

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC V. AVISTA

DOCKETS UE-120436, *et.al.*

TESTIMONY OF SEBASTIAN COPPOLA (SC-17CT)

IN OPPOSITION TO THE MULTIPARTY SETTLEMENT STIPULATION

ON BEHALF OF PUBLIC COUNSEL

NOVEMBER 9, 2012

REDACTED VERSION

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TABLE OF CONTENTS

	<u>PAGE</u>
I. INTRODUCTION	1
II. ASSESSMENT OF PROPOSED SETTLEMENT	1
III. SPECIFIC ISSUES NOT ADDRESSED IN THE PROPOSED SETTLEMENT	5
A. Officer Salary Levels	5
B. Allocation of Executive Salaries	6
C. Annual Incentive Pay	8
D. Board of Directors' Fees	9
E. D&O Insurance	11
F. Other Compensation Related Adjustments	13
IV. CONCLUSION	13

TABLES

Table 1: Public Counsel Summary Adjustments	14
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1 overall revenue requirement will be addressed by other Public Counsel expert witnesses.
2 However, the Proposed Settlement is largely a “black box” settlement and therefore fails
3 to address a number of issues of significant importance to the Commission and the
4 customers of Avista.

5 In its order in Dockets UE-110876 & UG-110877, the Commission discussed at
6 length its concerns with the level of executive compensation paid by Avista and the
7 proper allocation of this expense to utility operations.¹ The Commission noted that its
8 attention had been drawn to the issue of executive compensation several times during the
9 proceeding, and it quoted at length comments made by Avista customer Ms. Dawn
10 Voelker, who offered public comment testimony.² In particular, Ms. Voelker’s
11 noteworthy testimony stated as follows:

12 *One of Avista's business principles is integrity; to do what*
13 *is right. Where is integrity of constantly raising our natural gas*
14 *and electricity rates, all the while they are netting millions of*
15 *dollars? How can the top executives who are making hundreds of*
16 *thousands of dollars and the CEO who is making millions of*
17 *dollars display to the consumer integrity and ask us to pay more?*
18 *Would they be willing to take a cut in their salary for the sake of*
19 *integrity?*

20
21 *Our state and country is in a recession. Cuts are being*
22 *made across the board. Yes, Avista is adding to its programs to*
23 *help those who need assistance. But what about the middle*
24 *income families who do not qualify...?”³*

25
26 The Commission also commented on Mr. Norwood’s testimony, which
27 characterized the questions regarding allocation between utility and nonutility and the
28 level of executive compensation as not being questions of rule or law. The Commission

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

² *Id.* ¶ 38.

³ *Id.* (Italics added).

1 emphasized that when deciding such questions, it considers the public comment
2 testimony from Avista’s customers as well as other factors “that militate in favor of
3 reducing the amount of executive compensation that ratepayers are required to bear.”⁴

4 The last Avista rate case settled. The Commission discussed Public Counsel’s
5 ability to join that settlement, noting that Ms. Daeschel testified that one of the factors
6 significant to garnering Public Counsel’s support was a negotiated \$1.373 million
7 adjustment to the Company’s A&G expenses. That adjustment included a reduction in
8 the amount of executive compensation that Avista would be allowed to recover in rates.
9 However, the Commission noted that the adjustment answered only the question of how
10 much executive compensation should be allocated to utility operations, and did not
11 answer the question of the overall level of compensation paid to the Company’s
12 executives.⁵ Indeed, the Commission stated that, “Neither the testimony offered in
13 Avista’s direct case, or that offered by the parties in support of the Settlement, would
14 allow us to further reduce executive salaries beyond the reductions already provided for
15 by the Settlement.”⁶

16 As a result of these concerns, the Commission ordered the Company to file with
17 the Commission certain information regarding its executive compensation.⁷ The

⁴ *Id.* at ¶ 39.

⁵ *Id.* at ¶ 40.

⁶ *Id.* at ¶ 41.

⁷ *Id.* at ¶ 42. The Commission required Avista to file the following information:

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

1 information was to be filed by February 29, 2012, and updated upon filing the
2 Company's next general rate case. The Commission required updating at the time the
3 next general rate case was filed in order to ensure that "the Company's testimony can be
4 evaluated for the prudence of Avista's executive compensation expense both in terms of
5 the levels of compensation and the allocation of its recovery from utility customers."⁸

6 The Commission's stated intent was to ensure that there would be sufficient information
7 to evaluate "whether there should be some further adjustment to the Company's revenue
8 requirement with respect to the recovery of executive compensation in the future."⁹

9 The Proposed Settlement clearly fails to address this issue, despite its importance
10 to the Commission and Avista's customers. The Proposed Settlement also ignores board
11 of director fees, and director and officers insurance, two additional important contested
12 issues in this case. Therefore, I recommend that the Commission reject the Proposed
13 Settlement, or alternatively, if the Commission chooses to modify the Proposed
14 Settlement, it should incorporate the recommendations I proposed in my direct testimony,
15 which are further highlighted in this testimony.

