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8 BEFORE THE WASHINGTON UTILITIES &
TRANSPORTION COMMISSION
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10 DOCKET NO. UE-991606
DOCKET NO. UG-991607
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12 REBUTTAL TESTIMONY OF KATHERINE E. MITCHELL
REPRESENTING AVISTA CORPORATION
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19 WUTC
20 DOCKET NO. UE-991606
21 EXHIBIT # 393
ADMIT ✓ W/D REJECT
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Exhibit T-393 (KEM-T)

1 Q. Please state your name, business address, and present position with Avista
2 Corporation.
3 A. My name is Katherine E. Mitchell. My business address is East 1411
4 Mission Avenue, Spokane, Washington. I am employed by Avista Corporation (the
5 Company) as a Rate Analyst.
6 Q. Have you previously provided testimony in this proceeding?
7 A. Yes.
8 Q. What is the scope of your rebuttal testimony in this proceeding?
9 A. My rebuttal testimony and exhibits will cover the WUTC Staff's adjustments
10 for Pro Forma Labor/Benefits, Bonuses and Relocation Expenses. Additionally, my
11 testimony will address questions raised by Public Counsel Witness Lazar regarding salary
12 increases in FERC Account 920. My testimony is intended to be complementary to that of
13 Company Witness Feltes who will speak more to policy issues regarding compensation and
14 hiring practices and labor markets in general.
15 Q. Are you sponsoring any exhibits to be introduced in this proceeding?
16 A. Yes. I am sponsoring Exhibit No(s). ___(KEM-1), ___(KEM-2) and (KEM-
17 3), which were prepared under my supervision and direction.
18 **Executive Officer Compensation**
19 Q. Please summarize the Company's position regarding Executive Officer
20 compensation.
21 A. My testimony combined with that of Company Witness Feltes shows that the
22 Company's overall level of Washington Electric and Gas Pro Forma Officer Compensation
23 is reasonable. As a reference point, total compensation for all eleven officers for the
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1 Washington Electric and Gas jurisdictions is $1.2 million and $300,000, respectively. (See
2 Table 1 below.) This includes base compensation; signing bonuses (which are amortized
3 over the term of the 5-year employment agreement period), restricted stock awards (deferred
4 compensation) and incentive pay.

5 Table 1

All Officer Comp	System	WA El	WA Gas	Subsidiaries
Base Comp	$2,531,000	$883,000	$221,000	$674,000
Signing	250,000	75,000	19,000	92,000
Incentives	473,000	119,000	30,000	220,000
Restricted Stock	511,000	150,000	38,000	194,000
Stock Options	--No Expense to Company or Utility--			
Total	$3,765,000	**$1,228,000**	**$307,000**	$1,179,000

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11 Q. Please compare the Company's proposal to Staff's.

12 A. The Company proposes a Pro Forma adjustment removing expenses of
13 $417,021 and $105,703 from its Washington Electric and Gas operations, respectively.
14 Staff proposes (on pages 3 and 4 of Witness Huang's testimony) removing expenses of
15 $884,000 and $222,000 from the Washington Electric and Gas operations, respectively.
16 Staff excludes restricted stock compensation, signing bonuses and part of the CEO's base
17 compensation and reduces the base compensation for the other executives as well. After
18 this 43% reduction in executive compensation, Staff then further reduces officer
19 compensation by allocating 48% of the remainder to the subsidiaries.

20 Q. Do you agree with Staff Witness Huang's reduction of the CEO's base
21 compensation from $750,000 to $570,000?

22 A. No. Mr. Matthews's salary (base compensation) is within the range of
23 reasonableness considering the total results of the Towers and Perrin study. The Company
24 was competing for executive talent not just from the smaller company pool ($1-$3 billion)

