the adjustments beginning on page**
16 **8, subsequent to column (z).**

17 A. The adjustment in column (PF1), **Pro Forma Power Supply**, was made under the
18 direction of Mr. Johnson and is explained in detail in his testimony. This adjustment includes
19 pro forma power supply related revenue and expenses to reflect the twelve-month period January
20 1, 2008 through December 31, 2008. Mr. Johnson's testimony outlines the system level of pro
21 forma power supply details that are included in this adjustment. This adjustment calculates the
22 Washington jurisdictional share of those figures, and also eliminates an offsetting direct

1 assignment of certain power supply costs included in the base Results of Operations. The net
2 effect of the power supply adjustments decreases Washington net operating income by
3 \$20,792,000.

4 The adjustment in column (PF2), **Pro Forma Production Property Adjustment**, adjusts
5 production and transmission revenues, expenses, and rate base by a factor that is the ratio of 2006
6 Washington test year retail load divided by 2008 Washington pro forma rate year retail load. The
7 adjustment is made to avoid the over-recovery of production and transmission costs, since the
8 revenue requirement associated with those costs is being spread to test year retail load. Further
9 explanation of the adjustment is provided in Company witness Mr. Norwood's direct testimony.
10 The effect of this adjustment on Washington net operating income is an increase of \$5,660,000.
11 The effect on Washington rate base is a decrease of \$28,763,000.

12 The adjustment in column (PF3), **Pro Forma Labor-Non-Exec**, reflects known and
13 measurable changes to test period union and non-union wages and salaries, excluding executive
14 salaries, which are handled separately in PF4. Test period wages and salaries are restated as if
15 the wage and salary increases through March 2008 were in place during the entire pro forma test
16 period. The methodology behind this adjustment is consistent with Docket Nos. UE-011595 and
17 UE-050842, and is similar to Docket No. UE-99106. The effect of this adjustment on
18 Washington net operating income is a decrease of \$1,375,000.

19 The adjustment in column (PF4), **Pro Forma Labor-Executive**, reflects known and
20 measurable changes to executive compensation, restating their salaries as if wage and salary
21 increases through March 2008 were in place for the entire pro forma test period. This adjustment
22 takes into account changes in executive staffing made during 2006 and includes compensation

1 for the planned executive team in 2008 only. Compensation costs for non-utility operations are
2 excluded as executives routinely charge a portion of their time to non-utility operations,
3 commensurate with the amount of time spent on such activities. The current executives' salary
4 allocations are set at their expected pro forma test period utility/non-utility percentage splits. The
5 impact of this adjustment on Washington net operating income is an increase of \$29,000.

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

7 A. Column (PF5), **Pro Forma Transmission Rev/Exp**, was made under the
8 direction of Mr. Kinney and is explained in detail in his testimony. This adjustment includes pro
9 forma transmission-related revenues and expenses to reflect the twelve-month period January 1,
10 2008 through December 31, 2008. The net effect of the transmission revenue and expense
11 adjustments decreases Washington net operating income by \$857,000.

12 The adjustment in column (PF6), **Pro Forma Transmission Capital Additions**, pro
13 forms in the capital cost and expenses associated with the major transmission project upgrades.
14 This adjustment includes projects completed during 2006, and thus were normalized to reflect
15 annual amounts, and projects expected to be completed and transferred to plant-in-service by
16 December 31, 2007, in time for new rates to be approved. The capital costs have been averaged
17 for their appropriate pro forma period with the associated depreciation expense and property tax,
18 as well as the appropriate accumulated depreciation and deferred income tax rate base offsets.
19 This adjustment decreases Washington net operating income by \$1,078,000 and increases rate
20 base by \$40,274,000.

21 The adjustment in column (PF7), **Pro Forma Generation Capital Additions**, pro forms
22 in the capital cost and expenses associated with the major generation project upgrades. This

1 adjustment includes projects completed during 2006, 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, 2007, in time for new rates to be approved. The capital costs have been averaged for their
4 appropriate pro forma period with the associated depreciation expense and property tax, as well
5 as the appropriate accumulated depreciation and deferred income tax rate base offsets. This
6 adjustment decreases Washington net operating income by \$361,000 and increases rate base by
7 \$11,739,000.

