BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC V. AVISTA

DOCKET NOS. UE-120436, *et. al.*

DIRECT TESTIMONY OF SEBASTIAN COPPOLA (SC-1CT)

ON BEHALF OF

PUBLIC COUNSEL

SEPTEMBER 19, 2012

REDACTED VERSION

DIRECT TESTIMONY OF SEBASTIAN COPPOLA (SC-1CT)
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EXHIBIT LIST

Exhibit No. SC-2	Sebastian Coppola Summary of Qualifications
Exhibit No. SC-3C	Avista Executive Compensation Peer Group
Exhibit No. SC-4C	**[Begin Confidential**] **XX** **[End Confidential]** Executive Compensation Peer Group
Exhibit No. SC-5C	Comparison and Recalculation of Officers Salaries
Exhibit No. SC-6	Position Held by Avista Officers at Subsidiaries
Exhibit No. SC-7C	Survey of CEO Calendar Activities
Exhibit No. SC-8C	Allocation of Officers Salary Expense
Exhibit No. SC-9	Adjustment of Officers Utility Salary Expense
Exhibit No. SC-10	Executive STIP Adjustment
Exhibit No. SC-11C	Survey of Directors Compensation & Peer Group
Exhibit No. SC-12C	List of Board Topics in 2010 and 2011
Exhibit No.SC-13	Adjustment of Directors Stock-Based Compensation
Exhibit No. SC-14	Adjustment of Directors Cash Compensation
Exhibit No. SC-15	Adjustment of Directors and Officers Insurance Costs
Exhibit No. SC-16	Other Compensation Related Adjustments

1 **I. INTRODUCTIONINTRODUCTION / SUMMARY**

2 **Q: Please state your name and business address.**

3 A: My name is Sebastian Coppola. My business address is 1359 Springwood Lane,
4 Rochester Hills, Michigan 48309.

5 **Q: By whom are you employed and in what capacity?**

6 A: I am President of Corporate Analytics, Inc., a consulting firm that provides expert
7 witness services on regulated energy issues and other services.

8 **Q: On whose behalf are you testifying?**

9 A: I am testifying on behalf of the Public Counsel Section of the Washington Attorney
10 General's Office (Public Counsel).

11 **Q: Please describe your educational background and professional experience.**

12 A: In summary, I am a business consultant specializing in financial and strategic
13 business issues in the fields of energy, utility regulation, manufacturing and service
14 industries. I have more than thirty years of experience in public utility and related
15 energy work, both as a consultant and utility company executive. I have testified in
16 several regulatory proceedings before State Public Service Commissions. I have
17 prepared and/or filed testimony in electric and gas rate case proceedings, power
18 supply and gas cost recovery mechanisms, revenue and cost tracking
19 mechanisms/riders and other regulatory proceedings. As accounting manager and
20 later financial executive for two regulated gas utilities with operations in Michigan
21 and Alaska, I have been intricately involved in gas cost recovery and reconciliation
22 cases, gas purchase strategies and rate case filings.

1 Please see Exhibit No. SC-2 for more information regarding my professional
2 experience and educational background.
3 **Q: What experience do you have with executive compensation plans?**
4 A: In my role as senior executive at MCN and SEMCO Energy I was intricately involved
5 in the design and administration of both short-term and long-term incentive plans.
6 The short-term incentive plans typically provided cash awards if certain performance
7 goals were achieved. The long-term incentive plans generally provided the grant of
8 stock and stock options if certain return objectives relative to a peer group of
9 companies were achieved.
10 Along with the human resources department and compensation consultants,
11 such as, Towers Watson or its predecessors, I reviewed compensation surveys and
12 assisted in the design and administration of compensation plans and modifications to
13 those plans.
14 My responsibilities also included management of the investments of the
15 trustee benefits plans, such as defined benefits plans, defined contribution plans
16 (401K and other savings plans), benefit VEBA plans and grantor trusts.
17 As an expert witness, I have testified in several cases on the reasonableness
18 and the recovery of expenses related to management compensation and benefit plans,
19 such as short-term incentive plans, long-term stock based compensation plans,
20 Supplemental Executive Retirement Plans (SERP), non-qualified savings plans and
21 board of directors' compensation.

1 **Q: Have you previously filed testimony before the Washington Utilities &**
2 **Transportation Commission?**
3 A: No. I have submitted written testimony before the Michigan Public Service
4 Commission, the Public Utilities Commission of Ohio, and the Regulatory
5 Commission of Alaska. Exhibit No. SC-2 lists these testimonies and my credentials
6 in the regulated energy field.
7 **Q: What is the purpose of your testimony?**
8 **A:** I have been requested by the Public Counsel Section of the Washington Attorney
9 General (Public Counsel) to review Avista Corporation's (Avista or the Company)
10 compensation plans for its officers and Board of Directors, including the Directors
11 and Officers insurance program, and make recommendations regarding the
12 appropriate recovery of costs related to those plans and programs in Avista Utilities'
13 rates.
14 **Q: What exhibits are you sponsoring in this proceeding?**
15 A: I am sponsoring the following exhibits:
16 1. Exhibit No. SC-2 Sebastian Coppola Summary of Qualifications
17 2. Exhibit No. SC-3C Avista Executive Compensation Peer Group
18 3. Exhibit No. SC-4C **[Begin Confidential]** XX **[End Confidential]** Executive
19 Compensation Peer Group
20 4. Exhibit No. SC-5C Comparison and Recalculation of Officers Salaries
21 5. Exhibit No. SC-6 Position Held by Avista Officers at Subsidiaries
22 6. Exhibit No. SC-7C Survey of CEO Calendar Activities

7. Exhibit No. SC-8C Allocation of Officers Salary Expense
8. Exhibit No. SC-9 Adjustment of Officers Utility Salary Expense
9. Exhibit No. SC-10 Executive STIP Adjustment
10. Exhibit No. SC-11C Survey of Directors Compensation & Peer Group
11. Exhibit No. SC-12C List of Board Topics in 2010 and 2011
12. Exhibit No.SC-13 Adjustment of Directors Stock-Based Compensation
13. Exhibit No. SC-14 Adjustment of Directors Cash Compensation
14. Exhibit No. SC-15 Adjustment of Directors and Officers Insurance Costs
15. Exhibit No. SC-16 Other Compensation Related Adjustments

II. SUMMARY OF TESTIMONY

Q: Please summarize your major findings and recommendations.

A: After reviewing the Company-filed testimony and exhibits on executive compensation and other items addressed herein, I have discovered several issues for which I have recommended appropriate adjustments.

1. Executive Compensation

a. Officer Salary Levels – The Company has set executive salaries based on a peer group of companies that are not comparable to its utility business. As a result, officer salaries are inflated. Similarly, the Company has not allocated a sufficient portion of officer salaries to its non-utility businesses. The combined impact of these two issues is that utility expenses for officer salaries are overstated by $368,719. I recommend that the Company's revenue requirements be reduced by $289,835for WA electric and $78,885 for WA gas.

b. Short Term Incentive Compensation – The Company has proposed to recover a portion of its annual executive cash bonus payments. The Company's claim that these payments are justified by significant customer benefits from meeting various Short-Term Incentive Plan metrics is not supported by the evidence. Therefore, my recommendation is that the Commission should remove $355,724 of bonus payments included in this rate case filing. This means reducing the Company's revenue requirements by $279,801 for WA electric and $75,923 for WA gas.

2. Board of Directors Compensation

a. Stock-Based Compensation – The Company has allocated 90% of this expense to the utility business. Yet, for executive officers the Company has chosen to not request recovery in rates of stock-based compensation. This inconsistency is not logical. As a result, I recommend that $324,934 be removed from the Company's revenue requirements of which $255,587 relates to WA electric and $69,347 to WA gas.

b. Cash Compensation – The Company's cash payments to Directors is significantly above the median level of its peer group. As a result, this portion of Directors compensation is out of line and needs to be adjusted downward. Additionally, the Company has allocated 90% of this expense to the utility business. The evidence shows that Directors are spending at least 50% of their time on matters not related to the utility business. As a result, I recommend that $226,083 ($177,833 WA electric and 48,250 WA gas) be removed from the Company's revenue requirements to realign both the level of compensation and a 50% allocation to Avista Utilities.