16 This rate case is an opportune time for the Commission to address issues of great
17 importance to customers and to provide appropriate direction to the Company for future

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- 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.

⁸ *Id.* at ¶ 43.

⁹ *Id.* at ¶ 44.

1 rate case filings. It would be unreasonable to the interest of customers to deny the
2 Commission the opportunity to address the issue of executive compensation and other
3 related issues in this case, particularly since the next opportunity to address these issues
4 would be no earlier than a 2014 general rate case, which would decide rates to go into
5 effect in 2015.

6 **III. SPECIFIC ISSUES NOT ADDRESSED IN THE PROPOSED SETTLEMENT**

7 **A. Officer Salary Levels.**

8 **Q: Please describe your concerns with the proper level of executive salaries not being**
9 **addressed in the Proposed Settlement.**

10 A: The Company has set executive salaries based on a peer group of companies that are not
11 comparable to its utility business. As a result, officer salaries are inflated. As discussed
12 in more detail beginning on page 9 of my direct testimony in this case, the peer group is
13 heavily weighted with companies much larger than the Avista Utilities business.

14 It also includes companies involved in non-utility businesses in a variety of
15 industries not like the regulated power generation and distribution business of Avista
16 Utilities. Such large, non-regulated businesses, often with international operations, have
17 compensation levels much higher than local or regional utilities. Their compensation
18 level accounts for the span and complexity of responsibilities of companies of that nature.
19 These companies are not comparable peer companies.

20 Staff Witness Joanna Huang filed direct testimony in this case also concluding
21 that the Company is not using an appropriate peer group to establish the amount of
22 executive compensation recoverable in rates and recommended a large disallowance

1 adjustment to the executive compensation proposed by the Company.¹⁰

2 On page 12 of my direct testimony, I recommended that the Company use the
3 **[Begin Confidential]** XXX **[End Confidential]** peer group. This peer group consists of
4 **[Begin Confidential]**XXXXXXXXXXXXXXXXXXXX **[End Confidential]** in size and
5 breath of operations much closer to the business of Avista Utilities.

6 These utility companies have sales and employee counts much closer to Avista
7 Utilities. For the most part, their businesses are in the regulated power generation and
8 distribution of natural gas and electricity in the continental U.S. **[Begin Confidential]**
9 XXX
10 XXXXXXXXXXXXXXXXXXXXXXX. **[End Confidential]**

11 In my opinion, this is a more appropriate peer group of companies, and I
12 recommend that the salary information from this peer group be used to determine the
13 salary levels for Avista’s officers who charge the utility for their time managing the
14 business.

15 In modifying the Proposed Settlement, the Commission should order that in the
16 Company’s next rate case filing, it must present executive salary information based on a
17 peer group of companies similar to the **[Begin Confidential]** XXX **[End Confidential]**
18 peer group.

19 **B. Allocation of Executive Salaries.**

20 **Q: Please discuss the importance of establishing an appropriate allocation of executive**
21 **compensation expense between utility and non-utility businesses.**

¹⁰ Testimony of Joanna Huang , Docket UE-120436, et al, Exhibit No. JH-1CT, pp. 16-28.

1 A: The Company has not allocated a sufficient portion of officer salaries to its non-utility
2 businesses. As discussed in more detail beginning on page 14 in my direct testimony, the
3 percentage of executive compensation expense allocated by the Company to non-utility
4 operations varies from 0% in the case of the Chief Counsel of Regulation to 80% for the
5 Chief Strategy Officer. Generally, the senior staff officers (CEO, CFO, SVP of HR &
6 Corporate Secretary, General Counsel and Corporate Controller) allocate between 10-
7 20% to non-utility businesses. The Chief Information Officer only allocated 1% to the
8 non-utility businesses.

