Exh. CSH-7T
Dockets UE-170485/UG-170486
Witness: Christopher S. Hancock

BEFORE THE WASHINGTON
STATE UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-170485 and UG-170486 (*Consolidated*)**

CROSS-ANSWERING TESTIMONY OF

Christopher S. Hancock

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Response to Testimony of Bradley Mullins and Mark Garrett

December 1, 2017

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I. INTRODUCTION

Q. Are you the same Christopher S. Hancock who provided testimony in this proceeding, Exh. CSH-1Tr (revised November 6, 2017), on behalf of Commission Staff?

A. Yes.

II. SCOPE OF TESTIMONY

Q. What is the purpose of your testimony?

A. In this cross-answering testimony, I will respond to the response testimonies of Mr. Bradley Mullins, representing NWIGU/ICNU, and Mr. Mark Garrett, representing Public Counsel.

Q. What topics will you address?

A. Both witnesses address topics that merit a response from Staff. Those topics are:

- Party descriptions of Avista's rate plan as an "attrition adjustment."
- Avista's pending depreciation study.
- Avista's pending merger with Hydro One Limited ("Hydro One"), and how it relates to a potential rate plan.

Q. Will you be amending any conclusions or recommendations from your initial testimony, Exh. CSH-1Tr?

A. No.

III. THE PROPOSED RATE PLANS ARE NOT ATTRITION ADJUSTMENTS

Q. Mr. Garrett and Mr. Mullins both characterize Avista's rate plan as an "attrition adjustment." See, e.g., Garrett, Exh. MEG-1T at 2:20-3:1; Mullins, Exh. BGM-1T at 13:19-21. Do you agree that Avista's rate plan includes one or more attrition adjustments?

A. No. Avista's rate plan includes no attrition adjustments. Staff's rate plan also includes no attrition adjustments.

Q. What is an attrition adjustment?

A. In its final order in Avista's 2015 general rate case, the Commission explained that an attrition adjustment "is a discrete adjustment to the modified historical test year that the Commission may use when it determines attrition is present."[1] In a footnote, the Commission emphasized that the adjustment is an add-on to the revenue requirement developed using a modified historical test year, *for the first year of rates*:

> When developing an attrition adjustment, parties first provide a revenue requirement analysis based on a modified historical test year. Parties then perform an attrition study to determine the utility's

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[1] *Wash. Utils. & Transp. Comm'n v. Avista Corp. d/b/a Avista Utils.*, Dockets UE-150204 and UG-150205, Order 05, Final Order Rejecting Tariff Filing, Accepting Partial Settlement Stipulation, Authorizing Tariff Filings, p. 19, ¶ 47 (Jan. 16, 2016).

> revenue requirement in the rate year. The attrition adjustment is the difference between the revenue requirement provided by the modified historical test year and the revenue requirement provided by the attrition study.[2]

In other words, an attrition adjustment is an adjustment designed to make up for a revenue insufficiency that remains after developing a modified historical test year revenue requirement. It is an additional source of revenues provided for in the first year of rates, based on a Commission finding that revenues developed from a modified historical test year approach will not provide a utility with the opportunity to achieve its authorized rate of return.

This is *not* the case with Avista's rate plan model, and it is definitely not the case with Staff's proposed rate plan. Avista's rate plan model, and Staff's, develop revenue requirements for the second and third years of the rate plan. These models do not produce revenue requirement figures for the first year of rates, or any adjustment to the revenue requirement for the first year of rates.

Instead, both Staff and Avista develop first year revenue requirements through a modified historical test year. Staff's approach in developing the revenue requirement for the first year of rates is distinguished by the use of traditional *pro forma* adjustments, whereas Avista's approach uses *pro forma* adjustments in a more indiscriminate manner.[3] The result is that Staff and Avista develop revenue requirements in years two and three by escalating from substantially different escalation bases.

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[2] *Id.* at 19, ¶ 47 n.60.
[3] Hancock, Exh. CSH-1Tr at 24:20-21.

Q. How do you reconcile this with your statement that "one of the primary purposes of a multi-year rate plan" is to "combat attrition?"[4]

A. Here, it is helpful to return to the definition of attrition: "a scenario in which a utility's costs grow at a faster rate than the utility's revenues, thus eroding the regulated utility's opportunity to achieve a reasonable rate of return."[5] A multi-year rate plan combats attrition by providing for revenues that maintain the Company's opportunity to achieve a reasonable rate of return in the years subsequent to the rate year without requiring additional general rate proceedings.

