

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NOS. UE-120436 & UG-120437

DOCKET NOS. UE-110876 & UG-110877

REBUTTAL TESTIMONY OF

KELLY O. NORWOOD

REPRESENTING AVISTA CORPORATION

IN SUPPORT OF MULTIPARTY SETTLEMENT

**I. INTRODUCTION**

**Q. Please state your name, employer and business address.**

A. My name is Kelly O. Norwood and I am employed as the Vice President of State and Federal Regulation for Avista Utilities (Company or Avista), at 1411 East Mission Avenue, Spokane, Washington.

**Q. Have you previously provided testimony in these Dockets?**

A. Yes. I have sponsored Exhibit Nos. \_\_\_\_ (KON-1T) through (KON-5), and Exhibit No \_\_\_\_ (KON-6T) which were filed as part of the Company's direct and cross-answering case, as well as the Joint Testimony in support of the Multiparty Settlement Exhibit No. \_\_\_\_ (T).

**Q. Are you sponsoring any Exhibits with this testimony?**

A. Yes. I am sponsoring Exhibit No. \_\_\_\_ (KON-8) which is a summary of information related to the Company's voluntary severance plan.

**Q. What is the purpose of your rebuttal testimony in this matter?**

A. The purpose of my testimony is to respond to the testimony filed by the Public Counsel Section of the Washington Office of Attorney General ("Public Counsel"), related to the Settlement Agreement. My rebuttal testimony will address, among other things, why the Settlement Agreement is in the public interest, and why the approach used is consistent with other settlements approved by this Commission. I will explain why it is supported by the evidence, and will provide background information on the Company's announced cost cutting measures, including adopting a voluntary severance plan. Finally I will address other issues raised by Public Counsel related to certain expenses, including executive compensation, the early implementation of rates agreed to in the Settlement,

1 return on equity, and accounting for renewable energy credits.

2 **Q. Notwithstanding Public Counsel’s objections, why is this Settlement in**  
3 **the public interest?**

4 A. The Multiparty Settlement is in the “public interest” for several reasons,  
5 which include:

- 6 • It occurred after the exchange of voluminous discovery over an extended  
7 period of nearly six months, which served to fully inform the parties of the issues,  
8 as well as after the pre-filing of staff/intervenor testimony which framed the  
9 remaining issues.
- 10 • It was the product of the give-and-take of negotiation that produced an “end  
11 result” that is just and reasonable.
- 12 • It is supported by the evidence, demonstrating the continuing rate pressure  
13 brought about by necessary expenditures and investment, the costs of which are  
14 not offset by a growth in sales margins.
- 15 • The Settlement enjoys broad-based support from a variety of constituencies,  
16 including industrial energy users (ICNU/NWIGU), as well as those with limited  
17 income (The Energy Project), serving to address their specific needs, and the Staff  
18 of the Commission representing all customers.
- 19 • The Settlement provides base rate certainty over the next two years  
20 (2013/2014), which will benefit all customers, as they plan and budget for their  
21 needs.
- 22 • It will prohibit Avista from filing to make effective a change in base rates prior  
23 to 2015, thereby breaking the yearly cycle of rate filings.
- 24 • The impact of the base rate increases in 2013 and 2014 of 3% will be  
25 mitigated, in part, by the use of ERM deferral balances that might not have been  
26 otherwise returned to customers unless and until the ERM “trigger” was reached.
- 27 • The “stay-out” provision preventing a change in base rates until 2015 will  
28 further challenge Avista to manage its costs in order to have the possibility of  
29 approaching the agreed-upon return on equity; indeed, the Company is already  
30 aggressively pursuing further cost savings, such as through its recently-announced  
31 voluntary severance program.
- 32 • Finally, as I will discuss later in my testimony, in order to allay any concerns  
33 that Avista might somehow “over-earn” during the 2013/2014 rate-effective  
34 period, Avista would agree to refund back to customers any earnings that exceed  
35 the 9.8% agreed-upon ROE during the 2013 and 2014 rate-effective periods, based  
36 on filed Commission Basis Reports (“CBR”).

37  
38 **Q. Witnesses for Public Counsel express concern regarding the “black**  
39 **box” nature of the Settlement Stipulation, and that some of their proposed**

1 **adjustments were not specifically addressed in the Settlement Stipulation.<sup>1</sup> What is**  
2 **the Company’s response to this testimony?**

3 A. Settlement agreements presented to the Commission often have a “black  
4 box” nature to them. The Commission has on many occasions previously expressed its  
5 view on, and support of, settlements that involve a “black box”. For example, the  
6 PacifiCorp Docket No. UE-032065 involved a multi-party settlement that was not  
7 supported by the Industrial Customers of Northwest Utilities (ICNU) and Public Counsel.  
8 In Order No. 06, dated October 27, 2004, in that Docket, on page 26, paragraph 61, the  
9 Commission stated as follows:

10 “ICNU developed through cross-examination and Public Counsel argues on brief  
11 that the settlement, in this sense, has a “black box” character. This implied  
12 criticism ignores the fact that all settlements have a so-called black box quality to  
13 one degree or another – they are by nature compromises of more extreme positions  
14 that are supported by evidence and advocacy. In addition, as do many settlements  
15 presented to the Commission, the Settlement Agreement here includes a disclaimer  
16 that:

17  
18 By executing this Settlement Agreement, no party shall be deemed to have  
19 approved, admitted or consented to the facts, principles, methods or theories  
20 employed in arriving at the terms of this Settlement Agreement, nor shall any  
21 Party be deemed to have agreed that any provision of this Settlement  
22 Agreement is appropriate for resolving issues in any other proceeding.  
23

24 For these reasons, except to the extent they help us understand the compromise  
25 nature of the parties’ agreement to an overall revenue requirement, and to give us  
26 insight into things the settling parties considered in arriving at their compromise,  
27 close scrutiny of the individual adjustments is not required. (emphasis added)  
28 (footnotes omitted)”  
29

30 In a footnote to this portion of Order No. 06 (footnote 52, page 27), the  
31 Commission noted that:

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<sup>1</sup> Lea Daeschel (Exhibit No. \_\_\_\_ (LD-1CT), page 2, line 11), and James Dittmer (Exhibit No. \_\_\_\_ (JRD-12CT), page 4, line 4).

1 “Public Counsel and ICNU have been parties to many settlements presented to, and  
2 approved by, the Commission, including settlements that lack even the level of  
3 analytical detail presented here.”  
4

5 The Commission went on to state, in this same Order, on page 27, in paragraph 62.

6 that:

7 “Ratemaking is not an exact science. As our Supreme Court has observed: “[t]he  
8 economic judgments required in rate proceedings are often hopelessly complex and  
9 do not admit of a single correct result.” (footnote omitted) Thus, while Public  
10 Counsel and ICNU would have us make different adjustments, or assign different  
11 values to certain of the adjustments made in the Settlement Agreement, we are  
12 confident in our judgment, made on the basis of the record before us, that the  
13 overall result in terms of revenue requirement is reasonable and well supported by  
14 the evidence.”  
15

16 **Q. Have these same issues been addressed in other orders of the**  
17 **Commission?**

18 A. Yes. Another example is in the Avista Docket Nos. UE-050482 and UG-  
19 050483, where a multi-party settlement agreement was presented to the Commission for its  
20 consideration. All parties supported the settlement agreement except Public Counsel and  
21 ICNU. The following discussion was included in the Commission’s Order No. 05, dated  
22 December 21, 2005, beginning in paragraph 28 on page 13:

23 “Both Staff and Avista address ICNU’s and Public Counsel’s criticisms of the  
24 settlement process with discussions of prior proceedings in which the Commission  
25 has approved contested settlements, including the recent PacifiCorp proceeding,  
26 where the Commission approved a multiparty, nonunanimous settlement  
27 agreement, subject to conditions, as a reasonable resolution of PacifiCorp’s request  
28 for a general increase in electric rates. Staff observes:

29  
30 In the *PacifiCorp* case, as in this one, the proposed settlement was opposed  
31 by both Public Counsel, and ICNU. Among other contentions, those parties  
32 argued that the Commission was required to analyze and approve every  
33 individual adjustment that comprised the overall revenue requirement in the  
34 parties’ settlement agreement, even though that agreement clearly was the  
35 product of negotiation and compromise. The Commission disagreed.

