EXHIBIT NO. ____(KCH-1T)
DOCKET NO. UE-072300/UG-072301
2008 PSE GENERAL RATE CASE
WITNESS: KEVIN C. HIGGINS

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-072300** **Docket No. UG-072301** **(C*onsolidated*)**

PREFILED RESPONSE TESTIMONY OF KEVIN C. HIGGINS ON BEHALF OF NUCOR STEEL SEATTLE, INC.

May 30, 2008

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RESPONSE TESTIMONY OF KEVIN C. HIGGINS

Introduction

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. By whom are you employed and in what capacity?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. On whose behalf are you testifying in the gas portion of this proceeding, UG-072301?

A. My testimony in the gas portion of the proceeding, UG-072301, is being sponsored by Nucor Steel Seattle, Inc. ("Nucor"). Nucor owns and operates a steel mill in Seattle and takes gas transportation service from Puget Sound Energy, Inc. ("PSE") under Schedule 57.

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward the Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist

private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before this Commission?

A. Yes. I testified in the PSE 2006 and 2004 general rate cases and participated in the settlement discussions that resulted in partial settlement agreements pertaining to electric rate spread and rate design issues in those proceedings. I also testified in the interim phase of the PSE 2001 general rate case and participated in the collaborative process that led to the settlement agreement submitted by the parties to that general rate proceeding, which was subsequently approved by the Commission.

Q. Have you testified before utility regulatory commissions in other states?

A. Yes. I have testified in more than eighty proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arizona, Arkansas, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Utah, Virginia, West Virginia, and Wyoming.

A more detailed description of my qualifications is contained in Attachment A, appended to my response testimony.

Overview and Recommendations

Q. What is the purpose of your testimony in the gas proceeding?

A. My testimony addresses the cost-of-service and rate spread for PSE's gas distribution service. I recommend modifications to the Company's cost-of-service analysis and proposed rate spread in support of a just and reasonable outcome. I also comment on rate design for Schedules 57 and 87.

Q. Please summarize your conclusions and recommendations.

(1) PSE's cost-of-service study allocates Schedules 85, 87, 57, and special contract customers a much greater proportion of small main costs than is reasonable. As a result, PSE's study substantially overstates the revenue requirement responsibility for these rate schedules. PSE's treatment of small mains in this case is inconsistent with the Company's prior practice and is unreasonable because it lacks a basis in cost causation.

(2) PSE has proposed to increase rates for Schedules 87 and 57 customers in excess of 20 percent. This is almost wholly attributable to the change in the formulation of PSE's cost-of-service study. In short, these customers are facing a very large rate increase proposal from the Company because they are being allocated a significant share of costs for a portion of the distribution system that they fundamentally do not use.

(3) I recommend modifying PSE's cost-of-service study to correct the undue weighting being given to small mains in the allocation of distribution main costs to larger customers. My alternative is designed to change as little of PSE's approach as possible. I adopt the same initial four steps used by PSE in its study, but modify the Company's fifth step by constraining the allocation of small mains to Schedules 85, 87, 57, and special contract customers to the amount of small mains directly assigned to these customers in the allocation of peak demand.

(4) Constraining the allocation of small main costs to larger customers in the allocation of average demand significantly reduces the costs allocated to Schedules 87, 57, and special contracts. Under the Company's study, Schedule 87 requires a 27.15 percent increase to achieve parity at the Company's requested revenue requirement. In contrast, under my recommended alternative approach, Schedule 87 warrants a 15.94 percent *decrease*. Residential customers move from a parity ratio of 1.01 under the Company's approach to 1.00 under my approach -- a very small change.

(5) Because the Company's cost-of-service study significantly over-allocates costs to Schedules 87 and 57, the Company's rate spread proposal should not be used for these rate schedules. In addition, the Company's rate spread proposal includes an inordinately low rate increase for Rentals (Schedules 71, 72, and 74) and CNG (Schedule 50) compared to their respective costs-of-service.

(6) At PSE's proposed revenue increase of $58.1 million, I recommend the following rate spread approach:

(a) There should be no rate change from current rates for those rate schedules with parity ratios greater than 1.30 [41, 85, 86, 87, Transport & Contracts].
(b) The rate increase for Residential customers should be the same as recommended by PSE. [17.5%]
(c) The percentage rate increase for Rentals (Schedules 71, 72, and 74) and CNG should be set equal to the percentage rate increase for Commercial & Industrial (excluding gas) to better reflect cost-of-service.
(d) The rate increase for Commercial & Industrial should remain approximately the same as recommended by PSE [25.3%].

(7) If the Commission reduces PSE's proposed 17.1 percent increase by up to 5.0 percentage points to 12.1 percent, then the reduction in rates should be applied pro-rata to the rate schedules experiencing an increase pursuant to my recommendation above. If the Commission reduces the Company's requested increase by more than 5.0 percentage points, then the incremental percentage reduction beyond 5.0 percent should be applied to <u>each</u> rate schedule.

