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Witness: Julia Frayer
Request from: Public Utilities Regulatory Authority

Question:

(OM&A PFP AND S-FACTOR) Exhibit CLP-PBR-3 and Interrog. Resps. OCC-444. LEI's econometric benchmarking model uses pooled Ordinary Least Squares (OLS) with a linear time trend and heteroskedasticity-robust standard errors.

a. Because the dataset contains repeated annual observations for the same utilities, re-estimate the models using fixed effects in place of the linear time trend and standard errors clustered at the utility level. Use the estimated utility fixed effects to construct an industry-level benchmark and compare the Company's cost performance to that benchmark. Explain how the industry-level benchmark is constructed from the utility-specific effects and provide the Company's resulting efficiency gap.
b. Provide the resulting coefficient estimates, standard errors, model fit statistics, and Company benchmarking results, and compare them with the results from LEI's originally submitted specifications.

Response:

a. This is a time-consuming request that could not reasonably be completed during the discovery process. More importantly, it is LEI's expert opinion that such analysis is not likely to yield reliable results. LEI considered a utility fixed-effects specification during preliminary development of the econometric models. However, given the size of the benchmarking sample (88 EDCs), such a model specification would have required introduction of 87 utility-specific indicator variables in addition to the business drivers. This would materially reduce the degrees of freedom available to estimate the relationships between costs and the selected explanatory variables, resulting in less reliable statistical estimates in the context of benchmarking.

   In order to support a fixed-effects specification with a larger number of utility-specific effects, LEI would need to extend the study period substantially further back in time, thereby introducing older data into the benchmarking sample. LEI does not consider this preferable because an econometric benchmarking study should reflect the current efficiency of an individual firm relative to other firms in the industry. LEI's selected 10-year study period therefore strikes a balance between using sufficiently recent data to provide a current measure of relative cost performance and using a sufficiently long period so that the results are not unduly influenced by events or conditions affecting only a single

year. As a result, LEI did not proceed with a utility fixed effects specification and instead selected specifications that provided more reliable and interpretable estimates of relative cost performance across EDCs.

b. LEI could not reliably deploy a fixed-effects approach described in subpart (a) to construct an alternative cost-level benchmark.