

Exhibit No. (BGM-1CT)
Dockets UE-150204/UG-150205
Witness: Bradley G. Mullins

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	DOCKETS UE-150204 and
TRANSPORTATION COMMISSION)	UG-150205 (<i>Consolidated</i>)
)	
Complainant,)	
)	
v.)	
)	
AVISTA CORPORATION d/b/a)	
AVISTA UTILITIES)	
)	
Respondent.)	

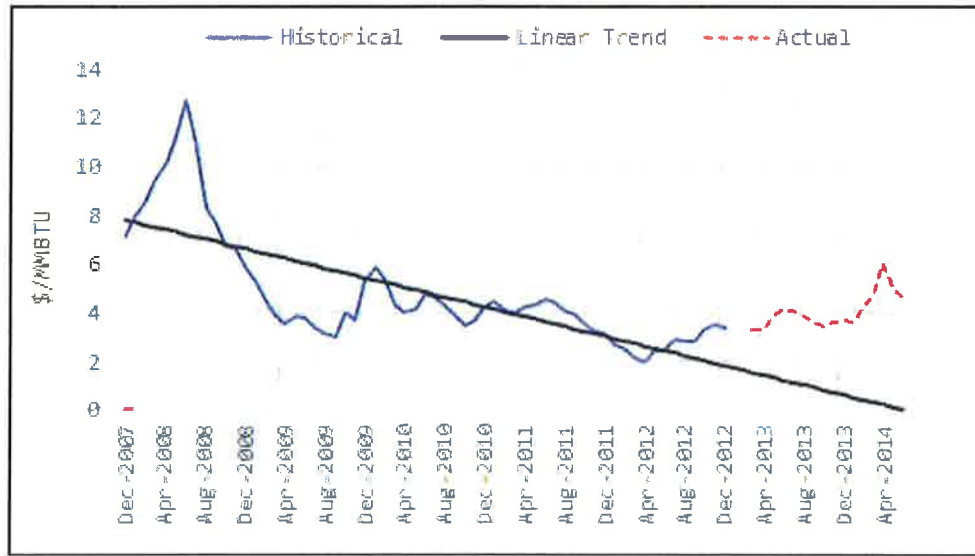
**REDACTED RESPONSE
TESTIMONY OF BRADLEY G. MULLINS**

ON BEHALF OF

THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

July 27, 2015

FIGURE 1
Henry Hub Natural Gas Prices
Trending Forecast Based On Pricing 2007 – 2012
(Source: Energy Information Administration)



- 1 **Q. DOES THE USE OF A TRENDING STUDY PENALIZE THOSE UTILITIES**
2 **THAT ARE WORKING TO CONTROL COSTS?**
- 3 A. Yes. A trend-based revenue requirement methodology is also flawed because only those
4 utilities with rapidly increasing costs and capital expenditures benefit from a trend-based
5 attrition allowance. A utility that is working hard to reduce its costs and prioritize capital
6 expenditures could, in fact, be penalized and subject to a negative attrition adjustment
7 under such a methodology. In its 2014 general rate case, representatives for Pacific
8 Power cited such reasoning in opposition to the use of a trend-based attrition allowance
9 methodology.^{21/} One of Pacific Power’s reasons in that case for not proposing an
10 attrition allowance adjustment similar to that proposed by the Company was that the
11 “existing mechanisms assume a consistent level of growth in the costs that PacifiCorp is

^{21/} Dockets UE-140762 *et al.*, Exh. No. ___RBD-1T at 11:8-17.

1 actively managing to control.”^{22/} It is bad policy to reward those utilities with rapidly
2 escalating costs, while penalizing those utilities that are undertaking efforts to control
3 costs. Such a policy will send a strong incentive for a utility to disregard cost controls
4 and to engage in unrestrained spending on capital projects.

5 **Q. DOES THE COMPANY HAVE AN INCENTIVE TO OVER-SPEND ON**
6 **CAPITAL IN ORDER TO INCREASE ITS EARNINGS?**

7 A. Yes. It has been widely documented that utilities subject to rate of return regulation have
8 an incentive to over-invest in capital in order to increase earnings.^{23/} This phenomenon is
9 often referred to as the Averch-Johnson Effect, based on the economists who first
10 developed the model to describe the phenomenon, and has a real and significant impact
11 on how utility operations are managed. For example, in presentations to shareholders,
12 utilities, including the Company, are often quick to point out the efforts undertaken to
13 increase rate base. In [REDACTED]

14 [REDACTED]

15 [REDACTED] According to Board minutes, [REDACTED]

16 [REDACTED]

17 [REDACTED]^{24/} Immediately following [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]^{25/}

^{22/} Id.
^{23/} See Harvey Averch & Leland L. Johnson, *Behavior of the Firm Under Regulatory Constraint*, 52 AM. ECON. REV. 996, 1052 (1962).
^{24/} Exh. No. ___ (BGM-4C) (the Company’s Response to ICNU DR 220C, Conf. Att. A at 75).
^{25/} Id. (the Company’s Response to ICNU DR 220C, Conf. Att. A at 76); accord id. (the Company’s Response to ICNU DR 220C, Conf. Att. A at 92).

1 **Q. DOES THE COMPANY’S FILING LEND ITSELF TO A CASE-BY-CASE**
2 **REVIEW OF ITS PROPOSED CAPITAL ADDITIONS?**

3 A. No. While the Company presented a voluminous amount of data for the 150 capital
4 projects proposed for 2015 and 2016, it would be impractical within the scope of the
5 evidentiary record in this proceeding for the Commission to evaluate the merits of each
6 and every pro forma capital project proposed by the Company. The Commission, by only
7 considering post-test-year rate base additions that are “major,” has traditionally not
8 performed the level of case-by-case review of pro forma capital additions requested by
9 the Company in this proceeding.

10 With respect to pro forma capital, the Commission has stated that “the amount
11 typically cannot be an estimate, a projection, the product of a budget forecast, or some
12 similar exercise of judgment – even informed judgment – concerning future revenue,
13 expense or rate base.”^{49/} In this case, however, the majority of capital items are not
14 discrete capital items which the Commission has any ability to review on the basis of
15 being known and measureable and used and useful. Rather, the majority of capital
16 amounts in question represent “blanket” budgets for non-discrete spending on particular
17 activities.

18 For example, the largest capital item under the category “Electric Transmission /
19 Distribution” in 2015 is for a project called “Reconductors and Rebuilds.”^{50/} The
20 Company budgeted \$14.2 million of capital spending for this category in 2015, yet it is
21 representative of a series of small projects, for which no meaningful review can take

^{49/} Id. at ¶ 167 (quoting WUTC v. PSE, Docket Nos. UE-090704 *et al.*, Order 11 ¶ 26 (Apr. 2, 2010)).
^{50/} Exh. No. ___(KKS-5), Att. No. ___ETD-11.