3. Directors and Officers Insurance – The Company has proposed to allocate 90% of this insurance expense to utility. This allocation does not

1 reflect the fact that shareholders are the major beneficiaries of D&O
2 insurance and utility customers only marginally benefit from this
3 insurance coverage. My conclusion and recommendation is that only 50%
4 of these costs should be allocated to utility customers. As a result of this
5 lower allocation to utility customers, I recommend a reduction in revenue
6 requirements of $263,535 of which $206,231 relates to WA electric and
7 $57,305 to WA gas.
8 4. **Other Compensation Related Adjustments** – As a result of the
9 executive salary expense adjustments proposed above, I am also proposing
10 adjustments to employee benefit expenses. Additionally, I am proposing
11 an adjustment to utility expenses to remove an error by the Company in
12 allocating the cost of a compensation study to utility expense instead of
13 charging a non-utility account. The result is a reduction in revenue
14 requirements of $259,810 of which $204,229 is for WA electric and
15 $55,601 for WA gas.
16 The following table, Table 1: Public Counsel Adjustment Summary,
17 summarizes the adjustments I propose which reduce the Company's revenue
18 requirement:

19 / /

20 / / /

21 / / / /

22 / / / / /

1 **Table 1: Public Counsel Summary Adjustment**

Public Counsel - Officers & Directors Compensation Revenue Requirement Summary Adjustments:

	Total	**Electric**	**Gas**
Executive Salaries	$ (368,719)	$ (289,835)	$ (78,885)
Short Term Incentive	(355,724)	(279,801)	(75,923)
Board of Directors Fees	(551,017)	(433,420)	(117,597)
D&O Insurance	(263,535)	(206,231)	(57,305)
Other Adjustments	(259,810)	(204,229)	(55,601)
Total	**$(1,798,805)**	**$ (1,413,516)**	**$ (385,311)**

2
3 Please note that adjustments to revenue requirements mentioned in my testimony
4 exclude the effect of any revenue taxes and may differ slightly from the specific
5 revenue requirements calculated by Public Counsel Witness James Dittmer.

6 **III. EXECUTIVE COMPENSATION**

7 **Q: Please explain the areas of executive compensation on which you plan to focus**
8 **your analysis.**

9 A: In Avista's last general rate case, the Commission expressed the need for the
10 Company to provide more information on its executive compensation practices and
11 for the Commission Staff and Public Counsel to evaluate this information and provide
12 recommendations in the next rate case.[1] Specifically, the Commission ordered the
13 Company to provide the following information:

14 • A description of current executive compensation, including but not limited to
15 base salary, non-equity incentive pay, and incentive pay. This description

[1] *WUTC v. Avista Corporation d/b/a Avista Utilities*, Docket Nos. UE-110876 & UG-110877 (*Consolidated*), Order 06 at ¶¶ 38 – 44.

should state what elements and amounts are included in rates for the Company and what elements and amounts are not recovered through rates.

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

In response to the order, the Company has filed testimony and reports defining how it determined the amount of executive compensation it seeks to recover in rates in this case.

My testimony will focus on executive salaries, the executive short term incentive pay plan, and the allocation of these expenses between utility and non-utility businesses. Since the Company has chosen not to ask for recovery of long term incentive payments or the recovery of expenses related to special benefit plans for executive officers, I am not addressing those subjects.

Q: Did Avista comply with the Commission's Order with respect to executive pay information?

A: Not entirely. The Commission requested the Company to discuss the basis for selecting comparable utilities in its compensation survey. In my opinion, the Company did not adequately explain why it chose to include companies in its peer group that have operations considerably far afield from its utility business. The result

1 is that it set up a false premise that its executive compensation levels are fair and
2 reasonable to include in customer rates.

3 **Q: What basic tests do you use to determine if and what amount of executive**
4 **compensation should be included in rates?**

5 A: I use a two prong test. First, the Company must show that the compensation it seeks
6 to recover in rates has created real and tangible benefits to customers that
7 significantly exceed the expense. This test is particularly critical in justifying the
8 recovery of incentive compensation.

9 Once the first test is met, the second test is to determine what amount of
10 compensation is fair and reasonable to include in customer rates.

11 IV. OFFICERS SALARIES

12 **Q: Please provide a brief summary of the Company's base compensation program**
13 **for its executive officers.**

14 A: In setting the salaries of its executive officers, the Company utilizes regional and
15 national compensation surveys, including the services of compensation consultants,
16 such as Towers Watson. In response to discovery, the Company provided a Towers
17 Watson report dated February 2, 2012, which formed the major basis for the
18 Company's contention that its compensation programs are reasonably competitive in
19 the industry and labor market.[2]

20 The Towers Watson report contains the results of a survey of compensation
21 practices by a group of companies which Towers Watson calls the **[Begin**

[2] Avista Response to Public Counsel Data Request No. 18C (Confidential Attachment C).

1 **Confidential]** “XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
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3 **XXXXXXXXXXXXXXXXXXXXXX.**
4 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**
5 **XXXXXXXXXXXXXXXXXXXXXXXXXX. [End Confidential]**

6 **Q: Please provide your assessment of the Company's compensation peer group.**

7 A: The peer group utilized by the Company to set compensation levels for its officers is
8 not an appropriate peer group that results in reasonable compensation for Avista
9 Utilities. The peer group is heavily weighted with companies much larger than the
10 Avista Utilities business. It also includes companies involved in non-utility
11 businesses in a variety of industries not like the regulated power generation and
12 distribution business of Avista Utilities. Such large, non-regulated businesses, often
13 with international operations, have compensation levels much higher than local or
14 regional utilities. Their compensation level accounts for the span and complexity of
15 responsibilities of companies of that nature. These companies are not comparable
16 peer companies.

17 The objective in setting a proper level of compensation for the officers of
18 Avista Utilities should be to use a peer group of companies that are in size and profile
19 of operations much closer to Avista's utility business. Although the Company may
20 prefer to use a more diversified group of companies to account for the combined
21 utility and non-utility businesses of Avista, such an approach is not appropriate when
22 including the recovery of officer compensation in the rates charged to utility

1 customers. The more appropriate approach is to determine what the proper
2 compensation level is for officers managing a utility business only.
3 **Q: What do you recommend as a more appropriate peer group?**
4 A: The Towers Watson compensation report dated February 2, 2012, included the
5 **[Begin Confidential]** XX **[End Confidential]** peer group as another comparable peer
6 group surveyed by Towers Watson. As stated earlier in my testimony, this peer group
7 consists of **[Begin Confidential] XXXXXXXXXXXXXXXXXXXX [End**
8 **Confidential]** in size and breath of operations much closer to the business of Avista
9 Utilities. See Exhibit No. SC-4C.
10 These utility companies have sales and employee counts much closer to
11 Avista Utilities. For the most part, their businesses are in the regulated power
12 generation and distribution of natural gas and electricity in the continental U.S.
13 **[Begin Confidential] XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**
14 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXX. [End Confidential]**
15 In my opinion, this is a more appropriate peer group of companies, and I
16 recommend that the salary information from this peer group be used to determine the
17 salary levels for Avista's officers who charge the utility for their time managing the
18 business.
19 **Q: Have you determined the financial impact of using the [Begin Confidential] XX**
20 **[End Confidential] peer group?**
21 A: Yes. Exhibit No. SC-5C presents the salaries for the top five executives extracted
22 from the **[Begin Confidential] XX [End Confidential]** peer group. The comparison

1 of these salaries to the salaries paid by the Company shows that three of the five
2 positions are currently above the **[Begin Confidential]** XX **[End Confidential]** peer
3 group level, while the other two positions are in line with the peer group. On
4 average, the five positions are currently paid 5% above the **[Begin Confidential]** XX
5 **[End Confidential]** peer group level.
6 Since the **[Begin Confidential]** XX **[End Confidential]** peer group survey
7 within the Towers Watson report did not specify salary levels for the other executive
8 office positions, I decided to apply the 5% differential from the top five positions to
9 the other executive positions. I believe this is a reasonable approach to adjust down
10 the pay levels of the remaining executive positions. The Company relied primarily on
11 the **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXX**[End**
12 **Confidential]** to set its compensation target for all of its executive officer positions.
13 If the salary levels for the top five positions are in excess of the **[Begin Confidential]**
14 XX **[End Confidential]** peer group, one can reasonably conclude the other executive
15 officer positions on average would also be similarly inflated.
16 As shown in Exhibit No. SC-5C, the total impact is that executive officers'
17 salaries are excessively higher by $182,000. The portion applicable to the
18 Washington jurisdiction before allocation between utility and non-utility operations is
19 $111,000 as shown in Exhibit No. SC-5C.
20 **Q: What is your conclusion and recommendation with regard to executive salaries?**
21 A: My conclusion is that the Company should utilize a peer group of companies that are
22 in size and profile of operation similar to the its utility business when establishing the

1 appropriate level of salary expense it wishes to recover in rates for its officers.