1 but also from a larger universe of companies ($3-$6 billion.) As shown in the Towers and
2 Perrin study, even before an allocation of Mr. Matthew's salary to subsidiaries and other
3 jurisdictions, this base salary is slightly less than the 50th percentile for the latter group as
4 shown on page 6 of Exhibit C-388. The study was designed to evaluate compensation
5 opportunities reflective of the goals of the Company. (It should be remembered that after
6 allocations to the Company's subsidiaries and its other utility jurisdictions, the Washington
7 Electric and Gas jurisdictional pieces of Mr. Matthew's salary are $212,000 and $53,000,
8 respectively.) The Company's board of directors should be given some measure of
9 discretion in terms of what salaries are necessary to attract the sort of CEO candidate who
10 will lead a company that is clearly repositioning itself – especially as that discretion results
11 in base compensation within the range of reasonableness shown by studies such as that
12 prepared by Towers and Perrin. Per the results of the Towers and Perrin study, the CEO's
13 base compensation is just under the 50th percentile for the $3-$6 billion group and between
14 the 75th and 100th percentile for the $1-$3 group.
15 Q. Do you agree with Witness Huang's portrayal on page 7 of her testimony of
16 Signing Bonuses and Restricted Stock awards as "non-recurring", "related to non-regulated
17 activities" and "not reflective of ongoing normal business expenses"?
18 A. No. These elements of compensation are necessary recruitment tools – and
19 have been amortized over 5 years, consistent with the terms of the employment agreements.
20 (Please refer to Witness Feltes testimony for further discussion.) Their overall impact is
21 included in our Pro Forma (please refer back to Table 1 on page 2) totaling $225,000 and
22 $57,000 for Washington Electric and Gas jurisdictions, respectively. Staff's logic is flawed;
23 even if the Company had no subsidiaries, these items would still be a necessary recruitment
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1 tool. Of the companies in Staff's own data set (Exhibit___JH-2), 30 out of the 40 use stock
2 awards as a compensation tool and 8 out of the 40 noted signing bonuses/and or relocation
3 allowances for their executive officers in their Proxy Statements.
4 Q. Do you agree with Staff's proposed "target salaries" for the remaining
5 executive officers (those officers other than the CEO)?
6 A. No. The Towers and Perrin study, introduced by staff as Exhibit C-388 (see
7 page 5) stated, "In general: Base pay for Avista officers falls at or somewhat above the
8 median competitive market levels for $1 to $3 billion peer companies", - still well within
9 the range of reasonableness. The same study also concludes that in other areas, such as
10 expected value of stock option grants, Avista compensation lags behind the peer group.
11 Staff, nevertheless, chooses to limit the other officer Pro Forma increases to 3.2%. This
12 statistic is the overall U.S. wages and benefits increase per an April 6, 2000 Wall Street
13 Journal article entitled "Executive Pay". (This same article also noted that base pay of chief
14 executives increased 5.4% in 1999 and that pay for nonunion salaried workers increased
15 4.2%.) The Company believes that total base compensation of $671,000 (Washington
16 Electric) and $168,000 (Washington Gas) for the remaining ten executive officers is well
17 within the range of reasonableness per in the Towers and Perrin study.
18 Q. Please compare in dollars the Company's Pro Forma base compensation for
19 the remaining officers to that of the $1-$3 million peer group?
20 A. The Pro Forma total system base compensation for the remaining ten
21 officers, is $1,781,000 (before allocations to subsidiaries and other jurisdictions) compared
22 to $1,785,000 for the 50th percentile of the $1-$3 billion peer group as shown in the same
23 Towers and Perrin study. In fact, if Witness Huang were to apply her own recommendation
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of pegging the CEO's base compensation at the 50th percentile of the $1-$3 billion peer group to the remaining ten officers, there would be essentially no difference between Staff's proposal and the Company's Pro Forma in base compensation for those officers.

Allocations to the Company's Non-Regulated Operations

Q. Please describe Staff's proposal.

A. Staff proposes allocating executive compensation 52% to the regulated and 48% to the non-regulated operations. Staff ignores the allocations resulting from the executives' own informed judgements and proposes a formulaic approach. (The executives' charges result in 31% of all officer compensation charged to the subsidiaries.)

Q. Is a formulaic approach appropriate in this situation?

A. No. This type of allocation doesn't lend itself well to a formulaic approach. As noted in Table 2 below, the Company's Pro Forma allocation varies by officer - it would be wrong to apply a specific percentage across the board, as does Staff.