1 (emphasis added)  
2

3 The Commission noted that the settlement agreement must be viewed as a  
4 whole, with a view to whether the “overall result in terms of revenue  
5 requirement is reasonable and well supported by the evidence.”  
6

7 Staff further observes:  
8

9 “As in this case, the parties in *PacifiCorp* included several individual revenue  
10 requirement adjustments as a part of the negotiated settlement. Public  
11 Counsel and ICNU argued that because these were essentially “a means to an  
12 end,” – items that were a product of compromise, and hence not necessarily  
13 derived by mathematical formulas – that the settlement was somehow a  
14 “black box” that must be rejected. Again, the Commission disagreed: “This  
15 implied criticism ignores that fact that all settlements have a so-called black  
16 box quality to one degree or another – they are by nature compromises of  
17 more extreme positions that are supported by evidence and advocacy.”  
18 (footnotes omitted)  
19

20 **Q. Is the Commission bound by, or limited to, certain methods or**  
21 **mathematical formulas in arriving at its decision regarding appropriate retail rates?**

22 A. No. RCW 80.28.010(1) (Duties as to Rates, Services, and Facilities)  
23 provides that “all charges made, demanded or received by any gas company, electrical  
24 company . . . shall be just, fair, reasonable and sufficient.” (See also RCW 80.28.020) As  
25 the Supreme Court explained in the Hope Natural Gas case, the requirement that rates be  
26 “fair, just and reasonable” does not define a method by which rates are to be calculated;  
27 instead, the fixing of fair, just and reasonable rates involves a balancing of investor and  
28 consumer interests.<sup>2</sup> Simply put, the “end result” must be reasonable. These standards  
29 have been incorporated into RCW 80.28.010 and 80.28.020.

30 The Commission specifically addressed the importance of this “end result” in its  
31 Order No. 05, dated January 12, 2007, in Cascade Natural Gas Docket No. UG-060256. In

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<sup>2</sup> Fed. Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944)

1 that Docket, which again involved a multi-party settlement, Public Counsel took issue with  
2 the lack of detail surrounding rate of return in the settlement agreement, and recommended  
3 that, “the Commission should either set-aside Staff and Company representations regarding  
4 cost of capital or ‘reopen’ the Settlement to ensure that it is reasonable.” (*Id.* at p.20)  
5 (footnote omitted) The Commission’s response, at page 20, was as follows:

6 “We address each of these contentions in turn, having previously identified our  
7 standards for reviewing settlements. First, [by] their nature, settlements are the  
8 product of negotiation and therefore are often opaque as to some of the methods,  
9 details and calculations that produce a result on which the parties can agree. A  
10 settlement can take many forms. In some cases the Commission has determined  
11 that an agreed adjustment to revenue requirement is acceptable even if it does not  
12 identify a specific rate of return. In other cases, the Commission has approved  
13 settlements that include a rate of return but no detail concerning capital structure or  
14 the cost for the equity and debt components of capitalization. In still other  
15 examples, approved settlements have been explicit about all of the components of  
16 the cost of capital. In all of these examples, it was the end result of the proposed  
17 settlement’s terms and revenue requirement that mattered, not the specific detail  
18 about how the result was achieved. We conclude that the lack of detail concerning  
19 cost of capital in this proposed settlement does not preclude its being a fair and  
20 reasonable resolution of the case, or prevent us from performing our statutory  
21 function of setting fair, just, reasonable and sufficient rates.” (emphasis added)  
22 (footnotes omitted)  
23

24 The Multiparty Settlement in this case satisfies the requirements of Washington  
25 statutes, prior US Supreme Court rulings, and is consistent with prior Commission  
26 decisions, in that the Settlement strikes an appropriate “balance” and produces an “end  
27 result” that is well within “an acceptable range of possible outcomes.” (*See e.g.,* Utilities  
28 and Transp. Comm’n v. PacifiCorp, d/b/a Pacific Power & Light Co., Docket UE-080220,  
29 Order 05 (October 8, 2008) at para. 31.)

30 The Settlement in this matter occurred after extensive discovery and the filing of  
31 responsive testimony of all parties. Therefore, the Settling Parties had before them the pre-  
32 filed testimony of Public Counsel witnesses and all of the issues raised by those witnesses.

1 While the Settlement Agreement does not specifically identify and address separately each  
2 of the issues raised by Public Counsel, all of their issues were taken into consideration in  
3 developing the final agreed-upon revenue requirement.

4

5 **II. THE SETTLEMENT IS SUPPORTED BY THE EVIDENCE**

6 **Q. What is the Company's response to the claims of Public Counsel**  
7 **witnesses that the revenue increases in the Settlement Agreement are not supported**  
8 **by appropriate evidence in the record?**

9 A. A significant amount of information has been provided to the parties for the  
10 record that demonstrates a need for rate increases in excess of the amounts included in the  
11 Settlement Agreement for 2013 and 2014.

12 First, the combined revenue increases for 2013 and 2014 in the Settlement  
13 Agreement of \$34.35 million<sup>3</sup> represents approximately 64% of the Company's justified  
14 need for rate relief in these Dockets of \$53.3 million, reflecting corrections and updated  
15 information provided to the parties. This is shown in the Illustration No. 1 below<sup>4</sup>. It is  
16 important to recognize that the actual need for rate relief of \$53.3 million is related solely  
17 to the 2013 rate year.

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<sup>3</sup> 2013 = \$13.65 million electric and \$5.3 million natural gas. 2014 = \$14.0 million electric and \$1.4 million natural gas.

<sup>4</sup> While the Company has provided corrections and updated information to all parties through Avista's supplemental response to PC DR 342 which would have increased the Company's filed electric and natural gas revenue requirement requests, it did not seek to revise its originally filed tariffs to reflect these changes.



**Illustration No. 1: Actual Need for Rate Relief in 2013**

	<u>(\$Millions)</u>	
	<u>Electric</u>	<u>Natural Gas</u>
<b>Original Filing</b>	<b>\$41.0</b>	<b>\$10.09</b>
Updated Power Supply	(5.4)	
FIT/DFIT Correction	(3.0)	(0.03)
JP Deferral Amortization Correction		0.47
Transmission Revenue Correction	1.1	
Updated Attrition Adjustment	<u>8.2</u>	<u>0.88</u>
<b>Adjusted Total</b>	<b>\$41.9</b>	<b>\$11.4</b>
<b>Combined Electric/Natural Gas Total</b>		<b>\$53.3</b>
<b>2013/2014 Settlement Revenue Increases</b>		<b>\$34.35</b>

As Avista explained in the Joint Testimony supporting the Settlement Stipulation, the revenue increase requests in the table above are prior to consideration of the need for additional revenue increases in 2014. Avista provided information demonstrating the need for additional rate relief for 2014. The information showed that Net Plant Investment and Non-Fuel O&M will continue to increase at a much faster pace than kWh Sales and Therm Sales for 2014 and beyond, which will require additional rate increases for 2014 and future years.<sup>5</sup>

**Q. Has this Commission previously approved a multi-year rate plan that extends beyond the upcoming rate year?**

A. Yes. In the Commission's Third Supplemental Order, dated August 9, 2000, in Docket No. UE-991832, the UTC approved a five-year rate plan for PacifiCorp. The approved plan included base rate increases for each year of a three-year period, followed by two years of no general rate increases. On page 19 of the Order, paragraph 50, the Commission stated that:

<sup>5</sup> See the pre-filed direct testimony of Kelly Norwood (Exhibit No. \_\_\_\_ (KON-1T)) beginning on page 3.

1 “The cumulative effect on customers under the settlement is a rate increase that is  
2 approximately one-half what PacifiCorp requested by its filing. In addition, the  
3 small increase under the settlement is more gradual than would have been the case  
4 under PacifiCorp’s as-filed request that would have phased in the increases over  
5 two years, not three. The cumulative increase in rates at the third year under the  
6 settlement, results in the customers experiencing less of an increase as of January 1,  
7 2003, than what PacifiCorp proposed in its filing to implement November 1, 2000.”  
8

9 In a similar manner, the combined rate increases over the next two years for both  
10 2013 and 2014 are well below the Company’s request for 2013, even standing alone. It  
11 will also provide base-rate certainty for customers over the next two years.

12 **Q. Is there additional information available in the record that supports the**  
13 **need for the 2013 and 2014 revenue increases?**

14 A. Yes. In its original filing, Avista submitted a comprehensive Attrition  
15 Study, sponsored by Dr. Mark Lowry (see Exhibit No. \_\_\_\_MNL-1T)). This study was  
16 developed independently from the traditional pro forma ratemaking adjustments, and was  
17 based on the historical trends of operations and maintenance (O&M) costs, and net plant  
18 investment, as compared to the growth in retail revenue. The study revealed a continuing  
19 attrition, or regulatory lag, problem resulting in historical earned ROEs well below the  
20 authorized level. And the study demonstrated that this revenue short-fall will continue if  
21 this mismatch of the growth in utility costs and revenues is not reflected in the ratemaking  
22 process in some way, whether through a specific attrition adjustment or some other means.

23 The attrition study supports an electric revenue increase for 2013 of \$41 million<sup>6</sup>,  
24 which is well above the 2013 electric revenue increase of \$13.65 million. The natural gas  
25 attrition study supports a rate increase of \$10.4 million for 2013, compared with the natural

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<sup>6</sup> An updated Attrition Study was provided to all parties on July 27, 2012 through Avista’s supplemental response to Staff DR 178.