2 Therefore, I recommend that the Commission adopt the salary levels and
3 expense I have proposed in Exhibit No. SC-5C. Furthermore, I recommend that the
4 Commission order the Company to present in future rate cases a peer group that is
5 more in line with the **[Begin Confidential] XX [End Confidential]** peer group along
6 with the respective salary levels for its executive officers. This would allow the
7 Commission, the Commission Staff, Public Counsel, and other intervenors the ability
8 to more adequately assess the reasonableness of the executive officers' salary expense
9 proposed by the Company for recovery in its utility rates.

10 **Q: Did you also review the apportionment of salary expense between utility and**
11 **non-utility businesses of Avista?**

12 A: Yes.

13 **Q: Please elaborate on your review.**

14 A: In its rate case filing, the Company assumed that a certain percentage of its executive
15 officers' salary expense would be allocated to non-utility operations to account for
16 duties performed for non-utility businesses. The percentage allocations to non-utility
17 operations vary from 0% in the case of the Chief Counsel of Regulation to 80% for
18 the Chief Strategy Officer. Generally, the senior staff officers (CEO, CFO, SVP of
19 HR & Corporate Secretary, General Counsel and Corporate Controller) allocate
20 between 10-20% to non-utility businesses. The Chief Information Officer only
21 allocated 1% to the non-utility businesses.[3]

[3] Avista Response to Public Counsel Data Request No. 83, Attachment A.

1 In response to discovery questions, the Company stated that executive officers
2 do not keep a daily log of specific time spent on utility and non-utility tasks[4].
3 Instead, annually in conjunction with the annual budget planning process, officers are
4 requested to estimate what percent of time they will spend on non-utility operations
5 for the coming year. These individual percentages are then used by the accounting
6 system to allocate salaries and other compensation to the utility and non-utility
7 businesses. Witness Andrews Work Paper 3.03 details the percentage for each
8 executive officer position and calculates the amount of salary expense to be included
9 in utility rates.

10 **Q: What is your assessment of the allocation of the Company's executive salary**
11 **expense between utility and non-utility businesses?**

12 A: First of all, I am surprised by the informality of the process of determining the
13 amount of time that executive officers spend on each type of business. I would
14 expect at least a weekly or monthly log that each officer would be required to
15 maintain to account for his/her time spent on each business and properly supported by
16 a daily calendar of activities. Such a log would be useful to the Company and others
17 to support real time allocation of compensation expense.

18 Secondly, officers of Avista hold multiple positions in at least 10 non-utility
19 subsidiaries. Although some of these companies are not large operating entities they
20 still require some amount of oversight, administrative, financial and accounting time.
21 Exhibit No. SC-6 shows the officers of Avista and the various positions they hold in

[4] Avista Response to Public Counsel Data Request No. 237.

1 the non-utility subsidiaries. Many of the officers hold positions and are involved in
2 the affairs of six or more subsidiaries in addition to their role of managing staff
3 functions that provide services to both utility and non-utility operations.
4 More specifically with regard to the CEO of Avista, I analyzed the activities
5 outlined in his business calendar for the first three months of 2011. In Exhibit No.
6 SC-7C, I have shown the activities that relate to providing oversight, strategic
7 direction and managing the utility business, as well as, corporate governance in
8 planning and participating in Avista and Edison Electric Institute (EEI) Board of
9 Directors meetings. The cumulative result of tallying the hours spend on these
10 activities, relative to the total work hours available for the three months, is that
11 approximately 37% of the CEO's time was spend on activities that one could
12 reasonably consider as pertaining to utility operations.[5] The remainder of the time
13 appears to be spent on non-utility businesses, outside board interests, lobbying and a
14 variety of other activities that do not closely relate to the utility business.
15 With regard to the CEO position, I am also struck by the fact that Avista has a
16 President for Avista Utilities who charges 99% of his time to the utility business.
17 Based on a Company response to discovery, it is my understanding that this position,
18 which reports to the CEO, is responsible for day to day operations of the utility
19 business.[6] Therefore, the CEO provides more strategic direction to the business than
20 day to day management. Yet, the CEO allocates 80% of his time to the utility

[5] See Exhibit No. SC-7C.
[6] Avista Response to Public Counsel Data Request No. 270.

1 business and 20% to the non-utility businesses.[7] It is important to note that Ecova,
2 which is the major non-utility subsidiary, also has a president responsible for day to
3 day operations.

4 **Q: What other factors should be considered for a proper allocation of executive**
5 **salary expense between utility and non-utility businesses?**

6 A: Since 2008, Ecova has grown significantly, primarily through acquisitions. Ecova
7 has acquired four companies between December 2010 and January 2012. Sales will
8 have **[Begin Confidential]** XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
9 XXXXXXXXXXX. **[End Confidential]** Although sales at Ecova and other non-
10 utility businesses will be approximately **[Begin Confidential]** XXXXXXXXXXX
11 XXXX **[End Confidential]** for 2012[8], this statistic does not adequately represent the
12 total time dedicated by Avista senior staff officers in the oversight, management, and
13 strategic direction of non-utility operations.

14 As a former senior financial executive of a diversified energy company with
15 both utility and non-utility businesses, I am keenly aware of the time requirements
16 and attention that newer and faster growing non-utility businesses require from senior
17 management. Whether it is involvement in reviewing and approving business
18 acquisitions, coordinating and developing new employee compensation and benefit
19 programs, establishing new controls and accounting processes, financial reporting,
20 financing requirements, or answering security analyst questions, faster growing
21 businesses require more attention relative to the more stable utility operations. The

[7] Avista Response to Public Counsel Data Request No. 83, Attachment A.
[8] Avista Response to Public Counsel Data Request No. 22C, Confidential Attachment A.

1 time required to perform these activities are not fully captured in sales or profit
2 numbers.

3 **Q: What are your conclusions as to a proper allocation of executive salary expense**
4 **between utility and non-utility businesses?**

5 A: Based on the information reviewed and the factors indicated above in my testimony,
6 it is my conclusion that the following Avista officers should allocate a higher level of
7 expense to non-utility businesses as indicated below:

8 **Table 2: Officer Salary Allocation**

Salary Expense Allocated to Non-Utility:	PC Proposed Allocation	Company Allocation
Chief Executive Officer	50%	20%
Chief Financial Officer	25%	10%
SVP & General Counsel	25%	20%
SVP Human Resources & Corporate Secretary	25%	10%
VP Controller	25%	10%
VP Finance/Strategy Officer	100%	80%
VP Chief Information Officer	25%	1%
Treasurer	25%	0%
Assistant Corporate Secretary	25%	16%
Assistant Treasurer	25%	0%

9

10 As indicated earlier in my testimony, a review of the CEO's calendar for the
11 first three months of 2011 indicated that 37% or nearly one-third of his time can be
12 attributed to utility related activities, so a 50% allocation of his salary expense to
13 utility operations is generous.

