Exhibit No. CSH-10T
Dockets UE-160228/UG-160229
Witness: Christopher S. Hancock

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-160228 and UG-160229 (*Consolidated*)**

CROSS ANSWERING TESTIMONY OF

CHRISTOPHER S. HANCOCK

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Response to the Testimony of Glenn Watkins and Bradley Mullins

September 19, 2016

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I. INTRODUCTION

Q. Are you the same Christopher S. Hancock who testified previously in this case?

A. Yes.

Q. What is the purpose of your cross-answering testimony?

A. I am responding generally to the attrition-related testimonies of Mr. Glenn Watkins of Public Counsel, and Mr. Bradley Mullins, of ICNU and NWIGU.

II. RESPONSE TO THE TESTIMONY OF GLENN WATKINS

Q. Please summarize your response to Mr. Watkins' testimony.

A. First, Mr. Watkins' reliance on general inflation rates is unreasonable. The same Bureau of Labor Statistics (BLS) that publishes the general inflation data also provides utility-specific data. The BLS's utility-specific data is a more applicable and reasonable gauge of cost pressures facing Avista. Indeed, the BLS publishes utility-specific data *because* it is more relevant to utilities.

Second, Mr. Watkins' discussion of truly competitive markets is not relevant to Avista's current situation.

A. CPI is Not a Fair Comparison to the Company's Labor Costs in this Case.

Q. Mr. Watkins mentions the rate of inflation throughout his testimony. What is inflation?

A. Inflation is a process of continually rising costs. There are numerous ways of measuring inflation.

Q. What measure of inflation is Mr. Watkins using?

A. Mr. Watkins is using the Consumer Price Index, or CPI.[1]

Q. What is the CPI measuring?

A. The CPI is "a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services."[2] This measure of inflation attempts to capture "inflation as experienced by consumers in their day-to-day living expenses."[3] The goods and services in the CPI basket comprise over 200 categories of items arranged into eight major groups. Examples of some of the items in these categories are: breakfast cereal, rent of primary residences, men's shirts, new vehicles, prescription drugs, televisions, college tuition, and tobacco and smoking products.

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[1] Watkins, Exh. No. GAW-1T 5.
[2] "Consumer Price Index Frequently Asked Questions," U.S. Department of Labor, Bureau of Labor Statistics, last modified June 29, 2016, http://www.bls.gov/cpi/cpifaq.htm#Question_1.
[3] *Id.* at http://www.bls.gov/cpi/cpifaq.htm#Question_12.

Q. Why is CPI an inappropriate measure in this case?

A. Utilities do not eat breakfast cereal, or smoke cigarettes, or attend college.

The CPI is a good tool for evaluating the rise and fall of costs that consumers like you and I face. The CPI is not an ideal tool for measuring the rise or fall in costs that utilities face. The CPI is a particularly inappropriate tool in this case because the BLS also publishes utility-specific labor cost data.

Q. Is there a better measure of inflation for labor costs facing utilities?

A. Yes. The Employment Cost Index (ECI) is also collected and maintained by the Bureau of Labor Statistics, and is a very good measure of labor costs. The Bureau of Labor Statistics also reports the ECI specific to utilities. Utility-specific ECI data is a much better measure of inflation for labor-related utility costs than the CPI.

For non-labor costs, the Producers Price Index specific to utilities (which is also used in Staff's attrition anaylsis) is also a much better measure than the Consumer Price Index, for similar reasons.

Q. Mr. Watkins notes that Avista's employee wages have grown at a faster rate than CPI.[4] How does the growth in Avista's employee wages compare to the ECI?

A. The growth in Avista's wages[5] in both natural gas and electric service look much more reasonable when using the ECI. Between 2007 and 2015, the Employment