8 The adjustment in column (PF8), **Pro Forma Depreciation Study**, reflects an increase in
9 depreciation expense due to the utilization of new depreciation rates that were the result of a
10 detailed depreciation study performed by a consultant from Gannett Fleming, Inc. The Company
11 last changed its depreciation rates on October 1, 2000. Company witness Mr. DeFelice is
12 sponsoring this adjustment and will explain it in more detail. This adjustment decreases
13 Washington net operating income by \$660,000 and decreases rate base by \$330,000.

14 The adjustment in column (PF9), **Pro Forma Wood Pole Test & Treat**, pro forms in the
15 O & M expense associated with the Wood Pole Management Program as described further by
16 Company witness Mr. Kinney. This adjustment decreases Washington net operating income by
17 \$198,000.

18 The last column, Pro Forma Total, reflects total 2006 pro forma results of operations and
19 rate base consisting of 2006 actual results and the total of all adjustments.

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

1 A. For the State of Washington, the actual test period rate of return was 7.21%. The
2 pro forma rate of return is 5.85% under present rates. Thus, the Company does not, on a pro
3 forma basis for the test period, realize the 9.39% rate of return requested by the Company in this
4 case.

5 **Q. How much additional net operating income would be required for the State**
6 **of Washington electric operations to allow the Company an opportunity to earn its**
7 **proposed 9.39% rate of return on a pro forma basis?**

8 A. The net operating income deficiency amounts to \$31,802,000, as shown on line 5,
9 page 2 of Exhibit No. ____ (EMA-2). The resulting revenue requirement is shown on line 7 and
10 amounts to \$51,139,000, or an increase of 15.85% over pro forma general business revenues.

11

12

III. NATURAL GAS SECTION

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

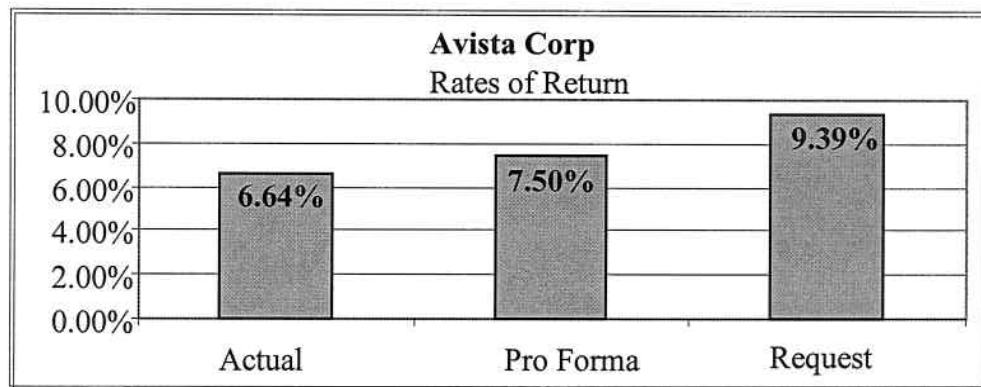
15 A. The test period being used by the Company is the twelve-month period ending
16 December 31, 2006, presented on a pro forma basis.

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

18 A. The last change to base gas rates in Washington occurred on January 1, 2006 as a
19 result of a settlement in Docket No. UG-050483.

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

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



12 **Q. What are the primary factors driving the Company's need for additional**
 13 **natural gas revenues?**

14 A. The Company's natural gas revenue requirement request is driven primarily by an
 15 increase in gross distribution plant additions between 2004 and 2006, of approximately \$19
 16 million or 10%. This causes an increase in the fixed costs of providing gas service to customers.

17

18 **Revenue Requirement**

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

20 A. Exhibit No. ____ (EMA-3) shows actual and pro forma gas operating results and
 21 rate base for the test period for the State of Washington. Column (b) of page 1 of Exhibit
 22 No. ____ (EMA-3) shows 2006 operating results and components of the average-of-monthly-

1 average rate base as recorded; column (c) is the total of all adjustments to net operating income
2 and rate base; and column (d) is pro forma results of operations, all under existing rates. Column
3 (e) shows the revenue increase required which would allow the Company to earn a 9.39% rate of
4 return. Column (f) reflects pro forma gas operating results with the requested increase of
5 \$4,531,000.