14 In response to discovery, the Company could not clearly define what the
15 responsibilities of the strategy officer are to justify allocating 20% of his salary

1 expense to utility operations.[9] The Company stated that this was a newly created
2 position as of April 2011, and his duties would be focused on growth opportunities,
3 innovation and emerging technologies among other responsibilities. My conclusion
4 is that until his duties are more specifically defined and real accomplishments are
5 identified that relate to the utility business his salary expense should be allocate 100%
6 to the non-utility businesses where most likely most or all his time will be spent.
7 With regard to the other executive officers of Avista, allocating 25% of their
8 salary expense is extremely fair and reasonable given the significant growth of the
9 non-utility businesses and the position responsibilities they hold with other non-utility
10 subsidiaries.
11 Lastly, I have included in the list of officers, the positions of Treasurer,
12 Assistant Treasurer and Assistant Corporate Secretary. The Company does not
13 consider these three positions as executive officers although they are appointed
14 officer positions by the Avista Board of Directors. I have included them on my list of
15 officers since they have duties and responsibilities that span both utility and non-
16 utility businesses. As such, their time needs to be properly allocated to the two
17 business sectors. Similar to the other staff officers, I have allocated 25% of their time
18 and expense to non-utility operation similar to the other staff officers.
19 Another indication of the increasing time requirements from non-utility
20 businesses is the decision by the Board to increase the amount of audit fees to be paid
21 to Deloitte for auditing the books of Ecova, which is only one of 10 non-utility

[9] Avista Response to Public Counsel Data Request No. 269.

1 subsidiaries, albeit the largest. In 2011, the Ecova audit service fees represented
2 **[Begin Confidential]** **XXX** **[End Confidential]** of the total Avista audit fees.[10]
3 Time spent on the other subsidiaries would easily push the total amount pertaining to
4 non-utility businesses to more than 30%.

5 **Q: What is your recommendation with respect to the proper allocation of executive**
6 **salary expense between utility and non-utility?**

7 A: In Exhibit No. SC-8C, I have detailed each officer salary and the apportionment of
8 those salaries between utility and non-utility accounts. In Exhibit No. SC-9, I have
9 compared my calculation of salary expense to the Company's calculation to arrive at
10 a total downward adjustment of $368,719 ($289,835 electric and $78,885) to the
11 Company's filed revenue requirements. This amount also includes the downward
12 adjustment in salaries due to the revised peer group discussed earlier in my testimony.
13 I recommend that the Commission make these downward salary expense
14 adjustments to the Company's electric and gas revenue requirements in this case.

15 **V. SHORT TERM INCENTIVE PAY**

16 **Q: Please provide a brief summary of the Company's short term incentive payment**
17 **plan.**

18 A: The Company has in place an annual cash bonus program for executive officers
19 which it calls the Short Term Incentive Plan (STIP). The STIP has seven
20 performance factors for 2011. Two of the factors, which add to 60% of targeted
21 payout, are tied to utility and non-utility earnings per share performance. The other

[10] Avista Response to Public Counsel Data Request No. 346.

1 five, which make up the remaining 40%, are Operations & Maintenance (O&M) cost
2 per customer (20%), Customer Satisfaction (5%), Reliability Index (5%), Response
3 Time (5%) and Performance Excellence (5%).[11] These factors and weightings have
4 changed over the past six years. For example, from 2006 to 2008, the earnings per
5 share factors were 70% of the total target payout, but that was lowered to 60% for
6 2009 to 2011. The Company does not seek recovery of the earnings per share
7 component of the STIP payout in this rate case.[12]
8 The components of the remaining 40% STIP target payout, for which the
9 Company is seeking recovery in rates, also have changed over the six year period. For
10 example, the Company had set a performance goal to manage capital expenditures
11 through 2008 and dropped it in 2009. Other performance factors have also morphed
12 over time with electric service reliability indices varying from as high as 10% to as
13 low as 4%, and O&M cost per customer having a double trigger to achieve a payout
14 level.[13] The reason I am describing these changes over a six year period is because
15 the Company has calculated a cost recovery amount which is the average of the STIP
16 payouts over the six year period from 2006 to 2011.
17 The average amount that the Company paid out over this six year period to
18 executive officers and which it seeks to recover in this rate case is $355,724.[14]
19 **Q: Please provide your assessment of the STIP and whether or not the benefits to**
20 **utility customers justify recovery of this expense.**

[11] Exhibit No. KSF-1T, p. 18.
[12] Exhibit No. KSF-1T, p.18.
[13] Avista Response to Public Counsel Data Request No. 50, Attachment A and Avista's Response to Public Counsel Data Request No. 276.
[14] Andrews Workpaper 2.15.

1 A: In analyzing the STIP over the six year period, I reviewed each performance factor,
2 how the threshold and target levels of those factors were achieved, how the factors
3 were modified over the years and what trend of performance the actual results show.
4 *O&M Cost per Customer* – The Company develops an O&M cost per
5 customer threshold and target level each year based on its internal budget, with
6 certain adjustments for incentive payments and unusual items. The Company utilizes
7 a mathematical function to set the threshold and target levels of performance. The
8 objective is to manage costs throughout the year so that actual O&M costs end the
9 year below a target level. The target level is set at a percent below the adjusted O&M
10 budget and, if achieved, will payout at 100%. The Company also sets a threshold
11 level of performance, which is not as aggressive and is below the target level. If the
12 threshold level is achieved, it pays out a fraction of the target amount. If actual
13 adjusted O&M costs are higher than the threshold level there is no payout. On the
14 other hand, if actual O&M costs come in lower than the target level, the payout can
15 be as high as 150% of the target amount.
16 Below is the percent payout for each of the six years:[15]

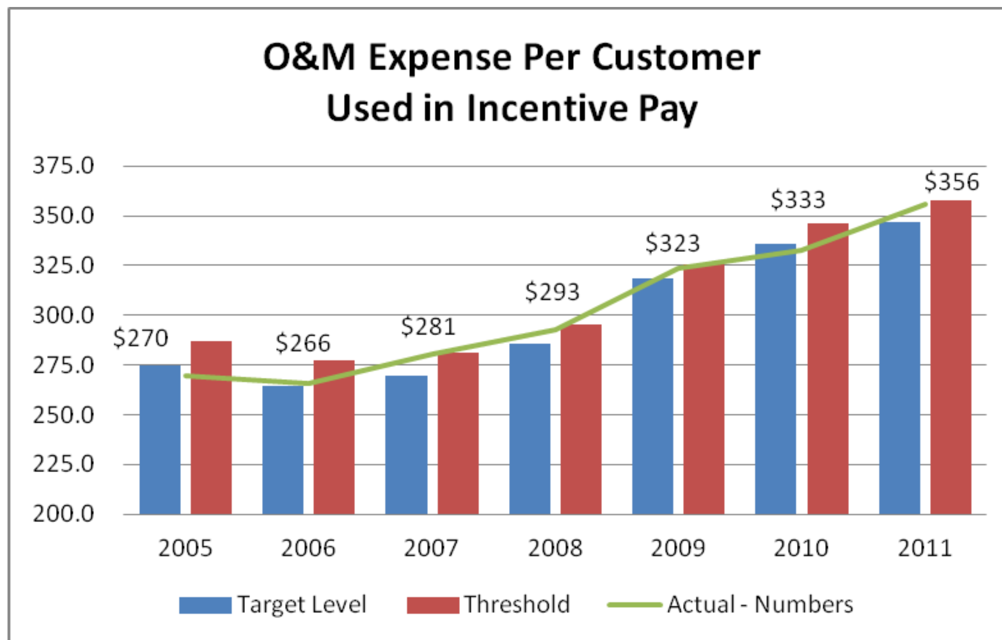
17	2006	97%
18	2007	51%
19	2008	64%
20	2009	66%
21	2010	130%
22	2011	20%

23 It is interesting to note that the Company reached at least the threshold level of
24 performance and paid out bonuses for O&M cost "savings" in each year.

[15] Avista Response to Public Counsel Data Request No. 50, Attachment A.