Table 2

Officer	Title	Utility % 98 ProForma
Matthews	Chairman of the Board, Pres & CEO	60
Meyer	Senior VP & General Counsel	70
Eliassen	Senior VP & CFO	60
Ely	Executive Vice President	50
Fukai	VP External Relations	100
Matthiesen	VP Human Resources	90
Peterson	VP and Treasurer	90
Burmeister-Smith	VP and Controller	90
Turner	VP & General Mgr Energy Delivery	100
Syms	VP & Corporate Secretary	98
Woodworth	VP Corporate Development	80

For example, if Staff's proposed allocation factor is applied to Mr. Turner (who spends perhaps 1 hour a week at most supporting the activities of only one subsidiary -

1 Avista Services, it would result in 48% of his labor allocated to subsidiary operations. This
2 is clearly a counterintuitive result.

3 Any formula that produces results spread across the entire officer group will not
4 recognize substantial differences among officers and their differing responsibilities. It will
5 not allow for use of informed judgement by each officer concerning prospective changes in
6 work responsibilities (regulated vs. non-regulated), as their responsibilities evolve over
7 time.

8 Q. Staff proposes an allocation formula that is a three-year average of Operating
9 Revenues, Number of Employees and Non-Officer Wages, similar to an allocation
10 methodology that was used in Docket UG-920840. Please discuss the applicability of this
11 formula to the Company regulated and non-regulated operations.

12 A. As it is currently proposed the formula is defective. For purposes of
13 developing the allocation formula, Staff uses subsidiary operating revenues as an input.
14 The majority of the subsidiary operating revenues result from the energy trading subsidiary
15 Avista Energy. Energy trading companies, like security trading companies, have high
16 volumes of revenues matched by high volumes of expenses. Most of the Avista Energy's
17 operating revenue transactions ultimately result in situations in which energy does not flow.
18 The Washington Department of Revenue has reviewed Avista Energy's Operating
19 Revenues and has concluded, that if the transaction is a purely "financial transaction"
20 (futures, forwards, options, swaps, bookouts, etc.), i.e. no energy flows, then the net trading
21 gain or gross margin will be the basis for the application of the B&O tax. The Department
22 of Revenue indicates that the proposed tax treatment will closely parallel the treatment
23 afforded "Stockbrokers & Security Houses" reflected in WAC 458-20-162. Staff should
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1 clearly follow the Department of Revenue's logic and adjust Avista Energy's Operating
2 Revenues likewise.
3 Q. Please compare the subsidiary operations that were the subject of the
4 allocation study in UG-920840 to the Company's subsidiary operations.
5 A. The non-regulated operations referenced in the allocation study in UG-
6 920840 were Merchandising and Jobbing of Non-Utility Products, a Gas and Oil
7 Exploration and Development business and a Home Security Business. None of the
8 businesses were Energy Trading operations. Additionally, Washington Natural Gas had
9 charged no executive compensation to its subsidiary operations, while Avista Executive
10 Officers have charged $1,179,000 to subsidiary operations in the Company's Pro Forma.
11 Q. Are there any other flaws in Staff's proposed formula?
12 A. Yes. Staff uses as one of its factors the number of subsidiary employees.
13 The subsidiary employee count used includes employees that do not appear in either the
14 Avista Corporation or Pentzer payroll records. The Avista Capital subsidiary Pentzer held
15 (until mid 1999) investments in a number of third and fourth-tier subsidiaries that are not
16 directly supervised or managed by Avista Corporation officers. Therefore it is not
17 appropriate to allocate executive compensation on the basis of this employee count.
18 Q. What would the resulting revenue and the employee count corrections
19 provide, even if the Company where to use Staff's formulaic approach?
20 A. The corrections would result in a overall subsidiary allocation factor of
21 15.22%, substantially less than the effective 31% percent charged by the officers to the
22 subsidiaries via their "informed judgement". Please refer to Exhibit___(KEM-1) to see the
23 derivation of the 15.22%.
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1 Q. Do you have any additional remarks regarding Staff's allocations?

2 A. Yes. In general cost allocations between business units typically occur when
3 one cannot identify (directly assign) those costs separately incurred for a particular unit or
4 business function. Direct assignment is the preferable approach as long as it is deemed cost
5 effective. Here Staff states (or identifies) that officer signing bonuses, restricted stock
6 compensation and a portion of Mr. Matthew's base compensation are incurred on behalf of
7 the non-regulated side of the business. After directly assigning 59% of the Company CEO's
8 compensation to the non-regulated side of the business, Staff then applies allocation factors
9 to the remaining "utility compensation" allocating additional executive compensation to the
10 subsidiaries.