1 gas revenue increase of \$5.3 million in the Settlement Stipulation.<sup>7</sup>

2 Furthermore, if we were to reduce the attrition analyses for 2013 to reflect the 9.8%  
3 ROE and 47% equity layer in the Settlement, it would reduce the need for an electric  
4 revenue increase from \$41 million to \$29 million, and the natural gas increase from \$10.4  
5 million to \$8.3 million.<sup>8</sup> This calculation of the total need for electric and natural gas rate  
6 relief of \$37.3 million is still well above the combined electric and natural gas increase in  
7 the Settlement for 2013 of \$18.95 million.

8 With regard to 2014, a simple extension of the trend analysis in the Attrition Study  
9 to 2014 from 2013 would show a need for an incremental electric revenue increase of  
10 approximately \$14.5 million for 2014. The trend analysis for 2013 shows an electric  
11 revenue need of \$29 million, using the cost of capital in the Settlement, as explained  
12 above. This \$29 million represents the incremental revenue need for the two-year period  
13 from 2011 to 2013. If we apply this same trend of revenues, expenses and rate base for  
14 one additional period, from 2013 to 2014, the incremental electric revenue need for 2014 is  
15 \$14.5 million, i.e., one-half of the two-year change from 2011 to 2013. The incremental  
16 natural gas revenue need from 2013 to 2014 would be \$4.2 million.

17 Therefore, the attrition analysis would show a total combined incremental electric  
18 and natural gas revenue need for 2013 and 2014 of \$56.0 million<sup>9</sup>, even using the cost of  
19 capital in the Settlement, which is well above the total revenue increases in the Settlement

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<sup>7</sup> The natural gas attrition Study was provided to all parties on May 25, 2012 through Avista's supplemental testimony and exhibits, Exhibit Nos. \_\_ (EMA-5T) and (EMA-6) and updated through Avista's supplemental response to Staff DR 178.

<sup>8</sup> Mr. Dittmer provided a simplified calculation of the resulting reduction to electric revenue requirement in his Exhibit No. \_\_\_\_ (JRD-13) of \$12.5 million, related to the cost of capital in the Settlement Agreement, and a reduction to natural gas revenue requirement of \$2.14 million in his Exhibit No. \_\_\_\_ (JRD-17).

<sup>9</sup> 2013 total of \$37.3 million (electric of \$29 million and natural gas of \$8.3 million), plus \$18.7 million in 2014 (electric of \$14.5 million and natural gas of \$4.2 million).

1 of \$34.35 million for the two years.

2 **Q. On page 6, line 6, of Mr. Dittmer's testimony (Exhibit No. \_\_\_\_ (JRD-**  
3 **12CT)), he states that, "The agreed upon electric operations revenue increases**  
4 **include a substantial implicit attrition adjustment." Do you agree with this**  
5 **testimony?**

6 A. No. The Stipulation explicitly states that the Settling Parties did not agree  
7 to a specific attrition allowance, but did take into account the respective litigation positions  
8 of the parties in reaching agreement. In addition, the Settling Parties agreed that the  
9 Settlement Stipulation represents a compromise in the positions of the Settling Parties and  
10 no Settling Party shall be deemed to have accepted or consented to the facts, principles,  
11 methods or theories employed in arriving at the Settlement Stipulation. (See para. 24 of  
12 the Multiparty Settlement Stipulation)

13 While Public Counsel Witness Mr. Dittmer, in Exhibit No. \_\_\_\_ (JRD-12T), attempts  
14 to back into the revenue requirement agreed to by the Settling Parties, using the various  
15 parties' positions described in their pre-filed litigation testimony, his analysis does not  
16 factor in the give and take that occurs in the development of a settlement agreement.

17 In my initial pre-filed testimony (Exhibit No. \_\_\_\_ (KON-1T)), I discussed at length  
18 the under-earning that the Company has been experiencing in the Washington jurisdiction  
19 for the past several years. In that testimony, I presented some of the specific indicators and  
20 objective measures that showed the nature and extent of the revenue shortfall. The  
21 Company also provided an attrition study prepared by Company witness Dr. Lowry  
22 (Exhibit No. \_\_\_\_ (MNL-1T)), which provided more detail regarding the changes in Avista's  
23 utility costs, net plant investment, and revenues over time. And lastly, Company witness

1 Ms. Andrews provided a third analysis (Exhibit No. \_\_\_\_ (EMA-1T)), through the use of  
2 adjustments which presented an independent “cross-check” on the reasonableness of Dr.  
3 Lowry’s overall attrition-adjusted revenue requirement. All three of these methods  
4 independently demonstrate a need for rate relief above that provided in the Settlement.

5 With regard to the term “attrition,” Mr. Ken Elgin provided a definition on page 64  
6 of his testimony (Exhibit No. \_\_\_\_ (KLE-1T)) in Puget Sound Energy (PSE) Dockets UE-  
7 111048 and UG-111049, as follows:

8 The term [attrition] typically is used to refer to the erosion of a company’s rate of  
9 return over time when the historical test period relationship in revenues, expense  
10 and rate base accepted by the Commission in a rate case does not hold during a  
11 future rate year.

12 The issue of “attrition” has been referred to using a number of “labels” including,  
13 among others, earnings erosion, revenue short-fall, under-earning, regulatory lag, etc. The  
14 Settlement Agreement was a means to address the rate relief necessary to address the  
15 under-earning the Company is experiencing without identifying, or agreeing to, a specific  
16 methodology, per se, for doing so. But the Settling Parties agreed that there is a  
17 demonstrated need for the revenue increases included in the Settlement, irrespective of the  
18 method employed.

19  
20 **Q. Did the Commission require the Company to present an attrition**  
21 **adjustment?**

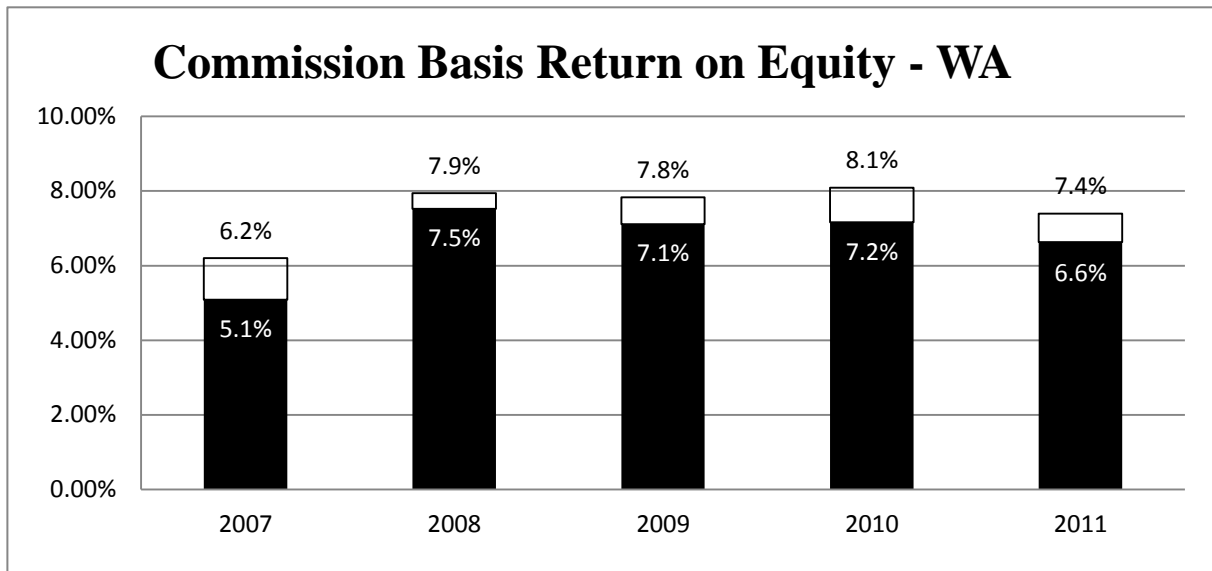
22 A. No, the Company was not required to present an attrition adjustment in this  
23 case. The Company was aware that the Commission had identified, in the last PSE general  
24 rate case order, an attrition allowance, based on an attrition study, as one method the  
25 Commission would consider to address the persistent under-earning. Avista is also aware  
26 that the Commission discussed a number of other methods in that order to address attrition,

1 including the use of pro forma adjustments and an upward adjustment to the equity share in  
 2 the capital structure. The Company provided an attrition study in this case, as well as other  
 3 analyses, demonstrating the need for rate relief to address its under-earning, and we believe  
 4 it is not necessary for the Commission to make a ruling in this case on a specific attrition  
 5 allowance, because there are multiple approaches or methods to address the same issue.