1 However, the so-called cost savings claimed by the Company are nothing
2 more than achieving targets or threshold levels which were increased every year
3 based on an increasing annual cost. In other words, if the bar is lowered each year,
4 then it is much easier to achieve the threshold or target level of performance based on
5 self-set goals. The following table shows this phenomenon:

6 **Table 3: O&M Expense Per Customer Used In Incentive Pay**



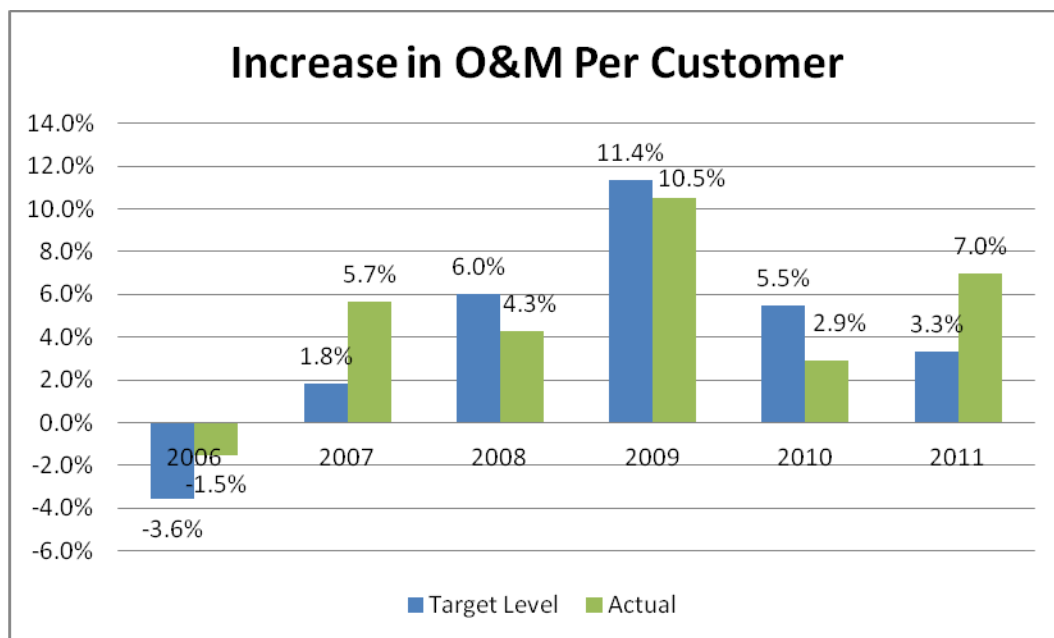
7

8 Table 3 was prepared from information provided by the Company through
9 discovery.[16] For each year, the first bar shows the target level of O&M cost per
10 customer. The second bar shows the threshold level, and the line shows the actual
11 O&M cost per customer for the year. As can be seen from Table 3, 2006 was the only
12 year where the Company achieved real cost savings and the threshold and target were

[16] Avista Response to Public Counsel Data Request No. 50, Attachment A and Avista Response to Public Counsel Data Request No. 276.

1 set at a lower level than the prior year. For each year thereafter, they were higher
2 than the year before.
3 More importantly, actual O&M costs have been on steady steep incline. Table
4 4 shows the annual increase in both target and actual cost levels.[17]

5 **Table 4: Increase In Other Cost Per Customer**



6

7 The actual annual compound rate of increase in O&M cost per customer has been
8 approximately 6% since 2006. This is almost three times the rate of inflation during
9 this period of time. In reality, the Company has not done an adequate job of
10 controlling costs, and customers have not benefited from any supposedly achieved
11 O&M cost "savings." The cost "savings" that the Company claims have been
12 achieved are self-fabricated by having set inflated targets.

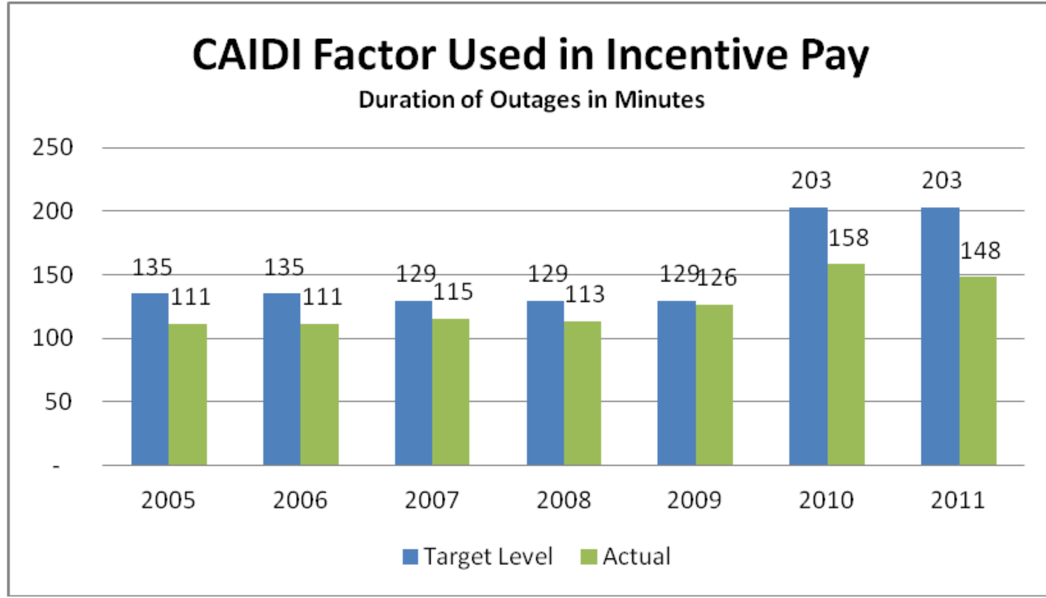
[17] Calculated from Avista Response to Public Counsel Data Request No. 50 and Public Counsel Data Request No. 276.

1 <u>*Service Reliability Indices*</u> – In some form or another, the Company has had
2 electric service reliability targets within the STIP since 2006. One has been the
3 Customer Average Interruption Duration Index (CAIDI), which measures the average
4 duration of service interruptions per customer in minutes. The other has been the
5 System Average Interruption Frequency Index (SAIFI), which measures the average
6 frequency of service interruptions per customer. The Company combined these
7 indices in 2010 and added a third factor, Customer Experiencing Multiple
8 Interruptions (CEMI), to calculate an average Reliability Index of the three indices.
9 CEMI measures the number of customers who experience multiple interruptions.[18]
10 In its STIP calculation, the Company claims to have achieved the CAIDI
11 index every year since 2006 and the SAIFI index only once in 2009. The Company
12 also claims to have achieved the new Reliability Index at 116% and 148% of target in
13 2010 and 2011 respectively.[19] The basic problem with the service reliability indices
14 is the same as with the O&M cost per customer targets and actual results. The targets
15 have been revised upwards in certain years and they have not been absolute targets.
16 Furthermore, actual results of the indices show a deteriorating trend in service
17 reliability. For example, the CAIDI shows the average service interruption has
18 increased to approximately 150 minutes in 2010/2011 from 111 minutes in 2006.
19 Similarly, the average number of interruptions has also increased by as much as 50%
20 from 2006 levels. The following tables with information supplied by the Company

[18] Exhibit No. KSF-1T, p. 19.
[19] Avista Response to Public Counsel Data Request No. 50, Attachment A and Public Counsel Data Request No. 344.