11 Q. If Staff were to correct for flaws in the allocation study, set all target
12 compensation at the 50th percentile for the entire officer group, and include the 5 year
13 amortized levels of signing bonuses and restricted stock compensation, what would the
14 resulting analysis show?

15 A. Please refer to Exhibit___(KEM-2). This worksheet was prepared under the
16 following assumptions: All executive base compensation is set at the 50th percentile of the
17 $1-$3 billion class. The Company's Pro Forma amounts for signing bonuses and restricted
18 stock compensation are included as compensation to be allocated together with base
19 compensation. (For purposes of this analysis, annual incentive pay was excluded.) After
20 applying jurisdictional allocation factors, one arrives at $1,245,000 and $313,000 for the
21 Washington Electric and Gas jurisdictions, respectively.

22 Q. How does this compare to the Company's officer compensation Pro Forma?

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1 A. This analysis arrives at essentially the same end result as what the Company
2 initially proposed. The Company's Pro Forma for Officer Compensation is $1,228,000 and
3 $307,000 for Washington Electric and Washington Gas, respectively. (Please refer back to
4 Table 1 on page 2 of my testimony, noting that the Pro Forma includes all elements of
5 compensation; base compensation, signing bonuses, restricted stock awards and incentives.)
6 Exhibit___(KEM-2) further demonstrates that the Company's overall executive
7 compensation, as filed, is reasonable.

8 **Team Incentives**

9 Q. Please summarize Staff's proposal.

10 A. Staff (at page 14 of Witness Huang's testimony) removes $4.4 million of
11 Team Incentives in its entirety stating that "the plans are not customer-service oriented and
12 do not benefit regulated customers" and that they "were geared to ultimately provide greater
13 shareholder value."

14 Q. Please discuss the Company's 1998 Team Incentives.

15 A. The Company's Executive Officers received $473,000 with $220,000 of that
16 charged to the subsidiary operations via the officer Pro forma Adjustment. $647,000 was
17 received by administrative employees. $1,164,000 was for the Energy/Market
18 Services/Generation employees and $2,116,000 went to the Energy Delivery/Transmission
19 team. (Included in the above numbers is $1,371,000 for union employees.)

20 Staff's assumption that customers derive no benefit from these payments is
21 erroneous.

22 Q. Please provide examples of goals providing benefit to customers.

23 A. The following are just a few examples of customer-oriented targets.

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1 Energy Delivery/Transmission Team

2 The incentive plan included an explicit Customer Satisfaction target, whereby
3 Energy Delivery employees would be eligible for incentives if a customer satisfaction rating
4 exceeding a 60% excellent rating was achieved for the "Contact Customers" survey
5 category. (Contact Customers are those who have contacted Company personnel for items
6 such as an outage report, a bill inquiry and opening/closing an account, etc. The rating scale
7 consisted of four categories; poor, fair, good and excellent.) The establishment of such a
8 goal reminds employees of the importance of exceptional standards in their day-to-day
9 interactions with customers, increasing the emphasis on customer service, respect and
10 courtesy.

11 Energy and Market Services

12 This area's plan included goals such as "incremental improvement of megawatt
13 availability for hydro plants above a baseline of 95%". This goal reinforces to employees
14 the importance of highly efficient use of low-cost hydro resources benefiting customers and
15 the region.

16 Administrative

17 This area included efficiency/teamwork goals such as "working with, and
18 encouraging operations personnel to process plant retirements in a timely manner". To
19 achieve this goal the Retail Accounting team developed training materials and conducted
20 training sessions with operations personnel. Goals like this encourage administrative
21 employees to strive to improve the reliability of the Company's accounting records which
22 are ultimately used for ratemaking and depreciation studies.

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The broader point, however, is that the Company is looking for additional ways to provide motivation for all employees to excel. A motivated workforce will, in the broader sense, provide additional benefit to customers. Witness Feltes will further discuss this use of team incentives as a necessary part of any compensation plan.

Q. The 1998 plan appears to be a departure from previous years in the total of the awards granted. Please explain the change further.