6 **Q. Is there other information in the record that either supports or**  
 7 **confirms the need for the revenue increases in the Settlement Agreement?**

8 A. Yes. As noted above, in my pre-filed direct testimony (Exhibit No. \_\_\_\_  
 9 (KON-1T)), beginning on page 7, I discussed the persistent revenue short-fall the  
 10 Company has experienced for the past five years. As part of that discussion, I provided the  
 11 bar chart (Illustration No. 2) reproduced below.

12 **Illustration No. 2:**



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1 Illustration No. 2 shows Avista's earned return on equity (ROE) each year from  
2 2007 to 2011 for our combined electric and natural gas operations in the State of  
3 Washington, under normalized operating conditions.<sup>10</sup> As I explained in my pre-filed  
4 direct testimony, based on the most recent ROEs authorized by the Commission, which  
5 would range from 9.8% to 10.2%, the Company is experiencing a short-fall in its earned  
6 ROE of at least 200 basis points. This annual revenue shortfall of 200 basis points of  
7 ROE for Avista's Washington utility operations is approximately \$21 million.<sup>11</sup>

8 What this means is the Company needs a revenue increase of \$21 million to  
9 address the revenue short-fall that is already occurring, prior to considering the incremental  
10 revenue increases that are needed for 2013 and 2014. All of the available data, whether  
11 historical or prospective, shows that net plant investment and operating expenses are  
12 growing at a much faster pace than retail revenues, which means that additional revenue  
13 increases are needed over and above the \$21 million, as we explained in the Joint  
14 Testimony Supporting the Settlement.

15 **Q. On page 19 of his testimony, Mr. Dittmer addresses the financial**  
16 **forecast information provided by the Company. Is this information supportive of the**  
17 **revenue increases in the Settlement Agreement for 2013 and 2014?**

18 A. Yes. Mr. Dittmer references Avista's response to UTC Staff Data Request  
19 No. 137, which was provided to all parties on May 22, 2012. The response includes  
20 Avista's financial forecast for the period 2012 to 2016. The forecast shows a need for  
21 retail revenue increases totaling \$49 million, on a system basis, for the combined 2013 and

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<sup>10</sup>The black bars represent the utility ROEs including the below-the-line expenses, and the total ROEs represent the ROE excluding these expenses.

<sup>11</sup> 2011 restated rate base of \$1,327,815,000 x 48.4% equity layer x 2.00% equity return, divided by conversion factor of 0.620815 = \$20.7 million (per footnote 4, page 10 of Norwood Exhibit No. \_\_\_(KON-1T)).

1 2014 two-year period, as compared to the \$34.35 million in the Settlement Agreement.

2 **Q. How do we know that the majority of the \$49 million retail revenue**  
3 **increase needs to occur in the State of Washington?**

4 A. In my original pre-filed testimony in this case (Exhibit No. \_\_\_\_ (KON-  
5 1T)), beginning on page 12, I testified that we are not experiencing the same kind of  
6 revenue short-fall in Idaho and Oregon that we are in Washington, and explained some of  
7 the reasons why in the following pages of that testimony.

8 In addition, the response to UTC Staff Data Request No. 379C, provided to all  
9 parties on August 1, 2012, showed the actual earned return on equity for Idaho and  
10 Oregon<sup>12</sup> for 2011 of approximately 10%, and the earned return on equity for Washington  
11 for 2011 of approximately 7%.

12 And finally, Avista files its Results of Operations Report (ROO Report) with the  
13 WUTC each quarter, which is posted on the Commission's web site. The ROO Report for  
14 the 12-months ended June 2012 was posted by the WUTC on August 9, 2012. That  
15 Report shows a rate of return of 6.8% for Washington electric operations, and 8.0% for  
16 Idaho electric operations for the 12-months ended June 2012.<sup>13</sup>

17 Therefore, the relative need for revenue increases in Idaho and Oregon for 2013  
18 and 2014 are small compared with that in Washington.

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<sup>12</sup> Avista files an earnings report with the Oregon PUC each year which is posted on the OPUC's web site ([apps.puc.state.or.us/edockets](http://apps.puc.state.or.us/edockets) [under Docket No. RG 34]). The report for calendar-year 2011, posted with a filing date of April 25, 2012, shows a return on equity for Oregon operations for 2011 of 10.47%.

<sup>13</sup> [www.utc.wa.gov/docs/pages/recordscenter.aspx](http://www.utc.wa.gov/docs/pages/recordscenter.aspx) Under Docket No. UE-121304.



1 **III. VOLUNTARY SEVERANCE & IMPACT OF COST CUTTING INITIATIVES**

2 **Q. What were the circumstances that led the Company to announce \$14**  
3 **million in O&M/A&G cost reductions, including the voluntary severance plan, for**  
4 **2013?**

5 A. The decision to pursue an estimated \$14 million in O&M/A&G cost  
6 reductions for 2013, that included a voluntary severance plan, was made by senior  
7 management after the settlement-in-principle was reached. At that time, management  
8 knew the amount of revenue that would be available in 2013 and 2014 to cover increased  
9 costs for that period, if the Settlement were approved by the Commission. In fact, the  
10 decision to enter into the Settlement by the Company was made with the knowledge that  
11 the only way the Settlement would work for Avista (i.e., provide a reasonable opportunity  
12 to earn a fair return) would be for Avista to make aggressive, incremental cuts to its costs  
13 for 2013 and 2014.

14 As I stated in the Avista statement of position contained within the Joint Testimony  
15 (Exhibit No. \_\_\_\_ (T)) filed with the Settlement Stipulation, on page 21:

16 The Settlement, together with Avista's aggressive management of the growth in  
17 utility costs going forward, will provide the opportunity for the Company to earn  
18 returns in 2013 and 2014 much closer to the Commission-authorized rate of return,  
19 as compared to prior years. I will emphasize, however, that the revenue increases  
20 from the Settlement Stipulation will provide a sufficient earnings opportunity for  
21 Avista only with the implementation of additional, aggressive cost management  
22 measures that the Company will undertake going forward. (emphasis added)  
23

1           **Q. Mr. Dittmer states that the Settling Parties were not aware of the**  
2 **Company's plans to institute the voluntary severance program at the time settlement**  
3 **was reached. Were the Settling Parties aware?**

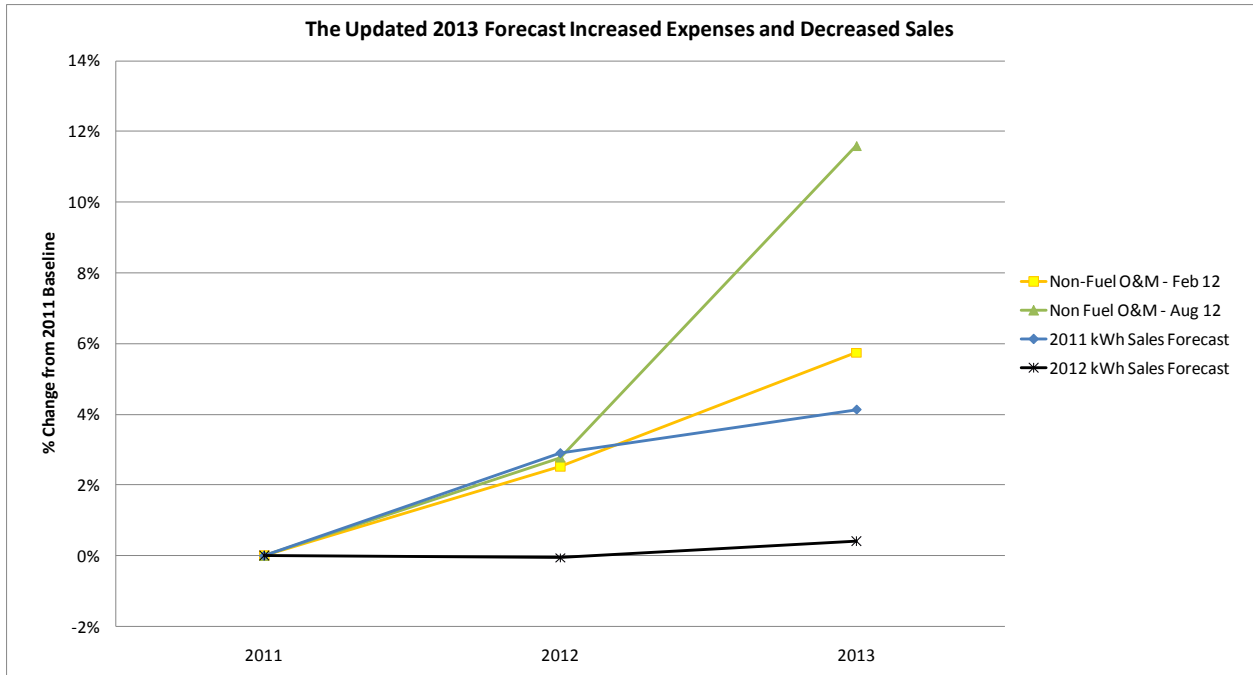
4           A. No, they were not, as the decision to implement the specific cost reduction  
5 effort was made after the general terms of the Settlement were known. The decision to  
6 initiate the voluntary severance program was based on an assessment by the Company that  
7 the revenue increases in the Settlement, if approved by the Commission in this proceeding,  
8 would not provide sufficient revenues to allow Avista to earn a rate of return close to that  
9 which was agreed to in the Settlement during the 2013 rate period. Material changes to the  
10 Company's actual and forecasted revenues and expenses occurred after Avista filed this  
11 general rate case.