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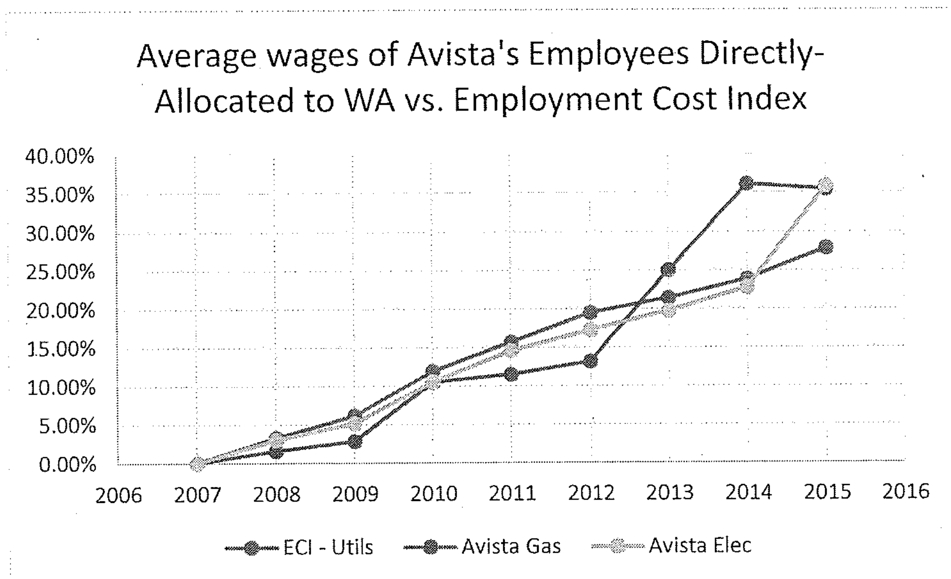
[4] Watkins, Exh. No. GAW-1T 17, 28.

[5] Here and in Mr. Watkins's testimony, wages are measured as average wage per employee for employees directly assigned to Washington.

Cost Index for Utilities grew 27.12% – almost twice as much as the 14.30% growth seen in Consumer Price Index. This discrepancy highlights the importance of choosing the most reasonable measure of inflation when making these comparisons.

It is important to note, though, that Avista's employee wages still outpace the ECI over this time. The graphic below illustrates this, using data on wages from Mr. Watkins's testimony.

Illustration 1



B. Avista Does Not Operate Under True Competition.

Q. In addressing Avista's rising costs, Mr. Watkins argues that "under true competition, a firm may not increase prices simply because its individual cost of providing service increases." Do you have any comments on this?

A. Yes. While Mr. Watkins is correct, the statement is irrelevant. We should acknowledge that Avista is not a business operating in an industry with "true competition." If utilities were competitive, there would be no need for the ratemaking process; the workings of a competitive marketplace would sort everything out for us.

A more relevant point made by Mr. Watkins is: "In competitive markets, prices may only change when the costs of <u>all producers</u> in that industry increase or decrease." (Emphasis added.) Avista operates as the single provider in a business that is a natural monopoly. In Avista's service territory, it *is* "all producers." Thus, if Avista's cost increases are prudent and reasonable, then, as the only producer in its market, the price the Company charges for its services should also increase. Avista's current rate request should be understood in that context.

III. RESPONSE TO THE TESTIMONY OF BRADLEY MULLINS

Q. Please summarize your response to Mr. Mullins' testimony.

A. Mr. Mullins' attrition study is arbitrary and seemingly engineered to produce similar results to that of his more traditional revenue requirements study.[6]

Q. Is Mr. Mullins' study consistent with the basic methodology approved in the Commission's Order 05 in Avista's last rate case?

A. No. The premise of the models approved in Avista's last rate case was that historical data could be extrapolated to provide insight on the revenue requirements for the company in the rate-effective period. This extrapolating was appropriate if the data

[6] The fact that the results of Mr. Mullins's attrition study closely match that of his "Traditional" approach is put forth as evidence of its reasonableness. Mullins, Exh. No. BGM-1CT 13.

was drawn from a consistent period of time, and if the data showed a reasonably strong relationship with the passage of time. Mr. Mullins's attrition study does not have this feature.

Q. What is so arbitrary about this approach?

A Mr. Mullins concedes that his model does not "adhere to any bright-line rules"[7] for historical periods or the escalation factors produced from those historical periods. The result is an *ad hoc* mismatch of subjective judgments. For instance, to derive some escalation factors, Mr. Mullins uses a 2005-2015 period, whereas for others he uses a 2009-15 period, and for yet others a 2013-15 period. The escalation factors do not follow any standard for "what degree of closeness was evidence of a trend."[8] Without a consistent methodology, there is no consistent definition of a trend. Instead, a trend in Mr. Mullins's attrition model is much like beauty, in that it is in the eye of the beholder.

Q. Can you provide an example of this?

A. Yes. As one example, please refer to Exhibit No. BGM-3, page 5. The line of best fit shown here is over only three data points. Mr. Mullins notes in his accompanying narrative that this line produces "a higher r-square value than any other period." But the high r-square value is largely a mathematical mirage because it is the result of using only three data points.