9 Other findings in the analysis presented in my direct testimony show that:

- 10 1. Executives do not keep a daily or weekly log of how they spend their time
11 between utility and non-utility operations. As a result, they make an
12 unsupported estimate each year of where they think their time will be spent.
- 13 2. Avista executives hold multiple positions in at least 10 non-utility subsidiaries
14 which demand management time and attention.
- 15 3. Only 37% of the CEO time can be readily attributed to utility operations.
- 16 4. Ecova, the Company's largest non-utility subsidiary, has grown significantly
17 in the past few years with multiple acquisitions. This high growth rate is
18 expected to continue, which will require more of management's time and
19 attention.

20 In table 2 on page 18 of my direct testimony I recommended a more appropriate
21 allocation of executive time to non-utility businesses. In modifying the Proposed
22 Settlement, the Commission should adopt these percentages and order the Company to
23 perform a more thorough analysis of the proper allocation of executive compensation
24 expense between utility and non-utility businesses when it files its next rate case.

25 Staff Witness Joanna Huang filed direct testimony in this case also concluding

1 that the Company is not using an appropriate allocation of executive compensation
2 expense between utility and non-utility businesses and based on her conclusions
3 recommended a large disallowance adjustment to the executive compensation expense
4 allocated by the Company to utility operations.¹¹

5 **Q: Were the Commission to modify the Proposed Settlement to reflect a more**
6 **appropriate allocation of expenses between utility and non-utility operations and a**
7 **proper level of executive pay, what would the impact be?**

8 A: The combined impact of these two issues is that utility expenses for officer salaries are
9 overstated by \$368,719. I recommend that the Company's revenue requirements be
10 reduced by \$289,835 for WA electric and \$78,885 for WA gas.

11 **C. Annual Executive Incentive Pay.**

12 **Q: Please discuss the importance of your recommendation to exclude Executive**
13 **Incentive Compensation from recovery in this rate case.**

14 A: The Company has proposed to recover a portion of its annual executive cash bonus
15 payments, also referred to as incentive payments. The Company's claim that these
16 payments are justified by significant customer benefits from meeting various Short-Term
17 Incentive Plan metrics is not supported by the evidence.

18 Beginning on page 20 of my direct testimony, I have presented a compelling case
19 that the measures which have triggered incentive payments to executives have not in fact
20 created significant benefits to customers in excess of the cost of the incentive pay. For
21 example, with regard to O&M costs, the actual annual compound rate of increase in

¹¹ *Id.*

1 O&M cost per customer has been approximately 6% since 2006. This is almost three
2 times the rate of inflation during this period of time. In reality, the Company has not
3 done an adequate job of controlling costs, and customers have not benefited from any
4 supposedly achieved O&M cost “savings.” The cost “savings” that the Company claims
5 have been achieved are self-fabricated by having set inflated targets.

6 With regard to the service reliability indices, the basic problem is the same as
7 with the O&M cost per customer. The targets have been revised upwards in certain years
8 and they have not been absolute targets. Furthermore, actual results of the indices show a
9 deteriorating trend in service reliability.

10 Generally, other incentive measures are either insignificant or duplicative of
11 others and have not created significant benefits for customers over the past six years
12 to justify recovery of STIP payments to executive officers.

13 The Commission should disallow recovery of STIP payments in this case.
14 Furthermore, the Commission should make clear to the Company that in future rate cases
15 unless it can clearly show that the incentive measures create customer benefits
16 significantly in excess of the incentive payments made to executives that recovery of
17 these costs will not be allowed.

18 Therefore, my recommendation is that the Commission should remove \$355,724
19 of executive incentive payments included in this rate case filing. This means reducing
20 the Company’s revenue requirements by \$279,801 for WA electric and \$75,923 for WA
21 gas.

22 **D. Board of Directors’ Fees.**

23 **Q: Does the Proposed Settlement address Board of Directors’ Fees?**

1 A: No, it does not.

2 **Q: Please discuss the important of disallowing recovery of certain Board of Director**
3 **fees.**

4 A: There is clear Commission precedent which supports sharing board of director fees
5 equally between shareholders and customers. In the 2009 Avista general rate case, the
6 Commission ruled that Board of Director fees and meeting expenses should be shared
7 equally between customers and shareholders.¹² The Company complied with the equal
8 sharing of meeting expenses, but disregarded the prior Commission order by allocating
9 90% of director's fees in this case to customers and only 10% to shareholders. A more
10 appropriate sharing of Directors' fees is supported by the analysis in my direct testimony
11 which is summarized below.