12           **Q. What are the changes that occurred to revenues and expenses after the**  
13 **Company filed its general rate case?**

14           A. Illustration No. 3 below, which was provided in the Company's response to  
15 Public Counsel's Data Request 427, shows the growth in Avista's total system O&M/A&G  
16 expenses for the period 2011 to 2013, based on the two financial forecasts developed in  
17 2012. The yellow line in the graph below reflects the growth in O&M/A&G from 2011 to  
18 2013 in the financial forecast at the time the Company filed its Washington general rate  
19 case (February 29, 2012 financial forecast). The green line reflects the significant increase  
20 in expected O&M/A&G costs for the same time period in the updated financial forecast  
21 (August 21, 2012 financial forecast).<sup>14</sup>

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<sup>14</sup> The February 29, 2012 forecast was provided to all parties on May 22, 2012 in the Company's response to UTC Staff DR 137. The August 21, 2012 forecast was provided to all parties in the Company's response to Public Counsel DR 427.

1 **Illustration No. 3:**

12 In the forecast, updated utility operating expenses increased approximately \$14  
 13 million in 2013 due, in part, to items such as pension expense, post-retirement medical  
 14 costs, and power plant O&M costs. The continued decline in interest rates is causing  
 15 growth in the expense we incur related to our future pension and post-retirement medical  
 16 obligations.

17 The blue and black lines on the graph show the change in total utility kilowatt-hour  
 18 sales for 2011 to 2013, from the 2011 retail load forecast, and the more recent 2012 load  
 19 forecast, respectively. The revised load forecast reflects a reduction in retail revenue in  
 20 2013 of approximately \$8 million as compared to the prior forecast, due primarily to an  
 21 expectation that the recovery in the economy will not occur as quickly as we had  
 22 previously expected. The graph illustrates the reduction in kWh sales reflected in the

1 recent forecast. Therefore, since the Company filed its general rate case, expenses for  
2 2013 increased significantly, while kWh sales for 2013 decreased significantly.

3 This level of increase in expenses for 2013 and the expected lower growth in  
4 revenues for 2013 were not reflected in the Company's original rate case filing in April  
5 2012. Moreover, these changes were generally not reflected in the revenue requirement  
6 recommendations to the Commission in the response testimony filed by the non-Avista  
7 parties on September 19<sup>th</sup>.

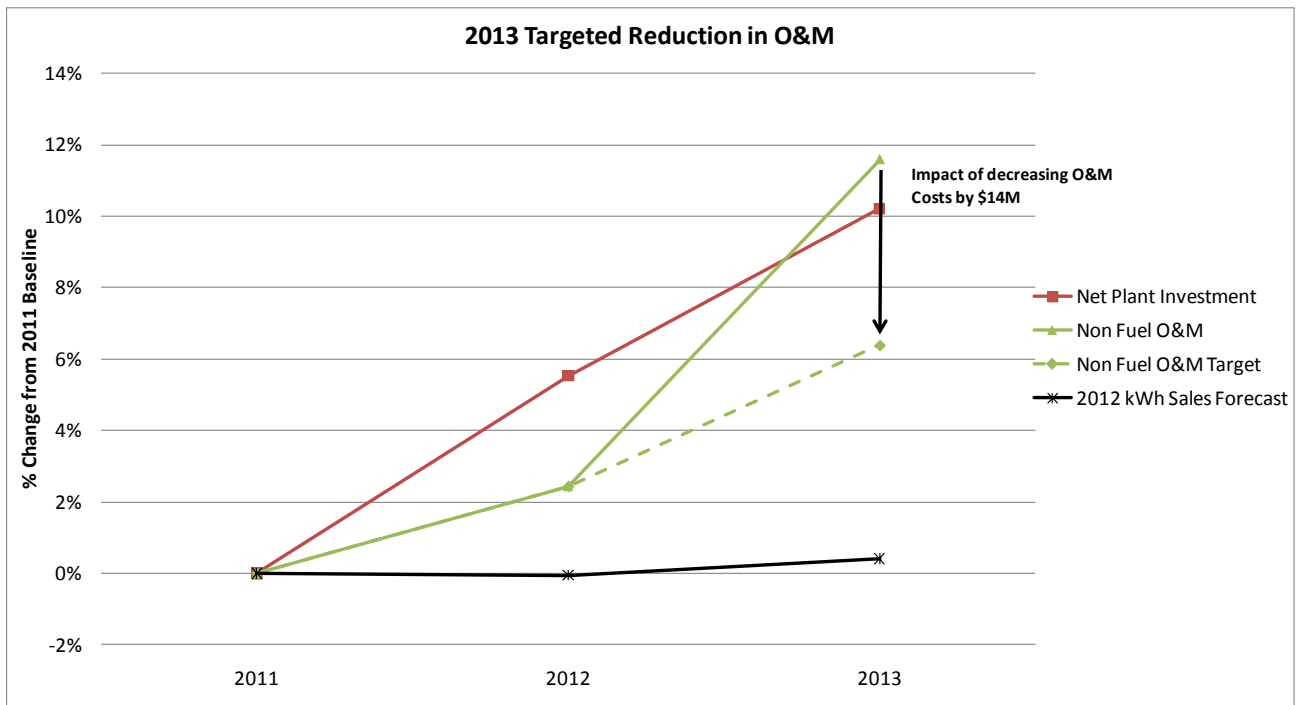
8 Following the unproductive settlement discussions on October 3<sup>rd</sup>, the Company  
9 had serious concerns that the revenue increases from the Washington rate case, whether by  
10 settlement or litigation, would not provide sufficient revenues in 2013 to cover the  
11 increased costs and provide a reasonable return. The Company began in earnest to  
12 consider options to aggressively cut costs for 2013 and beyond, with the goal that the  
13 combination of the aggressive cost cuts and the rate increases from this rate case would  
14 provide the opportunity to earn a reasonable return in 2013.

15 The senior officers of Avista first met to discuss a voluntary severance type plan on  
16 Friday, October 12, 2012. The full officer group met to review, discuss, and agree on next  
17 steps on October 15, 17, and 19. The final decision to move forward with a voluntary  
18 severance program was approved by the full officer group on October 19, 2012 – the same  
19 day that the Multiparty Settlement was filed with the Commission. A special meeting of  
20 the Compensation and Organization Committee of the Board of Directors was held on  
21 Monday morning, October 22, 2012, where the Voluntary Severance Incentive Program  
22 (VSIP) was approved. Avista's offering of the VSIP was then communicated to the  
23 Company's employees on that same day, Monday, October 22, 2012.

1           **Q.     What was the planned level of cost-cuts targeted by the Company?**

2           A.     Illustration No. 4 below shows the targeted reduction in non-fuel  
 3 O&M/A&G expenses for 2013 of \$14 million, on a system basis, that the Company  
 4 announced. The savings that will be realized from the VSIP will be a part of the \$14  
 5 million. As the graph illustrates, the \$14 million planned reduction in expense will not  
 6 reduce O&M/A&G costs below the level in 2011 or 2012, but it will slow the growth in  
 7 expenses.

8           **Illustration No. 4:**



1           **Q.     If the Settlement is approved by the Commission, and the Company is**  
 2 **able to realize the \$14 million in costs savings measures, what is the Company's**  
 3 **earnings opportunity for 2013 for its electric operations?**

4           A.     If the Settlement is approved by the Commission, Avista will have the  
 5 opportunity to earn an 8.45% ROE in 2013 as shown in the Table below – still well below  
 6 the agreed-upon ROE of 9.8%.

7 **Illustration No. 5: Earnings Opportunity in 2013 with Settlement**

	<u>\$Millions</u>		
	<u>Revenue</u>		
	<u>Requirement</u>	<u>NOI</u>	<u>ROE</u>
8			
9			
10			
11	<b>Original Filing</b>	<b>\$41.0</b>	<b>\$79.4</b>
12	Updated Power Supply	(5.4)	
13	FIT/DFIT Correction	(3.0)	
14	Transmission Revenue Correction	1.1	
15	Updated Attrition Adjustment	<u>8.2</u>	
16	Subtotal	\$41.9	<u>10.90%</u>
17	<b>Adjustments to Reflect Settlement</b>		
18	Revised Cost of Capital	(12.2)	(1.10%)
19	Eliminate Retail Revenue Credit Adj.	(3.6)	
20	Other Black Box Adjustments	<u>(12.5)</u>	(7.8)
21	<b>Settlement Agreement</b>	<b>\$13.7</b>	<b>8.45%</b>
22			

23           In order for Avista to have the opportunity to earn above the 8.45% ROE in 2013 in  
 24 its Washington electric operations, it must immediately implement the aggressive cost-  
 25 cutting measures that we have announced. An expense reduction of \$1 million (pre-tax),  
 26 applicable to Avista's Washington electric operations, would improve the Washington  
 27 electric ROE by 0.11%; in other words, the 8.45% ROE would move to 8.56%<sup>15</sup>. Avista's  
 28 Washington electric operations represent approximately 48% of its total system utility  
 29 operations. Avista has announced plans to reduce system O&M/A&G costs by \$14 million,

<sup>15</sup> Total of 8.45% ROE plus .11% ROE.