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[7] Mullins, Exh. No. BGM-1CT 19.
[8] Mullins, Exh. No. BGM-1CT 18:22.

A line that used only two points would, in fact, have the highest r-square value possible: 1.0. *Any* line connecting *any* two points in *any* data series would have this characteristic. The high r-square value Mr. Mullins finds for this particular data series says much more about how small his chosen sample is than it does about the predictive power of the resulting line of best fit.

This is a great example of why it is almost always more appropriate to use the same historical period for all items that are escalated, rather than a three-year period for some items and a twelve-year period for others. This is also a good example of why objectivity requires standards for what constitutes an appropriate line of best fit *prior to performing any analysis.* Establishing standards *after* or *while* performing the analysis amounts to selective data mining.

Q. Mr. Mullins argues that authorizing a "post-attrition adjustment" for a particular capital project after that project has been given pro forma treatment in the Traditional ratemaking method amounts to double-counting.[9] Do you agree?

A. No. The attrition study is a <u>separate</u> exercise in estimating the rate base, expenses, and revenues likely to be present in the rate-effective period. As a result, performing a pro forma adjustment to the Traditional method has no bearing on whether the capital project in question is reflected in the unadjusted rate base figures in the attrition study. [10]

[9] Mullins, Exh. No. BGM-1CT 23.
[10] Here I am assuming that an attrition allowance is found as the difference between the attrition study result and the result of the Traditional modified historical test year.

Q. Mr. Mullins states that it is appropriate to remove abnormal and major projects from the historical record when developing escalation rates.[11] Do you have any comments on this idea?

A. Yes. This idea has some intuitive appeal but turns out to be mathematically unnecessary and overly subjective. If we strip the historical data of so-called abnormal items, the task then becomes retroactively defining an abnormal project all the way back to 2007. It is not clear what criteria Mr. Mullins used in determining which projects were abnormal. It appears that only Project Compass met Mr. Mullins's standard.

Staff considered this issue in developing its own attrition study. Instead of attempting this messy and fraught task, Staff accepted the historical data on plant growth as it was. This avoided subjective judgments for distinguishing between which projects were appropriate to consider as part of a historical trend and which ones were not. Equally important, the unadulterated data showed statistically-significant and consistent trends anyway. The data was therefore statistically reliable and appropriate for developing escalation factors.

In other words, the presence in the historical data of projects that may be seen by some parties as being abnormal did not result in the data producing insignificant trends. Instead, the unadulterated data showed robust consistency with respect to plant growth over time.

It is also worth noting that Staff's approach, which does not remove so-called abnormal projects from the historical data, produces a higher bar for the Company to

[11] Mullins, Exh. No. BGM-1CT 24.

clear for consideration of pro forma adjustments to the attrition study rate base ("post-attrition adjustments"). Mr. Mullins's approach actually favors, or at least invites the potential for, more "post-attrition adjustments" because more "post-attrition" adjustments could be rationalized for any individual projects that deviate from the historical trend. Staff's approach only gives pro forma treatment to the known and measurable plant additions that are above and beyond what the historical trend would suggest.

Q. Mr. Mullins also argues that if post-attrition adjustments are entertained, the time over which rate base is escalated should be reduced. Do you agree?

A. No. Mr. Mullins's proposal for reducing the escalation period to counter the acceptance of a "post-attrition adjustment" is simply a means of reducing the resulting rate base figure. The number of years to escalate is immutably tied to the period over which we intend to estimate.

Staff and Avista both produce estimates of figures for the 12 months ending December 2017, and the 12 months ending June 2018. Staff and Avista used an escalation factor based on two years in their respective attrition studies because Staff and Avista are producing an estimate for two years in the future – for the tweleve months ending December 2017. Similarly, the purpose in escalating over two-and-a-half years (for the twelve months ending June 2018) is to produce an estimate of figures likely to be present in two-and-a-half years. The period of time over which escalations are made does not lend itself to usage as a bargaining chip.

A pro forma adjustment to the results of this escalation (a "post-attrition adjustment") is made to more accurately capture the rate base levels likely to be present during the rate-effective period, beyond what the historical trend would suggest. There is no reason to then reduce the escalation period to offset such an adjustment; in fact, doing so defeats the purpose.

Q. Does this conclude your testimony?

A. Yes.