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

7 A. Yes. Page 2 shows the calculation of the \$4,531,000 revenue requirement at the
8 requested 9.39% rate of return.

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

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

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

15 A. Page 4 begins with actual operating results and rate base for the 2006 test period
16 in column (b). Individual normalizing adjustments that are standard components of our annual
17 reporting to the Commission begin in column (c) on page 4 and continue through column (t) on
18 page 7. Individual pro forma and additional normalizing adjustments begin in column (PF1) on
19 page 7 and continue through column (PF4) on page 8. The final column on page 8 is the total pro
20 forma operating results and rate base for the test period. Additional details related to each
21 adjustment described below are provided in accompanying work papers.

22

1 **Standard Commission Basis Adjustments**

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

5 A. Yes, but before I begin, I will note that in addition to the explanation of
6 adjustments provided herein, the Company has also provided workpapers outlining additional
7 details related to each of the adjustments. The restating adjustments shown in columns *c* through
8 *t* are consistent with the treatment reflected in prior the Commission Order in Docket No. UG-
9 050483 and current regulatory principles.

10 The first adjustment, column (c) on page 4, entitled **Deferred FIT Rate Base**, reflects the
11 rate base reduction for Washington's portion of deferred taxes. The adjustment reflects the
12 deferred tax balances arising from accelerated tax depreciation (Accelerated Cost Recovery
13 System, or ACRS, and Modified Accelerated Cost Recovery, or MACRS), bond refinancing
14 premiums, and contributions in aid of construction. These amounts are reflected on the average
15 of monthly average balance basis. The effect on Washington rate base is a reduction of
16 \$24,645,000.

17 The adjustment in column (d), **Deferred Gain on Office Building**, reflects the rate base
18 reduction for Washington's portion of the net of tax, unamortized gain on the sale of the
19 Company's general office facility. The facility was sold in December 1986 and leased back by
20 the Company. The treatment of the gain on the sale follows the Commission's Order Granting
21 Application in Cause No. FR-86-150. This adjustment reflects the average of monthly averages

1 amount of the deferred gain for the 2008 rate period. The effect on Washington rate base is a
2 reduction of \$100,000.

3 The adjustment in column (e), **Gas Inventory**, reflects the adjustment to rate base for the
4 average of monthly average value of gas stored at the Company's Jackson Prairie underground
5 storage facility and the Plymouth LNG Plant. The effect on Washington rate base is an increase
6 of \$7,628,000.

7 The adjustment in column (f), **Weatherization and DSM Investment**, includes in rate
8 base the balance (net of amortization) of company investments in natural gas demand side
9 management (DSM) and Weatherization consistent with Docket Nos. UG-991607, UG-041515
10 and UG-050483. Rate base has been restated to the average of monthly averages for the 2008
11 rate period. The effect of this adjustment is to increase Washington rate base by \$1,120,000.

12 The adjustment in column (g), entitled **Customer Advances**, decreases rate base for
13 funds advanced by customers for line extensions, as they are generally recorded as contributions
14 in aid of construction at some future time. The effect of this adjustment on Washington rate base
15 is a decrease of \$75,000.

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

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

20 The first adjustment on page 5 in column (h), entitled **Weather Normalization & Gas**
21 **Cost Adjustment**, is a 3-fold adjustment taking into account known and measurable changes that
22 include revenue normalization, which reprices customer usage under presently effective rates, as

1 well as weather normalization and an unbilled revenue calculation. Associated gas costs are
2 replaced with gas costs computed using normalized volumes at the currently effective “weighted
3 average cost of gas,” or WACOG rates. Revenues associated with the Schedule 191 Tariff Rider
4 are excluded from pro forma revenues, and the related amortization expense is eliminated as
5 well. Mr. Hirschhorn is sponsoring this adjustment. The effect of this particular adjustment is to
6 increase Washington net operating income by \$686,000.