1 which would be about \$6.7 million applicable to Washington electric. The revenue from  
2 the Settlement, together with the planned expense reductions, would provide a Washington  
3 electric ROE opportunity of approximately 9.2%. This would be below the 9.8% ROE in  
4 the Settlement, but would be an improvement to the historical earned ROE in Washington  
5 of approximately 8.0%.

6 **Q. Please provide a brief overview of the VSIP?**

7 A. As Avista explained in its response to Public Counsel's Data Request 427,  
8 in general, all employees of Avista Corp. (excluding its subsidiaries) who are not covered  
9 by a collective bargaining agreement are eligible to participate in the VSIP. The VSIP is  
10 designed as a "Double Yes" program. Eligible employees will have until Friday,  
11 December 14, 2012 to elect to voluntarily leave the Company effective January 1, 2013  
12 (which constitutes the "1st Yes"). After weighing short and long term business needs,  
13 critical skill sets, and the ability to accommodate departure requests, the Company's  
14 management will decide which employee requests will be approved (constituting the "2nd  
15 Yes" of the "Double Yes" approach).

16 Each participant in the VSIP will be entitled to receive severance pay, determined  
17 based on the participant's years of service and base pay as of December 31, 2012. A  
18 summary of Plan eligibility documentation mailed to employees is provided as Exhibit  
19 No. \_\_\_\_ (KON-8). All employee reductions under the VSIP are expected to be completed  
20 by December 31, 2012. Because this Plan is voluntary, the level of participation is  
21 unknown at this time, and we cannot estimate the level of cost savings that will be  
22 realized. The Plan costs, which will be expensed in the fourth quarter of 2012, also cannot

1 be estimated at this time. The savings that will be realized from the VSIP will be a part of  
2 the planned \$14 million in O&M/A&G cost reductions for 2013.

3 **Q. If the Commission is concerned that the Company may earn more than**  
4 **the agreed-upon 9.8% return on equity (ROE) in the Settlement in 2013 or 2014, if it**  
5 **approves the Settlement, what further conditions would the Company agree to?**

6 A. The Company would agree to an after-the-fact earnings test, in conjunction  
7 with the Settlement Agreement, and would agree to refund to customers any earnings in  
8 excess of the 9.8% ROE for each of the years 2013 and 2014. This should further allay  
9 any concerns that the base rate relief in 2013 and 2014, together with any additional cost-  
10 cutting, may allow the Company to exceed its authorized return.

11 The Commission Basis Reports (“CBR”) that the Company already files every  
12 year, provide a framework for the earnings test. Avista is required to file its Commission  
13 Basis Reports by April 30 each year to show what the electric and natural gas earnings for  
14 the prior calendar year would have been under normal operating conditions.

15 If the electric or natural gas earnings in the CBRs for calendar years 2013 or 2014  
16 are greater than a 9.8% ROE, the Company would return any earnings above the 9.8% to  
17 customers. WAC 480-100-257 (electric) and WAC 480-90-257 (natural gas) already  
18 provide instruction on the manner in which the normalizing and restating adjustments are  
19 to be done.

20 If the CBR shows earnings in excess of 9.8%, the Company would make a tariff  
21 filing at the same time as it files the CBR to return any overearnings to customers. The  
22 proposed effective date of the tariff filing would be July 1st. The Company would not  
23 oppose a reasonable request for an extension of time to review such reports. The rate



1 spread for the tariff filing would be on a uniform percentage basis to the rate schedules,  
2 and on a uniform percentage basis to the blocks within each schedule.

3 **IV. OTHER ISSUES**

4 **Q. What is Avista's response to Public Counsel's testimony on the return**  
5 **on equity (ROE) the parties agreed to in the Stipulation?**

6 A. It should be noted that Public Counsel witness Mr. Dittmer states, "I am not  
7 offering any independent opinion as to the appropriate cost of common equity in the  
8 proceeding." (Page 22, line 10 of Exhibit No. \_\_\_\_ (JRD-12T)). While he presents  
9 observations and concerns regarding the reasonableness of the agreed upon ROE, his  
10 testimony should be considered in light of the fact that he has not offered an opinion as to  
11 an appropriate ROE.

12 The ROE agreed to by the parties represents a compromise by all parties and was  
13 agreed to as part of the give and take process of settlement negotiations. Concessions were  
14 made by all parties in many areas, including the ROE. For its part, Avista would not have  
15 agreed to a 9.8% ROE and a 47% equity ratio, were it not for concessions in other areas  
16 and an agreement on the overall revenue requirement.

17 The reference to the ROEs approved in the last general rate cases for PSE and  
18 PacifiCorp, in the Joint Testimony supporting the Stipulation, was to provide a general  
19 point of reference. The Company agrees there are differences between those companies  
20 and Avista. As explained by Company witness Dr. Avera (Exhibit No. \_\_\_\_ (WEA-1T)),  
21 Avista's relatively small size supports a higher return for investors. And mechanisms like  
22 the Power Cost Only Rate Case (PCORC) approved for Puget Sound Energy may also  
23 warrant a higher ROE for utilities that do not have such mechanisms. The ROE and equity

1 components are part of the integrated settlement package, which taken together provides an  
2 end result that is in the public interest.

3 **Q. In its testimony, Public Counsel recommended that Avista provide a full**  
4 **accounting of renewal energy credit (REC) revenue, and return 100 percent of these**  
5 **revenues to customers as bill credits.<sup>16</sup> What is the effect of Avista's current**  
6 **accounting for REC revenues in 2012?**

7 A. Base rates effective January 1, 2012, that were established in Avista's last  
8 general rate case, had \$4,077,485 of REC revenues (Washington share) credited to  
9 customers. The Company estimates that total Washington REC revenues in 2012 will be  
10 \$4,359,665. Therefore, Washington REC revenues will exceed the amount of REC  
11 revenues in base rates by \$282,180. Ninety percent or \$253,962, of the REC revenues  
12 received in excess of the base amount will be deferred for the benefit of customers in the  
13 ERM. The remaining ten percent or \$28,218 will be retained by the Company. Therefore,  
14 customers will receive the benefit of \$4,331,447 of the total REC revenues of \$4,359,665,  
15 which represents 99.35% of total REC revenues for 2012.

16 Beginning January 1, 2013, under the Settlement Agreement, 100% of the REC  
17 revenues would be credited to customers through base retail rates together with deferral of  
18 100% of the difference between actual and authorized REC revenues.

19 **Q. Please summarize the accounting for REC revenues in 2013, as agreed**  
20 **to by the parties in the Stipulation.**

21 A. Base rates that would become effective January 1, 2013, under the  
22 Settlement Agreement, includes \$3,410,297 of REC revenues (Washington share) credited

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<sup>16</sup> Page 9, line 9 of Ms. Daeschel's testimony (Exhibit No. \_\_\_\_ (LD-1CT)).

1 to customers. Beginning on January 1, 2013, Avista will track separately and defer 100  
2 percent of the difference between actual and authorized REC revenues. This deferral will  
3 be for the benefit of customers and not subject to any dead-band or sharing percentage.

4 **Q. Why is this accounting treatment for REC revenues in the Settlement**  
5 **beginning in 2013 better than Public Counsel's proposal?**

6 A. On page 14, line 4 of Ms. Daeschel's testimony, she makes the following  
7 recommendation:

8 Beginning January 1, 2013, Public Counsel recommends that Avista defer all REC  
9 revenues in a separate tracker outside of the ERM and return 100 percent of these  
10 proceeds to customers annually as bill credits.

11  
12 It appears that Public Counsel is recommending that REC revenues be removed  
13 from base retail rates and deferred separately in a tracker. Effective January 1, 2013, under  
14 the REC proposal in the Settlement Agreement, customers' base rates are reduced by the  
15 \$3,410,297 of REC revenues (Washington share) that have been factored into the  
16 Stipulation. The effect of Public Counsel's proposal would be to have the base rates on  
17 January 1, 2013 higher than they otherwise would be (by excluding the benefit of REC  
18 revenues), and then provide a bill credit to customers beginning sometime in 2014 for the  
19 2013 REC revenues. The REC proposal in the Settlement provides the benefit of the  
20 RECS to customers immediately, and any difference between the amount credited to  
21 customers in base rates, versus the actual revenues, would be deferred at 100% for the  
22 benefit of customers.