1 shows a visual depiction of these trends.[20]

2 **Table 5: CAIDI Factor Used In Incentive Pay**



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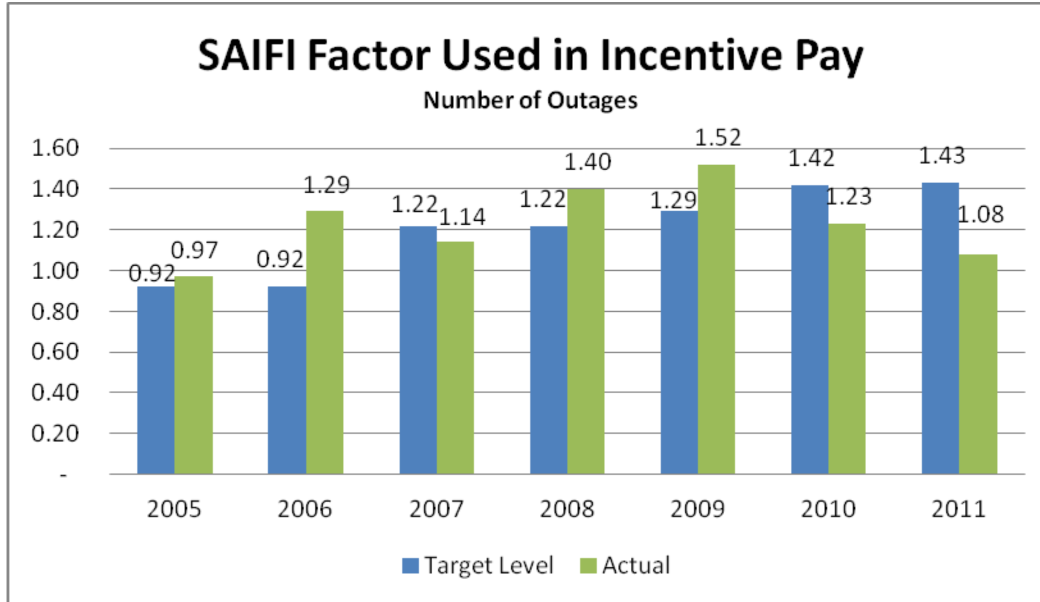
[20] Avista Response to Public Counsel Data Request No. 50, Attachment A and Public Counsel Data Request No. 344.

1 **Table 6: SAIFI Factor Used In Incentive Pay**



2

3 Again, despite the claim by the Company that it has achieved service level targets
4 which have provided benefits to customers, the actual trends show that customers are
5 worse off and have not seen any service level improvements from these factors used
6 in the bonus payout.

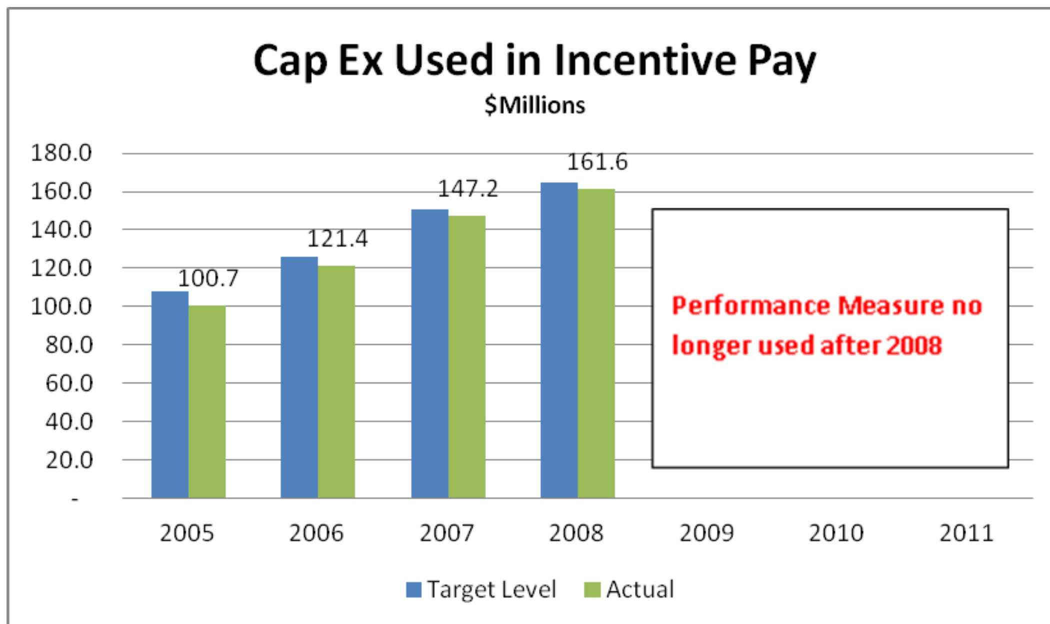
7 *Capital Expenditures* – From 2006 to 2008, the Company set a capital
8 expenditures target within the STIP. The objective appears to have been to control
9 capital expenditures to minimize the need for new capital and cash outlays.
10 Minimizing capital expenditures is a worthy goal since capital expenditures increase
11 rate base and ultimately rates to customers. The Company removed this goal from the
12 STIP in 2009.[21]

13 From 2006 to 2008, the Company claims to have achieved 100% of the target

[21] Avista Response to Public Counsel Data Request No. 50, Attachment A.

1 and made a bonus payout based on achieving this target. A review of the actual
2 expenditures shows the same negative trends discussed above for the other two
3 factors. By the end of the three year period, capital expenditures had increased
4 approximately 60% from a base of $100.7 million in 2005. This is depicted in Table
5 7.

6 **Table 7: Cap Ex Used In Incentive Pay**



7

8 Once more, targets were achieved based on internal arbitrary goals. In reality,
9 significant increases in capital expenditures, and ultimately a higher rate base, did not
10 provide benefits to customers. On the contrary, it resulted in higher rates.
11 *Customer Satisfaction Rating –* For the entire six years, the Company has set a
12 customer satisfaction rating of 90%. The Company measures customer satisfaction
13 by surveying customers shortly after they have had reason to contact the Company.
14 Actual survey results have shown average annual satisfaction ratings ranging from

1 93% and 94%. It appears the Company has met this annual goal. At 5% to 6%
2 weighting, the customer satisfaction rating has been a relatively small portion of the
3 overall STIP payout for the past three years.
4 Although there is some value in a high level of customer satisfaction, the
5 Company could not provide any quantifiable or tangible benefit that has resulted from
6 achieving this target within the STIP. Moreover, maintaining such a level of
7 customer satisfaction is expected from any company providing services, and there is
8 nothing exceptional here to justify a bonus payout.
9 *Response Time* – The Response Time factor measures the percentage of time
10 the Company responds to dispatched natural gas emergency calls within the targeted
11 time. This factor was introduced in 2011. The Company reported that it achieved
12 93% of target.[22] Without much history or information provided by the Company in
13 filed testimony, it is difficult to assess what real or incremental benefits this measure
14 offers to customers other than continuing what it has been doing in the past.
15 *Performance Excellence* – In 2011, the Company introduced a new factor
16 within the STIP to measure the achievement of 92 project milestones that would lead
17 to process improvements worth $6.2 million. According to the Company this factor
18 demonstrates its commitment to continuously look for opportunities for efficiency to
19 keep costs reasonable for its customers. The Company has indicated that it has met
20 100% the STIP target for this factor and made a payout to executive officers related

[22] Avista Response to Public Counsel Data Request No. 50, Attachment A.

1 to it.[23]

2 In response to discovery, the Company provided a list of the project
3 milestones, which is a list of activities to be completed within certain target dates.
4 Most of the activities were completed within the target dates, some were completed
5 after the target date, some were not completed and a few others were deferred.[24]

6 The Company has reported that it achieved $7.8 million in capital expenditure
7 savings and $5.5 million in O&M savings as a result of this initiative in 2011.
8 However, the O&M cost per customer factor does not seem to reflect such a
9 significant accomplishment. The O&M cost per customer in 2011 was $356, up from
10 the $333 level in 2010. The Company barely met the threshold level set in the STIP
11 of $357 and did not meet its target level of $347.

12 It would seem logical that if the Company was achieving real operating cost
13 savings they would show in the O&M cost per customer metric.

14 Most importantly, the Performance Excellence factor is duplicative in that, as
15 just discussed, real cost savings would be reflected in the O&M cost per customer
16 factor. Customers should not pay for the same real results twice, once from the
17 Company achieving a list of activities and cost savings and again from meeting the
18 O&M cost per customer threshold or target.

19 In my opinion, the Company has not demonstrated that the Performance
20 Excellence factor is sufficiently additive and beneficial to customers to merit a
21 recovery of bonus payments made to executive officers as a result of potentially

[23] Avista Response to Public Counsel Data Request No. 50, Attachment A.
[24] Avista Response to Public Counsel Data Request No. 289.