(8) With respect to the rate design of Schedules 57 and 87, as I am recommending no revenue change for these rate schedules at PSE's requested revenue requirement, I am also recommending no change to the relationship between the demand and volumetric charges. If rates are reduced, then PSE's objective of a relative increase in demand charges relative to volumetric charges can be achieved by applying the rate reduction to the volumetric charge. If, notwithstanding my recommendation for no rate increase for these rate schedules, a rate increase is assigned to these rate schedules, then I recommend a proportionate increase in the demand and volumetric charges.

Gas Cost-of-Service Study – Allocation of Distribution Main Costs

Q. Before proceeding with your analysis, are there any overarching matters that should be noted?

A. Yes. As summarized on page 5 of the direct testimony of PSE witness Janet K. Phelps, PSE is proposing a major reconfiguration of its rate schedules pertaining to transportation service. The Company is proposing to close Schedule 57, Distribution System Firm and Interruptible Transportation Service (Optional), to new customers and to terminate the rate schedule on December 31, 2012. Current transportation customers are expected to migrate to new transportation service options under Schedules 31, 41, 86, 86, or 87, although some customers are expected to remain on Schedule 57 until its proposed termination at the end of 2012.

The implication for evaluating PSE's cost-of-service study is that the Company's study assumes adoption of its reconfiguration proposal. Thus, for example, the cost-of-service results for Schedule 57 customers are not the results for today's Schedule 57 customers, but for the residual group that does not migrate. Similarly, the cost-of-service results for Schedule 87 are not the results for today's Schedule 87 customers, but for Schedule 87 after projected in-migration from Schedule 57 (including, as it happens, Nucor). And so on.

When cost-of-service results are discussed below, the reader should bear in mind that the results assume the adoption of PSE's rate schedule reconfiguration proposal, unless specifically noted otherwise.

Q. Toward what aspect of PSE's cost-of-service analysis is your testimony directed?

A. My testimony focuses on the allocation of distribution main costs.

Q. What is the significance of the allocation of distribution main costs?

A. FERC Account 376, distribution mains (plant in service less accumulated depreciation), comprises 55% of PSE's gas distribution rate base. The allocation of these costs plays a major role in determining cost-of-service responsibility for the various customer classes using the gas distribution system.

Q. What approach did PSE use to allocate the costs of its distribution mains?

A As described in the direct testimony of Ms. Phelps, PSE used a Peak and Average methodology to allocate the costs of its distribution mains. The peak demand allocator was based on class usage during the system design day as determined through a flow analysis. 67 percent of the distribution mains cost was allocated on this basis. The remaining 33 percent of distribution mains cost was allocated based on average demand.

PSE's allocation approach is carried out in five major steps as summarized by Ms. Phelps on pages 31-32 of her direct testimony:

(1) Total distribution mains plant was divided into a portion to be allocated on a peak demand basis (67%) and a portion to be allocated on an average basis (33%).

(2) The peak demand allocation for customers served on Schedules 85, 87, 57, and special contracts was directly assigned based on the results of the flow analysis.

(3) The directly assigned portion was assigned a value based on plant cost data.

(4) The remaining portion of costs to be allocated on peak day demand was allocated to all other customer classes based on their estimated contributions to system design peak day demand.

(5) The 33 percent of costs allocated on the basis of average demand was allocated to all classes based on annual throughput, with the throughput of customers on Schedules 85, 87, 57, and special contracts constrained to equal lowest monthly usage multiplied by twelve.

Q. Do you have any concerns about the approach used by PSE?

A. Yes. I have serious reservations about the derivation of the average demand allocator in Step 5. The distribution mains being allocated include all mains – large and small. Yet there is little evidence that the customers on Schedules 85, 87, 57, and special contracts make much use of the small mains, specifically those mains less than four inches in diameter. In the allocation of peak demand costs, the relatively scant utilization of small mains by these customers is captured through the direct assignment of costs to these customers described in Steps 2 and 3, above. These results are summarized in Table KCH-1, below, which shows the proportion of large mains directly assigned to these customers in contrast to the proportion of small mains allocated to them.

Table KCH-1
Direct Assignment of Small Mains and Large Mains

	Small Mains < 4" Dia.		Large Mains >= 4" Dia.	
Pro Forma Schedule	Ft.	2007 $	Ft.	2007 $
57G-C	13	$350	2,959	$326,531
57G-I	9,910	204,228	54,840	5,290,056
85G-C2	4,613	121,789	10,763	998,151
85G-I2	770	20,714	6,817	480,773
85T-C	4,556	104,457	22,759	1,937,315
85T-I	639	12,403	25,553	2,015,426
87G-C3	112	2,895	2,622	204,951
87G-I3	310	5,732	2,695	213,547
87T-C	0	0	65	4,645
87T-I	10	244	31,369	4,993,019
SC	6,986	154,811	50,076	5,175,319
Total Direct Assignment	27,919	$627,623	210,518	$21,639,733