1 **Executive Compensation**

2 **Q. What is Avista’s response to Public Counsel’s testimony regarding**  
3 **executive compensation?**

4 A. In Avista’s last general rate case proceeding, Dockets UE-110876 & UG-  
5 110877, the Commission ordered the Company to file, by February 29, 2012, a “Review of  
6 Executive Officer Compensation” report describing current executive compensation, how  
7 levels of executive compensation are set, and why the existing levels of executive  
8 compensation are appropriate for recovery in utility rates. The information was filed with  
9 the Commission on February 29, 2012, and provided to all parties; and updated  
10 information is included in the record of this proceeding. The views of the Settling Parties  
11 on this issue were factored into the end result of the Multiparty Settlement.

12 Both Mr. Coppola and Ms. Daeschel provide quotes of comments from customers  
13 regarding executive compensation. The customer quote on Page 8 of Ms. Daeschel’s  
14 testimony (Exhibit No.\_\_\_\_(LD-1CT)) refers to the executive compensation “at the  
15 ratepayers expense”. This quotes leave the impression that all executive compensation is  
16 included in the retail rates paid by customers, which we all know is not true.

17 The issue of executive compensation to be paid by customers has been specifically  
18 addressed in prior cases before this Commission. The prior decisions of this Commission  
19 have excluded executive compensation based specifically on shareholder value, or the  
20 earnings of the Company, as well as compensation related to time spent on non-utility  
21 operations. The initial filing by the Company reflected these principles, by removing long-  
22 term incentive payments and appropriately allocating other compensation between utility  
23 and non-utility operations.

1 The following table shows the amount of executive compensation included in the  
2 Company's original filing:

<b>Executive Compensation (All Officers) ('000s)</b>					
<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>% of Total</b>
<b>All Executive Officers (\$000's)</b>	<b>2012 Base Pay (a)</b>	<b>2011 STIP (b)</b>	<b>2011 LTIP (c)</b>	<b>Total Base Pay, STIP &amp; LTIP</b>	
Actual Total Officer Salary and Incentives	\$3,823	\$1,933	\$3,995	<b>\$9,751</b>	
<b>Proforma Amount (b)</b>	<b>\$3,699</b>	<b>\$577</b>	<b>\$0</b>	<b>\$4,276</b>	
WA Electric Portion	\$1,547	\$279	\$0	<b>\$1,826</b>	
WA Gas Portion	\$424	\$76	\$0	<b>\$500</b>	
Washington Total	\$1,971	\$355	\$0	<b>\$2,326</b>	24%
Idaho / Oregon Totals	\$1,231	\$222	\$0	<b>\$1,453</b>	15%
Shareholders	\$621	\$1,356	\$3,995	<b>\$5,972</b>	61%
(a) 2012 Base Pay information provided in Exhibit No. _(KSF-6C), page 1					
(b) 2011 Short-Term Incentive Plan (STIP) amounts as reflected in Ms. Andrews Restate Incentive adjustments included in Exhibit Nos. _(EMA-2) and (EMA-3), page 7					
(c) 2011 Long-Term Incentive Plan (LTIP) information provided in Exhibit No. _(KSF-2C), page 3					

13 The table above shows that approximately 24% of total compensation paid to all  
14 officers (\$2.3 million) is charged to Washington electric and natural gas customers, 15% to  
15 Idaho and Oregon customers, and 61% (\$6.0 million) is borne by shareholders, i.e., the  
16 majority of executive compensation is borne by shareholders, not customers.

17 **Q. What is the Company's response to Public Counsel's testimony**  
18 **regarding the peer group used to benchmark Avista's executive compensation?**

19 A. Public Counsel argues that the Company has set executive salaries based on  
20 a peer group of companies that is not comparable to its utility business, and recommends a  
21 peer group benchmarked with the Institutional Shareholder Services (ISS) group of  
22 companies.

1           The basis for the ISS peer group selection, however, is the S & P Global Industry  
2 Classification Standard (GICS) industry codes, which generally do not take into account  
3 variations in company profiles, and in some cases, also do not share characteristics similar  
4 to Avista. For example, UIL Holdings has no natural gas operations, whereas Piedmont  
5 Natural Gas Company has no electric operations. This lack of attention to individual  
6 company nuances within a given classification has drawn considerable attention in recent  
7 years by investors and is currently being addressed by ISS. In fact, the Harvard Law  
8 School Forum on Corporate Governance and Financial Regulation noted<sup>17</sup>, “ISS’s peer  
9 group selection methodology has drawn heated criticism in recent years, with many  
10 companies finding themselves grouped with companies that they do not consider  
11 comparable and with which they do not compete either in business or in recruiting and  
12 retention of talent.”

13           In addition, the ISS peer group reports only the top 5 executive officers, which can  
14 change year over year, and does not provide any benchmarking ability for other executive  
15 officers, contributing to the lack of consistency year to year.

16           The ISS peer group fails to take into account the primary purpose of the peer group  
17 – i.e., to include a group of companies with which Avista would most likely compete for  
18 talent. The Towers Watson Energy Services Peer Group provides a peer group that  
19 includes comparable diversified energy companies with revenues between \$1 billion and  
20 \$3 billion in size; utilizes several data sources, rather than one data source; provides

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<sup>17</sup> Posted on The Harvard Law School Forum on Corporate Governance and Financial Regulation, on November 7, 2012 [<http://blogs.law.harvard.edu/corpgov/2012/11/07/iss-proposes-2013-voting-policy-updates/>].

1 comparisons for all executives, not just the top five executive officers; and provides  
2 consistency year over year.

3 **Q. What is your response to Public Counsel’s recommendation to allocate**  
4 **more executive compensation to non-utility operations?**

5 A. Mr. Coppola proposes to allocate a higher level of executive salaries to non-  
6 utility businesses<sup>18</sup>. In doing so, Mr. Coppola made erroneous assumptions in his  
7 determination of the proper allocation between utility and non-utility operations.

8 For example, Mr. Coppola determined his allocation of time by reviewing portions  
9 of the CEO’s calendar. During this review, he selected only the first three months of the  
10 year and reviewed the documented events noted within the calendar. After this review, his  
11 analysis shows that “approximately 37% of the CEO’s time” was spent on utility  
12 operations. Mr. Coppola apparently assumes that any time not documented with a specific  
13 meeting or appointment (“open time”) is, by default, time spent on non-utility operations<sup>19</sup>.

14 As a second example, Mr. Coppola argues that a larger portion of executive  
15 compensation should be allocated to non-utility because Avista executives hold multiple  
16 positions in at least 10 non-utility subsidiaries which demand management time and  
17 attention. However, Mr. Coppola fails to point out that many of the non-utility subsidiaries  
18 of Avista Corporation no longer have active operations, have no employees, or are special  
19 purpose LLCs<sup>20</sup>. The two largest subsidiaries, Ecova and Advanced Manufacturing and  
20 Development, Inc. (AM&D), account for approximately 90% of subsidiary operations.  
21 Both perform their own accounting, tax returns, compliance, etc., with fully functioning

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<sup>18</sup> Coppola Exhibit No. \_\_\_\_ (SC-17CT) at page 6 line 11 to page 8 line 10.

<sup>19</sup> Coppola Exhibit No. \_\_\_\_ (SC-1CT) at page 16 lines 4 to 14 and Exhibit No. \_\_\_\_ (SC-7C).

<sup>20</sup> Avista’s response to Public Counsel DR 022 Attachment B.



1 back offices and do not rely on the corporate umbrella for these services. Ecova and  
2 AM&D have their own CFO, CIO, Controller, Treasurer and other vice presidents,  
3 directors and their own senior management team which supervise the day-to-day  
4 operations.

5 These are a few of the arbitrary assumptions used by Mr. Coppola to determine his  
6 allocation between utility and non-utility operations. In the final analysis, the best  
7 indicator of the amount of time spent on utility and non-utility operations comes directly  
8 from each executive officer's own determination, as it is based on actual experience of  
9 each individual. Each officer is periodically surveyed to gather this information, and this  
10 best reflects any change in circumstances over time.

11 **Q. Do you agree with the assertion by Public Counsel that the Company's**  
12 **service reliability indices have deteriorated and that other metrics within the**  
13 **executive short-term incentive plan are inappropriate?**

14 A. No. Mr. Coppola indicated in his testimony that "actual results of the  
15 indices show a deteriorating trend in service reliability."<sup>21</sup> However, Mr. Coppola had an  
16 error in "Table 5: CAIDI Factor Used in Incentive Pay" of his testimony<sup>22</sup> where he had  
17 taken hour/minute information and displayed them as minutes. Specifically, at line 18 of  
18 Exhibit No. \_\_\_(SC-1CT) page 25, Mr. Coppola assumes "1:50" is 150 minutes, as opposed  
19 to one hour and fifty minutes, or 110 minutes. When the data is corrected, the trend  
20 actually shows improvement, not deterioration in service reliability.