1 achieving this metric.

2 **Q: What is your conclusion and recommendation with regard to the Company's**
3 **proposal to recover $355,724 of STIP payments to executive officers?**

4 A: My analysis clearly shows that no significant benefits have accrued to customers over
5 the past six years to justify recovery of STIP payments to executive officers. O&M
6 costs per customers have gone up every year at an average rate nearly three times
7 higher than the rate of inflation, reliability indices have deteriorated, and other factors
8 are either insignificant or duplicative of others.

9 As reflected in Exhibit No. SC-10, my recommendation is that the
10 Commission should disallow 100% of the costs for the STIP expense related to
11 executive officers, since the Company has failed the test of creating benefits to
12 customers that exceed the amount of the expense. This represents an adjustment of
13 $355,724 to revenue requirement ($279,801 electric and $75,923 gas).

14 **VI. BOARD OF DIRECTORS COMPENSATION**

15 **Q: Please provide a brief summary of the Company's Board of Directors**
16 **compensation practices.**

17 A: The Company compensates directors serving on the Board with cash payments, grants
18 of shares of stock, and stock options. During 2011, the Company made cash retainer
19 fee payments of $752,158 and stock-based compensation payments of $585,325. The
20 Company allocated 90% of the cash retainer fees to the utility business and is seeking
21 to recover in rates the amount of $400,061 applicable to the Washington jurisdiction.
22 The Company also allocated 90% of stock-based compensation to the utility business

1 and is seeking to recover in rates the amount of $361,038 applicable to the
2 Washington jurisdiction.

3 **Q: Please provide your assessment of the amount of Board of Director fees that**
4 **should be recovered in rates.**

5 A: First, with regard to the stocked-based compensation to Directors, the Company's
6 proposal to recover 90% of the amount paid in 2011 from utility customers is
7 inconsistent with its decision to not seek recovery of the same type of compensation
8 paid to executive officers. In this case, the Company decided not to seek recovery of
9 such long term stock-based compensation given that this type compensation is
10 focused on shareholder value.

11 According to the filed testimony of Company witness Feltes in this case:

12 To summarize, Avista's overall executive officer compensation
13 program is a mix of base salary, annual incentive compensation
14 and long term incentive awards. A portion of base salaries and
15 the short term incentive plan (described above) associated with
16 utility operations is borne by the customers, <u>whereas all</u>
17 <u>amounts focusing on shareholder value, including the EPS</u>
18 <u>targets in the short term incentive plan and all components of</u>
19 <u>the long term incentive plan are borne by shareholders</u>.
20 Additional executive compensation benefits such as SERP and
21 deferred compensation are also borne by the shareholder,
22 because these benefits are over and above what is offered to
23 employees as part of their total compensation package
24 [Emphasis added].[25]
25
26 If the Company has taken the position that long term stock-based compensation for
27 executive officers is not a recoverable expense, then I cannot fathom a reason why
28 similar stock-based payments to Directors, who are further removed from the

[25] Direct Testimony of Karen Feltes, p. 29.

1 Company and more directly represent shareholders, should be borne by customers in
2 any amount. The Company's position articulated in discovery that Directors are
3 given a choice of stock versus cash and that this choice justifies recovery is simply
4 not convincing.[26]

5 Second, with regard to retainer fees, two issues arise: (1) whether or not the
6 amount of cash compensation paid to Directors is reasonable in comparison to other
7 peer companies, and (2) what percent of these payments should be recoverable in
8 rates?

9 With regard to reasonableness, the Company recently had Towers Watson
10 perform an analysis of Board of Directors compensation versus a group of other
11 utilities. This peer group is significantly different than the peer group used by
12 Towers Watson to set executive compensation and more in line with the gas and
13 electric business of Avista. In a report dated August 10, 2011, Towers Watson shows
14 that cash compensation to Avista Directors is about **[Begin Confidential]** XXXX
15 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
16 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
17 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
18 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX.
19 **[End Confidential]**[27] Avista Directors' compensation policy is skewed more toward
20 cash compensation and should be brought in line with the median of the peer group
21 for purposes of recovering this expense in rates.

[26] Avista Response to Public Counsel Data Request No. 410.
[27] *See* Exhibit No. SC-11C.

1 To help sort out the allocation issue, I reviewed the Board of Directors
2 meeting minutes for all of 2010 and 2011. In Exhibit No. SC-12C, I have cataloged
3 the discussion topics before the Board into four categories: utility, non-utility,
4 corporate governance/oversight for both utility and non-utility businesses, and strictly
5 shareholder topics.
6 A review of this list clearly indicates that a significant portion of the Board's
7 time is spent on non-utility, shareholder, and corporate governance matters applicable
8 to both utility and non-utility businesses. The Company has proposed to allocate
9 86.7% of the retainer fees to the utility business and 13.7% to the non-utility
10 businesses and shareholder matters. However, the Board minutes easily justify
11 allocating 50% of the fees to non-utility and shareholder matters.
12 Despite the fact that Ecova, Avista's largest non-utility subsidiary, has its own
13 Board of Directors, that Board functions similar to a Committee of the Avista
14 Corporation Board. Ultimately the Avista Board must review and approve matters of
15 importance for the entire corporation.
16 As mentioned earlier in my testimony when I discussed the appropriate
17 allocation of executives' compensation expense, newer and faster growing companies
18 demand more time and attention than the more established and stable utility business.
19 This is particularly true for Directors, who are concerned with the additional risk that
20 a newer, faster growing business presents to shareholders, especially one growing
21 mainly through acquisition of other companies.

1 Furthermore, in the 2009 Avista general rate case[28] the Commission ruled that
2 Board of Directors fees and meeting expenses should be shared equally between
3 customers and shareholders. The Company has complied with the equal sharing of
4 meeting expenses but not with Directors' fees. The Company should comply with the
5 prior Commission order and allocate only 50% of Directors' cash retainer fees to
6 utility customers.

7 **Q: What is your conclusion and recommendation about the amount of Board of**
8 **Directors' compensation that the Company should recover in rates?**

9 A: My conclusion is that the amount of compensation expense the Company seeks to
10 recover in rates for payments made to Directors is neither reasonable nor appropriate.
11 The Company seeks to recover stock-based compensation paid to Directors when this
12 expense should be paid entirely by shareholders. The Commission should not allow
13 the Company to recover in rates any portion of these payments. In Exhibit No. SC-
14 13, I have shown the amount of stock-based compensation that the Company has
15 retained in rates. I recommend that the Commission remove this amount of $324,924
16 ($255,587 electric and $69,347 gas) from the Company's revenue requirement.

17 The Company has set cash compensation for Directors at a level considerably
18 higher than the median level of its peer group. The Company also has only allocated
19 13.7% of this cash compensation to non-utility businesses. In Exhibit No. SC-14, I
20 have calculated the amount of cash compensation that is in line with what the median
21 company in the peer group pays its Board of Directors by applying a 75% factor to

[28] *WUTC v. Avista Corporation d/b/a/ Avista Utilities,* Docket No. UE-090134, Order No. 10 at ¶ 142.

1 the amount paid by the Company. Exhibit No. SC-14 also shows the amount of
2 expense recoverable in rates with 50% of the cash compensation payments allocated
3 to the utility business.

4 As a result, I recommend that the Commission remove $226,083 of expense
5 from the Company's revenue deficiency with $177,833 applicable to electric and
6 $48,250 to the gas business.

7 In total, my recommendation is that $551,017 of expense related to Directors'
8 compensation be removed from customer rates ($433,420 electric and $117,597 gas).

9 VII. DIRECTORS AND OFFICERS INSURANCE

10 **Q: Please provide a brief summary of the Company's costs for Directors and**
11 **Officers liability insurance (D&O insurance).**

12 A: The Company pays the cost of liability insurance which protects members of the
13 Board of Directors and its Officers from litigation and claims made against them.
14 The insurance premium payments in 2011 amounted to $1,307,237 according to
15 schedules provided by the Company in response to discovery.[29] These payments are
16 about 12% lower than in 2010 and somewhat higher than in 2009. In 2009, the
17 Company experienced a 40% reduction in premium costs from prior year levels as a
18 result of the sale of Avista Energy, which was the Company's non-utility energy
19 marketing company. This reduction in premium costs between 2008 and 2009 was
20 nearly $700,000.