12 **Stock-Based Compensation** – The Company has allocated 90% of the Directors
13 fees paid in Company stock to the utility business. Yet, for executive officers the
14 Company has chosen to not request recovery in rates of stock-based compensation. This
15 inconsistency is not logical and recovery of this expense should not be allowed by the
16 Commission. According to the filed testimony of Company witness Feltes in this case:

17 “A portion of base salaries and the short term incentive plan
18 (described above) associated with utility operations is borne by the
19 customers, whereas all amounts focusing on shareholder value,
20 including the EPS targets in the short term incentive plan and all
21 components of the long term incentive plan are borne by
22 shareholders” [Emphasis added].¹³

¹² *WUTC v. Avista Corporation d/b/a/ Avista Utilities*, Docket UE-090134, Order No. 10 at ¶ 142.

¹³ Direct Testimony of Karen Feltes, p. 29.

1 As a result, I recommend that the entire \$324,934 of Directors' stock-based
2 compensation included in utility expense by the Company be removed from the
3 Company's revenue requirements of which \$255,587 relates to WA electric and \$69,347
4 to WA gas.

5 **Cash Compensation** – The Company's cash payments to Directors is
6 significantly above the median level of its peer group. As a result, this portion of
7 Directors compensation is out of line and needs to be adjusted downward. Additionally,
8 the Company has allocated 90% of this expense to the utility business. The evidence
9 shows that Directors are spending at least 50% of their time on matters not related to the
10 utility business. As a result, I recommend that \$226,083 (\$177,833 WA electric and
11 \$48,250 WA gas) be removed from the Company's revenue requirements to realign both
12 the level of compensation and a 50% allocation to Avista Utilities. Details supporting the
13 adjustments to Board of Directors' fees are discussed beginning on page 31 of my direct
14 testimony.

15 In modifying the Proposed Settlement to include the aforementioned adjustments,
16 the Commission should also provide clear direction to the Company on the percent of
17 expense it should seek to recover from customers in future rates cases and the
18 requirement to perform a more rigorous analysis to support the level of Directors' fees it
19 seeks to recover.

20 **E. D&O Insurance.**

21 **Q: Does the Proposed Settlement address D&O insurance?**

22 **A:** No, it does not.

1 **Q: Please discuss the reasons for disallowing a larger portion of Directors and Officers**
2 **(D&O) insurance expense from the Company's revenue requirement.**

3 A: The Company has proposed to allocate 90% of D&O insurance expense to utility
4 operations. This allocation does not reflect the fact that shareholders are the major
5 beneficiaries of D&O insurance and utility customers only marginally benefit from this
6 insurance coverage.

7 D&O insurance claims usually arise from disputes between shareholders and the
8 company, and as such, the cost of providing insurance coverage should not be borne by
9 customers.

10 Historical experience shows the risk of litigation increases significantly when
11 companies engage in more volatile and risky businesses outside of the utility business.
12 Utility customers are only incidental beneficiaries of D&O insurance.

13 The Company's proposal to allocate only 10% to non-utility businesses is wholly
14 inadequate. Many regulatory commissions in other states typically allocate 50% of this
15 expense to utility customers. Beginning on page 36 of my direct testimony, I discuss in
16 more detail the reasoning to split this expense equally between customers and
17 shareholders of the Company.

18 Based on my proposal that only 50% of these costs should be allocated to utility
19 customers, I recommend a reduction in revenue requirements of \$263,535 of which
20 \$206,231 relates to WA electric and \$57,305 to WA gas.

21 The Commission should provide clear direction to the Company that beginning
22 with this rate case, it will not allow recovery in rates of more than 50% of this expense.

1 **Table 1: Public Counsel Summary Adjustments¹⁴**

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

	<u>Total</u>	<u>Electric</u>	<u>Gas</u>
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	<u>(259,810)</u>	<u>(204,229)</u>	<u>(55,601)</u>
Total	<u>\$(1,798,805)</u>	<u>\$ (1,413,516)</u>	<u>\$ (385,311)</u>

2
 3 It is clearly evident that the Proposed Settlement excludes issues that are
 4 extremely important to the Commission and to the customers of Avista. A proposed
 5 settlement agreement that sidesteps such important issues cannot be a just and reasonable
 6 settlement of a rate case whose purpose is to set fair and reasonable rates for customers.

7 Therefore, the Proposed Settlement must be rejected by the Commission or, in the
 8 alternative, modified to incorporate the critical issues discussed in this response
 9 testimony.

10 **Q: Does this conclude your response testimony?**

11 **A: Yes.**

¹⁴ Please note that adjustments to revenue requirements shown in this table and mentioned in my testimony exclude the effect of any revenue taxes and may differ slightly from the specific revenue requirement adjustments calculated by Public Counsel Witness James Dittmer.