21 With regards to the SAIFI Factor used in incentive pay, the Company has changed  
22 targets over the years and has changed the methodology in establishing this target.

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<sup>21</sup> Public Counsel witness Sebastian Coppola's testimony, Exhibit No. \_\_\_(SC-1CT), page 25.

<sup>22</sup> Public Counsel witness Sebastian Coppola's testimony, Exhibit No. \_\_\_(SC-1CT), page 26.

1 Therefore, it is inappropriate to analyze this metric over a six year period, as it will provide  
2 inconsistent results. However, it is appropriate to review 2010 to 2011 for purposes of  
3 comparisons; these metrics were derived using the same methodology. As clearly shown in  
4 Mr. Coppola’s testimony at Table 6, there is an improvement, not a deterioration of this  
5 factor from 2010 to 2011.

6 **Board of Director Compensation**

7 **Q. What is the Company’s response to Public Counsel’s testimony related**  
8 **to Board of Director’s compensation?**

9 A. Public Counsel first proposes to remove 100% of the Board of Directors’  
10 stock compensation, stating this is “inconsistent with [the Company’s] decision to not seek  
11 recovery of the same type of compensation paid to executive officers”<sup>23</sup>. However, the  
12 stock compensation paid to the Board of Directors is part of their base compensation for  
13 being on the Board of Directors. All Board of Directors that are not employees of the  
14 Company were required to receive a minimum of 42% of their annual retainer during 2011  
15 to be paid in the form of Company common stock and the remaining portion of their  
16 annual retainer in Company common stock, in cash, or in a combination of stock and cash.  
17 This is base compensation as opposed to incentive compensation.

18 In contrast, the stock-based compensation that is discussed on page 29 of the direct  
19 testimony of Company witness Ms. Feltes (Exhibit No. \_\_\_(KSF-1T) is part of the  
20 Executive Officer’s incentive compensation. These two forms of compensation are not  
21 similar, as one is base compensation, while the other is incentive compensation; therefore  
22 there is no basis for comparison.

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<sup>23</sup> Public Counsel witness Sebastian Coppola’s testimony, Exhibit No. \_\_\_(SC-1CT), page 32.

1           Public Counsel also recommends an overall reduction to the cash compensation, as  
2 well as a 50% sharing of Board of Director's retainer fees, based on its assertion that the  
3 levels paid to Avista's Board of Directors are not reasonable in comparison to other peer  
4 companies. As described in Company witness Ms. Andrews' direct testimony, however,  
5 the Company fully supported its use of a 90% utility / 10% non-utility allocation for Board  
6 of Director compensation. As with other contested adjustments, however, the Company  
7 took into account the litigation position of the parties in reaching an overall settlement.

8           **D & O Insurance**

9           **Q.     What is Avista's response to Public Counsel's testimony regarding**  
10 **D&O insurance?**

11           A.     Mr. Coppola argues that the 90% utility-allocated portion of Director and  
12 Officer (D&O) insurance in Avista's direct filed case, as previously approved by this  
13 Commission in Dockets UE-090134 and UG-090135, is inappropriate, and instead  
14 proposes the removal of 50% of the Company's utility D&O insurance. In its arguments,  
15 Public Counsel merely recites the same arguments that were rejected by the Commission in  
16 the Company's 2009 general rate case in Dockets UE-090134 and UG-090135. D&O  
17 insurance was created as a means to address the financial cost of risks attendant to serving  
18 as a director or officer of the corporation and is a necessary adjunct to operating as a  
19 publicly-traded company. As a publicly-traded company, it needs access to the public  
20 capital markets to finance its operations for the benefit of customers. Without adequate  
21 D&O insurance, the Company would be unable to attract or retain capable individuals for  
22 the board of directors or to otherwise serve as officers. No qualified individual would  
23 agree to serve as a board member or officer without the benefit of such insurance. The

1 purpose, therefore, of the insurance is not to pay shareholders, but to address the financial  
2 exposure risks of directors and officers. The Commission agreed with the Company in its  
3 order in Docket UE-090134 and UG-090135, when this Commission found that D&O  
4 insurance should be allocated 90/10 between utility and non-utility.<sup>24</sup>

5 **Miscellaneous A&G Expenses and Internal Accounting Audit**

6 **Q. What is the Company's response to Public Counsel's testimony**  
7 **regarding other miscellaneous A&G expenses, and the Company's Internal**  
8 **Accounting Audit of A&G expenditures?**

9 A. With regard to the accounting audit, the Company has complied with the  
10 past two Commission orders in which this Commission ordered Avista to complete an  
11 internal accounting audit of A&G expenses and report those findings to the Commission.  
12 In the Company's 2011 general rate case proceeding, Dockets UE-110876 and UG-  
13 110877, the Company provided the results of the 2010 Internal Accounting Audit of A&G  
14 expenditures completed in early 2011. This report explained what the Company was doing  
15 to improve its accounting records and treatment of utility versus non-utility expenditures,  
16 and the proper allocations between services and jurisdictions.

17 Again, in the Company's direct filing in this proceeding, Ms. Andrews included  
18 Exhibit No. \_\_ (EMA-4) providing the results of the 2011 Internal Accounting Audit of  
19 A&G expenses completed in February of 2012. This report showed the amount of the  
20 errors totaled approximately \$12,530. This amount was included as a reduction to expense  
21 within the Company's direct filing. The report also detailed improvements that have been  
22 made by the Company in certain areas during 2011 (see Exhibit No. \_\_ (EMA-4), page 5),

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<sup>24</sup> UE-090134/UG-090135, Order 10, at paragraph 136 and 137, pages 56 and 57.

1 such as formal training provided to the Company's employees; accounting guidelines  
2 which were developed, communicated, and made available to all employees; new detective  
3 controls, including the review of specific accounts and expenditure types, which were  
4 implemented in 2011; and experts within the Company were identified as a resource for  
5 employees to provide departments with guidance and support to ensure compliance with  
6 the Company's accounting guidelines.

7 As discussed by Ms. Andrews in her direct testimony, the revenue requirement  
8 calculations provided by Ms. Andrews included a "Miscellaneous Adjustment," which  
9 removed or reallocated of A&G expenses as a result of extensive analysis of 2011 test  
10 period results by Rate Department personnel, which also included the Internal Audit  
11 Report findings.

12 Going forward, although the Company cannot guarantee that errors for these types  
13 of costs or expenses will never occur (given the universe of 670,000 accounting  
14 transactions within Accounts 400-935), the Company believes it has taken, and continues  
15 to take, steps to minimize the accounting errors found in its test period results. This good  
16 faith effort is evident from the reduction in expenses needing removal from the Company's  
17 test period results as identified in the Company's direct filing; and even those identified by  
18 Public Counsel through their extensive audit efforts during the discovery process in this  
19 proceeding were relatively small.

20 The specific expenses which the Company agreed were charged to the utility rather  
21 than non-utility in error, totaled \$7,000 electric and \$6,000 natural gas<sup>25</sup>. Other expenses  
22 claimed to be charged to inappropriate utility expense accounts by Public Counsel, instead

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<sup>25</sup> This includes the compensation study error of \$5,000 electric and \$1,000 natural gas charged to Utility rather non-utility accounts, noted by Mr. Coppola at Exhibit No. \_\_ (SC-17CT), page 13, lines 6-9.

1 of energy efficiency (or DSM) programs, totaled \$3,000 electric and \$17,000 natural gas.  
2 Additional expenditures related to A&G (not including items such as incentives,  
3 compensation, or D&O insurance noted above) totaled \$170,000 electric and \$41,000  
4 natural gas, all of which would have been contested by the Company through litigation.

5 Staff witness Mr. Keating provided important perspective in his direct testimony in  
6 this proceeding at Exhibit No. \_\_T (EJK-1T), page 16, line 1, through page 17, line 12:

7 The Company's accounting for these items [A&G expenses] has been the subject of  
8 controversy over the past few rate cases, and the Company has made changes to its  
9 accounting procedures and it has trained its employees on these new systems.  
10 ...The Internal Audit concluded that the appropriate accounting and allocation of  
11 utility expenditures in Subset A was not occurring within the tolerable rate, while  
12 Subset B was within the tolerable rate. ...It is noteworthy that the majority of the  
13 errors were the result of booking expenditures to the wrong FERC Account or  
14 Service, not booking amounts to regulated operations rather than unregulated  
15 operations, or vice versa. While it is reasonable for the Commission to expect  
16 improvement in this area, it is not reasonable to expect perfection. The cost of  
17 improvements needs to be weighed against the benefits. This adjustment is  
18 important, but more for principle than materiality.  
19

20 **Q. Does this conclude your pre-filed rebuttal testimony?**

21 A. Yes.