A. $4.4 million is, on its face, a departure from previous years. The Company, however, needed to rethink compensation strategy both in terms of both fixed (base compensation) and variable (incentives or pay-for-performance). Each business unit and each functional discipline within each unit was allowed to create its' own incentive opportunity plan. The 1998 plan established a framework for greater incentive opportunity, as well as greater individual and line of business accountability. Although incentive amounts tend to vary from year to year, the Company continues to place increased emphasis on incentive compensation as a useful tool to drive results and direct employee focus. Again, Witness Feltes will describe the use of incentives as recruitment and retention tool. The 1998 incentives are part of 1998 employee compensation and are, therefore, included in the test period.

Relocation Adjustment

Q. Please summarize Staff's proposed relocation adjustment.

A. Staff Witness Huang (on page 15 of her testimony) selects and averages the two years (1997 and 1999) with the lowest relocation costs, throwing out 1998 year as non-representative. Staff also neglects to include any officer relocation expenses in this

1 calculation. Staff proposes relocation expense reductions of $166,000 for Washington
2 Electric and $42,000 for Washington Gas.
3 Q. Please explain how relocation costs tend to occur.
4 A. A corporate reorganization may result in increased relocation expenses for a
5 given year if the reorganization moves employees between a corporate headquarters and
6 divisional offices or between divisional offices. Sometimes, however, there are just a series
7 of relocation "chain reactions" caused by filling vacant positions internally. This is
8 especially true in the operations area. For example, when a vacancy exists in a divisional
9 office the best person for that position may be an employee from corporate headquarters or
10 from another division. One vacancy can occasionally result in several internal employee
11 relocations. The latter set of circumstances best explains the level of 1998 relocation
12 expenses.
13 Q. How much of the 1998 relocation expense included relocation of executive
14 officers?
15 A. Per the Company's response to WUTC Data Request No. 220, 1998
16 relocation expenses included $2,100 for executive relocations. The 1998 relocation
17 expense level, therefore, was not driven by executive relocations.
18 Q. Do you have any further comments regarding the level of 1998 relocation
19 costs?
20 A. Relocation costs will vary from year to year based on the number of
21 employees relocated and the level of those employees within the Company. To imply that
22 relocation costs should remain at some constant baseline level from year to year is not
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1 reasonable. Additionally, Staff's arbitrary exclusions of 1998 relocation expenses and
2 executive relocation costs results in a meaningless analysis of relocation expense.
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5 **Public Counsel's A&G Salary Analysis**
6 Q. Let us now turn to Public Counsel Witness Lazar's comparison of the 1998
7 Administrative and General Salaries to the 1984 level. He concludes on page 5 of his
8 testimony that after adjusting for inflation and customer growth that the difference between
9 the two years be disallowed. Are you in agreement with his analysis?
10 A. No. In fact, after making a valid comparison of the 1984 and 1998 amounts,
11 the Company's A&G salaries actually increased at approximately the same level of inflation
12 and customer growth proposed by Mr. Lazar.
13 Q. Please explain.
14 A. Please refer to Exhibit___(KEM-3). The 1998 number contains payroll
15 loading for payroll taxes, benefits and paid time-off, while the 1984 number does not. The
16 Company did not spread or allocate these items to account FERC Account 920 prior to the
17 installation in 1987 of its current General Ledger system. Additionally, the 1998 number
18 contains $1,695,000 of Team Incentives which Staff Witness Huang addresses separately.
19 For purposes of developing comparison of A&G salaries for the two years these items must
20 be subtracted.
21 Q. What conclusions do you draw from Exhibit___(KEM-3).
22 A. Even though the Company does not agree with Witness Lazar's premise that
23 growth in A&G salaries should be limited to inflation and customer growth, as discussed by
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1 Witness Feltes, Exhibit___(KEM-3) indicates that the increase in the Company's A&G
2 salaries actually approximates Mr. Lazar's proposed A&G salary level. The Company's
3 1998 adjusted A&G salaries are $5,725,000, only 2.8% higher than Mr. Lazar's proposal of
4 $5,568,000. Mr. Lazar's proposed adjustment is without basis.
5 Q. Does that conclude your rebuttal testimony?
6 A. Yes, it does.
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