Q. How do Mr. Garrett and Mr. Mullins misuse or misinterpret this concept when characterizing Avista's rate plan as an "attrition adjustment?"

A. I believe Mr. Garrett and Mr. Mullins have mistakenly focused on the fact that attrition studies in the recent past, and Avista's rate plan model in this case, both use Commission Basis Reports as their foundation. Similarly, past attrition studies and Avista's rate plan model (as well as Staff's in this case) develop estimates of required revenues in future periods based in part on the historical growth rate of certain types of costs.

However, the key distinction remains: in past attrition studies, an attrition adjustment was developed and added to the modified historical test year revenue requirement result for the first year of rates. Avista's rate plan model (as well as Staff's) do not use these Commission Basis Report-based models to develop revenue requirements, or adjustments to the revenue requirement, for the first year of rates.

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[4] Hancock, Exh. CSH-1Tr at 13:4-5.
[5] *Id.* at 7:19-23.

Instead, the rate plan models only develop revenue requirement increases for years beyond the first year of rates.

Finally, in the case of Staff's rate plan, Staff consciously embraces the regulatory lag produced by using a modified historical test year. An attrition adjustment does quite the opposite; it *minimizes* the effects of regulatory lag in the first year of rates.

IV. AVISTA'S PROPOSED MERGER WITH HYDRO ONE

Q. Is this docket the appropriate venue for merger-related issues?

A. No. The appropriate docket is U-170970. Any changes in Avista's costs of providing service to customers due to a merger should be handled in that docket.

Q. Public Counsel's witness, Mark Garrett, cites the proposed merger as a basis for the Commission to reject a rate plan. What is your understanding of Mr. Garrett's argument?

A. Mr. Garrett summarizes that his testimony "merely points out that, based upon Avista's own statements, it is premature to lock in Avista's projected rate increases in anticipation of a merger that could make those increases unnecessary."[6] Presumably, Mr. Garrett will advance this same objection to Staff's endorsement of a multi-year rate plan.

[6] Garrett, Exh. MEG-1T at 14:20 n.16.

Q. Is the proposed transaction relevant to the rate plan?

A. No. Again, Docket U-170970 is the appropriate venue to fully explore the impacts of Avista's proposed acquisition by Hydro One. The Commission can only approve the proposed transaction if it finds that the transaction would provide a net benefit to Avista's customers.[7] Accordingly, parties to that docket will have an opportunity to evaluate the cost savings, if any, provided by the acquisition.

Q. How can the financial or "pocketbook" benefits of a merger be delivered to customers?

A. In the long run, the "pocketbook" benefits of a beneficial merger are delivered to customers in the form of lower costs to operate the utility, and thus lower rates. However, in the short to medium term, utilities often deliver benefits to customers in the form of a rate credit.

Avista is proposing to provide rate credits to customers as part of its proposal in Docket U-170970. Should the Commission find that Hydro One's proposed purchase of Avista is likely to lower the cost of providing service to Avista's Washington customers in the rate plan years, the Commission can order that those benefits manifest themselves to customers in the form of rate credits, including expanded rate credits.

Q. Does a multi-year rate plan complicate the determination of benefits to customers?

[7] RCW 80.12.020(1).

A. No. The Commission would face the question with or without a multi-year rate plan. A rate plan does not introduce any considerations that the Commission would otherwise face regarding the proposed acquisition.

Q. Are Avista's costs likely to significantly change during the course of the rate plan, in a manner that is attributable to the proposed merger?

A. It is hard to say for certain, particularly because the effect of the merger on costs has yet to be fully considered, and that consideration will not occur through this proceeding. However, Avista expects that most of the benefits of the proposed merger will take many years to materialize.

Q. Is it a sure thing that the proposed merger will occur?

A. No. The proposed merger must clear regulatory hurdles with several regulatory agencies, including this one. The parties to the proposed merger have requested that the Commission reach a decision on this matter on or before August 14, 2018.[8] This is the same date as the Statutory Deadline in the Procedural Schedule in Docket U-170970.