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

13 The adjustment in column (j), **Property Tax**, restates the 2006 test period accrued levels
14 of property taxes to the most current information available and eliminates any adjustments
15 related to the prior year. The effect of this particular adjustment is to increase Washington net
16 operating income by \$16,000.

17 The adjustment in column (k), **Uncollectible Expense**, restates the accrued expense to
18 the actual level of net write-offs for the test period. The effect of this adjustment is to increase
19 Washington net operating income by \$38,000.

20 The adjustment in column (l), entitled **Regulatory Expense Adjustment**, restates
21 recorded 2006 regulatory expense to reflect the WUTC assessment rates applied to revenues for

1 the test period. The effect of this adjustment is to decrease Washington net operating income by
2 \$49,000.

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

4 A. The first adjustment on page 6 in column (m), **Injuries and Damages**, is a
5 restating adjustment that replaces the accrual with actuals to obtain the six-year rolling average of
6 injuries and damages payments not covered by insurance. As a result of the Commission's Order
7 in Docket No. U-88-2380-T, the Company changed to the reserve method of accounting for
8 injuries and damages not covered by insurance. The effect of this adjustment is to decrease
9 Washington net operating income by \$14,000.

10 The adjustment in column (n), **FIT**, adjusts the FIT calculated at 35% within Results of
11 Operations by removing the effect of certain Schedule M items and matches the jurisdictional
12 allocation of other Schedule M items to related Results of Operations allocations. This
13 adjustment also reflects the proper level of deferred tax expense for the test period. The effect of
14 this adjustment, all based upon a Federal tax rate of 35%, is to increase Washington net operating
15 income by \$11,000.

16 The adjustment in column (o), **Restate Debt Interest**, restates debt interest using the
17 Company's pro forma weighted average cost of debt, as outlined in the testimony and exhibits of
18 Mr. Malquist, and applied to Washington's pro forma level of rate base, produces a pro forma
19 level of tax deductible interest expense. The federal income tax effect of the restated level of
20 interest for the test period decreases Washington net operating income by \$207,000.

21 The adjustment in column (p), **Incentives and Other**, adjusts 2006 test year incentive
22 expense to the actual 2006 incentive expense paid in 2007 for the 2006 incentive plan and

1 removes any part of the 2006 executive incentive payout that was “not” based on the Customer
2 Satisfaction and Reliability targets (as further explained in the Electric Section). This adjustment
3 also removes other prior period and non-recurring items impacting the test period operating
4 income results. The impact of this adjustment on Washington net operating income is an
5 increase of \$16,000.

6 The adjustment in column (q), **Net Gains/Losses**, reflects a ten-year amortization of net
7 gains realized from the sale of real property disposed of between 1998 and 2006. This restating
8 adjustment is made as a result of the Commission's Order in Docket No. UE-050842. The effect
9 of this adjustment is to increase Washington net operating income by \$8,000.

10 The adjustment in column (r), **Eliminate A/R Expenses**, A/R representing Accounts
11 Receivable, removes expenses associated with the sale of customer accounts receivable. The
12 effect of this adjustment is to increase Washington net operating income by \$178,000.

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

14 The first adjustment on page 7 in column (s), **Office Space Charges to Subs**, removes a
15 portion of the office space costs (building lease and O&M costs, common area costs, copier
16 expense and annual office furniture rental) using the relationship of labor hours charged to
17 subsidiary activities by employee compared to total labor hours by employee. These percentages
18 are applied to the employees’ office space (expressed in square feet) and multiplied by office
19 space costs/per square foot. This restating adjustment is made as a result of the Commission's
20 Third Supplemental Order in Docket No. U-88-2380-T and is consistent with Docket No. UG-
21 050483. The effect of this adjustment is to increase Washington net operating income by \$4,000.

1 The adjustment in column (t), **Restate Excise Taxes**, removes the effect of a one-month
2 lag between collection and payment of taxes. The effect of this adjustment is to decrease
3 Washington net operating income by \$20,000.