21 In this rate case, the Company has included a pro-forma amount of $1,075,710

[29] Avista Response to Public Counsel Data Request No. 33.

1 for total company D&O insurance for 2012 and seeks to recover $592,954 from
2 Washington utility customers ($464,019 electric and $128,935 gas) after allocating
3 10% of the total premiums to non-utility businesses.

4 **Q: What is your assessment of the Company's allocation of D&O insurance costs to**
5 **utility customers?**

6 A: I do not dispute the total amount paid by the Company for D&O insurance for 2011
7 or its pro-forma estimate for 2012. Given the trend of insurance premiums in the
8 most recent three years, the pro-forma amount for 2012 appears reasonable as a base
9 from which to determine the appropriate allocation of this expense between utility
10 and non-utility businesses.

11 It is instructive to note that in 2009 premiums dropped significantly, by 40%
12 or nearly $700,000, as a result of the Company selling its non-utility energy
13 marketing subsidiary and removing a significant litigation and liability risk. In fact,
14 the last two litigation events in 2000 and 2002 covered under the D&O policy related
15 to non-utility wholesale energy marketing and trading activities.

16 According to the Company's responses to a discovery request,[30] the claims
17 asserted violations of federal securities laws under the Securities and Exchange Act of
18 1934. More specifically, the plaintiffs alleged misstatements and omissions in the
19 Company's Annual Report on Form 10-K related to trading activities in wholesale
20 energy markets, risk management policies, trading losses and failure to disclose
21 certain business practices with Enron Power Marketing and Portland General Electric.

[30] Avista Response to Public Counsel Data Request No. 336.

1 The claims asserted damages to shareholders as a result of the decline in the
2 Company's stock price. Although some of the claims were dismissed, the D&O
3 insurance policy paid for the cost of litigation and an $8.5 million payment into a
4 settlement fund.
5 The reason for mentioning this litigation is to point out that D&O insurance
6 policies most often cover claims initiated by shareholders who have experienced
7 stock price losses and question the disclosure made in financial statements prepared
8 and approved by the Officers and Directors of the company. These are usually
9 disputes between shareholders and the company, and as such, the cost of providing
10 insurance coverage should not be borne by customers.
11 It is also important to point out that experience shows the risk of litigation
12 increases significantly when companies engage in more volatile and risky businesses.
13 The two lawsuits filed against Avista in 2000 and 2002 are two cases in point. With
14 the Company's Ecova subsidiary on a fast growth path, primarily through
15 acquisitions, the risk of shareholder litigation and other lawsuits under the D&O
16 insurance policy is much higher. This fact needs to be taken into account in
17 apportioning D&O insurance expense between utility and non-utility businesses.
18 The Company's proposal to allocate only 10% to non-utility businesses is
19 wholly inadequate. Although the Company claims that utility customers benefit from
20 the Company having Directors and Officers liability insurance, both in terms of
21 attracting qualified individuals and avoiding losses from payment of claims, the
22 incurrence of such an expense does not mean that it should be necessarily recovered

1 in rates. For example, expenses such as corporate advertising and lobbying expenses
2 arguably provide some small benefit to customers; yet it has been the established
3 policy of this Commission - and most other regulatory commissions around the
4 country - that customers should not pay for these expenses. A similar argument can
5 compellingly be made for D&O insurance premiums. Utility customers are only
6 incidental beneficiaries of D&O insurance.

7 **Q: What has been the practice of other utility commissions around the country?**

8 A: The following list of cases from other jurisdictions provides a strong indication that
9 utility regulatory commissions often choose to split the cost of D&O insurance
10 equally between utility customers and shareholders.

11 - Southwest Gas, Docket No. 09-04003 (50%) (Nevada)
12 - Progress Energy, Docket No. 090079-El (50%) (Florida)
13 - Arkansas Western Gas, Docket No. 02-227-U (50%) (Arkansas)
14 - Centerpoint Energy Arkla, Docket No. 04-121-U (50%) (Arkansas)
15 - Consolidated Edison, Docket No. 08-E-0539 (50%) (New York)
16 - Entergy Arkansas Inc., Docket No. 06-101-U (50%) (Arkansas)
17 - Connecticut Power & Light, Docket 07-07-01 (30%) Connecticut)
18 - United Illuminating Company, Docket No. 05-06-04 (25%)
19 (Connecticut)

20 The arguments often made in these cases are the same discussed earlier in my
21 testimony: that shareholders should bear the lion share of D&O insurance, since they
22 are the primary beneficiaries and customers are only incidental beneficiaries.

1 **Q: How did the Commission rule on D&O insurance expense allocation in the last**
2 **contested Avista rate case?**
3 A: In its order in Docket Nos. UE-090134 and UG-090135, the Commission found that
4 D&O insurance benefits both shareholders and utility customers. Based on the
5 limited record on the case, the Commission decided to allocate 90% of this expense to
6 utility customers and 10% to shareholders. The Commission used the percent of
7 officer compensation allocated to the utility business as the basis to apportion 90% of
8 the D&O insurance expense to utility customers.
9 Although it is understandable why the Commission would reach such a
10 conclusion based on the limited information available in that case, the arguments I
11 have presented in this case show that D&O insurance premiums are more tied to
12 shareholder and non-utility issues than customer issues. As such, customers should
13 not bear the majority of these costs. An equal sharing of this expense between
14 shareholders and customers is more just and reasonable. Based on the specific
15 circumstances of this Company, as outlined above in my testimony, the Commission
16 could find a basis to allocate more than 50% of the cost to shareholders to lessen the
17 ratepayer burden.
18 **Q: What is your recommendation on the proper allocation of D&O insurance**
19 **expense?**
20 A: I recommend that, at most, 50% of the 2012 pro-forma D&O insurance expense
21 should be allocated to utility customers. In Exhibit No. SC-15, I have calculated the
22 amount applicable to the Washington jurisdiction to be $329,419 ($257,788 electric

1 and $71,631gas). The Company had allocated $592,954 to the Washington
2 jurisdiction ($464,019 electric and $128,935 gas). I recommend that the Commission
3 deny the Company's proposed expense level and adopt my reduction in revenue
4 requirement of $263,535, which consists of $206,231 for the electric business and
5 $57,305 for the gas business.

6 **VIII. OTHER COMPENSATION RELATED ADJUSTMENTS**

7 **Q: Please explain what other expense adjustments you propose.**

8 A: I am proposing two additional adjustments related to executive compensation that
9 impact revenue requirements. The first is for employee benefit expenses related to
10 executive salaries that the company has included in calculating its revenue deficiency.
11 The Company has allocated a portion of the cost for employee benefits to the
12 Washington electric and gas business based on labor expense charged to these
13 jurisdictional businesses. Since I have recommended a reduction in executive salary
14 expense, the amount of employee benefits allocated to the Washington jurisdiction
15 also needs to be reduced.

16 In Exhibit No. SC-16, I have shown the calculation for this adjustment by
17 applying an employee benefit cost loading factor used by the Company to the salary
18 expense adjustment to arrive at an adjustment of $253,642.

19 I recommend that the Commission reduce the Company's revenue
20 requirements by this amount and specifically $199,377 for the electric and $54,265
21 for the gas business.

22 The second adjustment I propose is for an incorrect allocation of a $10,000

1 payment made by the Company to a compensation consultant. This payment related
2 to a Performance Share Valuation study and should have not been charged to the
3 utility business. The Company discovered this error in responding to Public Counsel
4 Data Request No. 274. The adjustment reduces the revenue requirement by $4,852
5 for WA electric and $1,316 for WA gas.
6 Exhibit No. SC-16 shows both of these adjustments, which total $259,810.
7 **Q: Does this conclude your filed testimony?**
8 A: Yes.