Q. Can you summarize your testimony regarding a rate plan in the face of a possible acquisition?

A. Yes. First, short-term benefits to customers of acquisitions are typically delivered in the form of rate credits, and the appropriate venue for assessing benefits to customers

[8] Docket U-170970, Morris, Exh. SLM-1T at 2:17-19.

of an acquisition is the docket pertaining to that matter. Changes in the cost to provide utility services to customers that are attributable to a merger or acquisition typically manifest themselves after several years, rather than immediately. And finally, the Commission should not presume the outcome of the proposed acquisition of Avista by Hydro One in the present docket.

V. AVISTA'S PENDING DEPRECIATION STUDY

Q. Mr. Mullins and Mr. Garrett mention Avista's pending depreciation study as a reason to reject the proposed rate plan. What are your thoughts?

A. Staff shares these witnesses' regrets that Avista did not complete and submit its depreciation study prior to or with this general rate case filing. Filing such a depreciation study prior to or in this docket would have provided the Commission an opportunity to update depreciation rates on assets such as those at Colstrip Generating Station. Nevertheless, the Commission should authorize Staff's rate plan without concern for the Company's pending depreciation study.

Q. Please elaborate on Staff's perspective.

A. Ideally, Avista would file its depreciation study just prior to its general rate case so that the revised depreciation expense can be reflected in rates in a timely manner. However, the Commission can establish rates based on the most recent depreciation study. Commission practice has been to require that the depreciation study used to set rates in a general rate case must have been approved within five years of the test year used in the general rate case. That is true of this case, which uses calendar year 2016 as the test year and a depreciation study from 2012.

Q. What does Staff expect the results of the coming depreciation study to be?

A. Generally, Staff expects Avista's pending depreciation study will show an increase in electric depreciation expense, due to a shorter economic life for coal-fired plants.

Q. Please differentiate between "depreciation expense" and "depreciation rate."

A. For our purposes here, depreciation <u>expense</u> refers to expenses recognized as a given year's measure of consumption of a long-lived asset. Depreciation expense is appropriate for recovery from customers through the revenue requirement. Depreciation <u>rate</u> refers to the percentage rate at which an asset is decremented each year to achieve an expected future value at the end of an asset's useful life.

Q. Does Avista propose to account for the difference between the test year depreciation expense in this general rate case, and the depreciation rates (and consequent expenses) filed for approval in a future docket concerning the forthcoming depreciation study?

A. No, not in the present dockets. The Company states an intention to file for updated depreciation rates, which, if approved, would require it to reflect those new depreciation rates on their regulated books. Avista has proposed such a filing, in its response to the data request referenced by Mr. Garrett and Mr. Mullins.[9]

[9] Mullins, Exh. BGM-7 at 3 (Avista response to ICNU Data Request No. 49).

Specifically, the Company responded: "The Company is currently in the process of performing its next depreciation study and intends to file, by the end of the year, an application for the approval of updated depreciation rates associated with the study."

Q. Does Staff believe that the updated depreciation study will be filed by the end of the year?

A. In recent conversations, company representatives have indicated to me that the depreciation study may not be completed until after the end of the year.

Q. What if the coming depreciation study suggests that depreciation rates should be higher than what is currently in effect?

A. The Commission could accept, reject, or modify the Company's request to increase depreciation rates, presuming the Company elects to make such a request. Regardless of the Commission's decision on the appropriateness of proposed depreciation rates in such a filing, no change would be made in the Company's revenue requirement, and none would be called for.

Instead, the Commission would order the Company to adjust its ratemaking books to reflect these new depreciation rates. These new depreciation rates can later be incorporated into the Company's revenue requirement through an increase in depreciation expense in a future general rate case filing. In the interim, the Company would recover revenues from customers towards depreciation expense that are commensurate with the depreciation study from 2012, while the books reflect the newer depreciation rate. In such a scenario, rate base balances in a future rate case will be lower than what they would be if the Company were to not file a new depreciation study at all.

Q. Is this an appropriate rate-making practice?

A. Yes. The Company accepted this risk when it filed its general rate case. The Company could have elected to conduct a depreciation study sooner, so the findings of the study could be captured in this rate case filing. Or, the Company could have chosen to file a general rate case sometime next year, after the new depreciation study was filed and approved. It chose neither of these options. The company controls whether to conduct a depreciation study, when to perform one, when one is filed, when to file a general rate case, and what test year is used in a general rate case. Despite all of that, the Company chose to file a general rate case with a depreciation study from 2012 as the "acting" depreciation study.

Q. Does this conclude your testimony?

A. Yes.