4 The column on page 7, entitled **Restated Total**, subtotals all the preceding columns (b)
5 through column (t), exclusive of the previously discussed subtotal column. These totals
6 represent actual operating results and rate base plus the standard normalizing adjustments that the
7 Company includes in its annual Commission Basis reports.

8

9 **Pro Forma Adjustments**

10 **Q. Please explain the significance of the 4 columns subsequent to the Restated**
11 **Total column on page 7 of your Exhibit No. ____ (EMA-3).**

12 A. The adjustments starting on page 7 are pro forma adjustments to reflect material
13 known and measurable changes between the test period and the pro forma period. In this case,
14 they encompass only revenue and expense items, as there were no significant natural gas capital
15 projects. These adjustments bring the operating results and rate base to the final pro forma level
16 for the test year.

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

18 The adjustment in column (PF1), **Pro Forma Labor-Non-Exec**, reflects known and
19 measurable changes to test period union and non-union wages and salaries, excluding executive
20 salaries, which are handled separately in PF2. Test period wages and salaries are restated as if
21 the wage and salary increases through March 2008 were in place during the entire pro forma test
22 period. The methodology behind this adjustment is consistent with Docket No. UG-050483 and

1 similar to what the Company used in Docket No. UG-991607. The effect of this adjustment on
2 Washington net operating income is a decrease of \$363,000.

3 The adjustment in column (PF2), **Pro Forma Labor-Executive**, reflects known and
4 measurable changes to executive compensation, restating their salaries as if wage and salary
5 increases through March 2008 were in place for the entire pro forma test period. This adjustment
6 takes into account changes in executive staffing made during 2006 and includes compensation
7 for the planned executive team in 2008 only. Compensation costs for non-utility operations are
8 excluded as executives routinely charge a portion of their time to non-utility operations,
9 commensurate with the amount of time spent on such activities. The current executives' salary
10 allocations are set at their expected pro forma test period utility/non-utility percentage splits. The
11 impact of this adjustment on Washington net operating income is an increase of \$7,000.

12 The adjustment in column (PF3), **Pro Forma Depreciation Study**, reflects an increase in
13 depreciation expense due to the utilization of new depreciation rates that were the result of a
14 detailed depreciation study performed by a consultant from Gannett Fleming, Inc. The Company
15 last changed its depreciation rates on October 1, 2000. Company witness Mr. DeFelice is
16 sponsoring this adjustment and will explain it in more detail. This adjustment increases
17 Washington net operating income by \$217,000 and increases rate base by \$109,000.

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

19 The adjustment in column (PF4), **Pro Forma Storage Contract**, reflects a reduction in
20 revenue resulting from the recall of Jackson Prairie storage capacity, effective May 1, 2007,
21 which had been released to Cascade Natural Gas. Company witness Mr. Hirschhorn discusses

1 this adjustment in more detail in his direct testimony. This adjustment decreases Washington net
2 operating income by \$311,000.

3 The last column on page 8, **Pro Forma Total**, reflects total 2006 pro forma results of
4 operations and rate base consisting of 2006 actual results and the total of all normalizing and pro
5 forma adjustments.

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

8 A. For the State of Washington, the actual test period rate of return was 6.64%. The
9 pro forma rate of return is 7.50% under present rates. Thus, the Company does not, on a pro
10 forma basis for the test period, realize the 9.39% rate of return requested by the Company in this
11 case.

12 **Q. How much additional net operating income would be required for the State**
13 **of Washington gas operations to allow the Company an opportunity to earn its proposed**
14 **9.39% rate of return on a pro forma basis?**

15 A. The net operating income deficiency amounts to \$2,819,000, as shown on line 5,
16 page 2 of Exhibit No. ____ (EMA-3). The resulting revenue requirement is shown on line 7 and
17 amounts to \$4,531,000, or an increase of 2.27% over pro forma general business and
18 transportation revenues.

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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-050482 and UG-050483?

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. In Docket Nos. UE-050482 and UG-050483 consistent with the accepted allocation methodology, the Company reflected the reallocation of costs resulting from the sale of the Company’s California gas distribution properties in April 2005.

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

A. Yes, it does.