	Small	Large	Total
Estimated Percent of Total	43%	57%	100%
Total Acct 376 Plant in Service	$441,625,964	$592,915,348	$1,034,541,312
Direct Assignment to Total Costs Ratio	0.0003	0.0104	0.0108
Acct 376 Dollars from Ratio	$313,123	$10,796,143	$11,109,266
Percent	0.07%	1.82%	1.07%

As shown in the table above, collectively, customers on Schedules 85, 87, 57, and special contracts are directly assigned 1.82 percent of the system large mains on the peak day, but only 0.07 percent of the system small mains. This 26:1 relative disparity reflects the low level of utilization of small mains by these large customers.

In contrast, the average demand allocation apportions cost responsibility for small mains to these customers in direct proportion to their throughput as defined in Step 5 above. That is, they are being allocated cost responsibility for

the same proportion of system small mains as for system large mains – even though all indications are that these customers make very little use of the small mains. The result is that Step 5 allocates Schedules 85, 87, 57, and special contract customers a much greater proportion of small main costs than is reasonable. This, in turn, overstates the revenue requirement responsibility for these schedules in the cost-of-service results. The impact is significant because small mains comprise 43 percent of the distribution mains gross plant.

Q. Is the allocation of small main costs to these large customers on the basis of average demand a well-established practice by PSE before this Commission?

A. No. PSE's Response to Seattle Steam Data Request No. 017 details the history of PSE's proposed allocation of distribution mains over the previous three rate cases: 2001, 2004, and 2006.

In PSE's 2001 rate case, the Company used a Peak and Average allocation method. The cost of dedicated small mains was directly assigned to Schedules 85, 87, 57, and special contract customers, but small mains were excluded from any further allocation of costs to these customers. PSE justified this treatment because these customers did not utilize PSE's downstream distribution mains.

In PSE's 2004 rate case, the Company again used a Peak and Average allocation method. In this case, costs for Schedules 85, 87, 57, and special contract customers were directly assigned based on a flow analysis based on an average of actual weather for each day of the coldest month of the test year. No further allocation was made to these customers. Thus, while small mains were

part of the direct assignment, there was no additional allocation of small mains costs based on average demand.

In PSE's 2006 rate case, the Company used a Peak and Average approach as well. In this case, there was neither a direct assignment of small mains costs to Schedules 85, 87, 57, and special contract customers, nor an allocation of small mains costs to these customers.

Q. What do you conclude based on this review of previous cases?

A. I conclude that PSE's proposal in this proceeding to allocate small mains costs to larger customers based on average demand is inconsistent with the Company's prior practice. This change in the Company's approach in this case creates a major increase in the cost responsibility assigned to larger customers. In my opinion, this change is unreasonable as it lacks a basis in cost causation. As I will demonstrate below, PSE's change in the formulation of its cost-of-service study is the primary (if not sole) reason why Schedule 87 and 57 customers are facing a rate increase proposal in excess of 20 percent.

Q. Do you have a recommended alternative approach?

A. Yes. I recommend modifying PSE's approach to correct the undue weighting being given to small mains in the allocation of distribution main costs to larger customers. My alternative is designed to change as little of PSE's approach as possible. I adopt the same initial four steps used by PSE, but simply modify the fifth step by constraining the allocation of small mains to Schedules 85, 87, 57, and special contract customers to the amount of small mains directly assigned to these customers in the allocation of peak demand. This approach

recognizes that there is some utilization of small mains by these customers, but that it is very small.

Q. Have you re-calculated the results of PSE's cost-of-service study with this modification?

A. Yes. PSE made its cost-of-service model available subject to a license agreement, and I directed the re-running of the Company's study with the modification to Step 5 described above. The results are presented in Nucor Exhibit No.__ (KCH-1).

Q. What do these results show?

A. The results are summarized in Table KCH-2 on the following page. The results show that constraining the allocation of small main costs to larger customers in the allocation of average demand significantly reduces the costs allocated to Schedules 87, 57, and special contracts. Under the Company's study, Schedule 87 requires a 27.15 percent increase to achieve parity at the Company's requested revenue requirement. In contrast, under my recommended alternative approach, Schedule 87 warrants a 15.94 percent *decrease.* Similarly, Schedule 57 and special contracts goes from warranting a 4.33 percent decrease under PSE's study to a 31.73 percent decrease under my alternative.

Again, the only difference between the Company's study and mine is the treatment of small mains in the allocation of average demand costs. These results demonstrate that the adverse cost-of-service results for Schedule 87 customers in PSE's study is driven by the treatment of small mains in the allocation of average demand. In essence, Schedule 87 customers are facing a very large rate increase

proposal from the Company (discussed in the "Rate Spread" section below) because they are being allocated a significant share of costs for a portion of the distribution system that they fundamentally do not use.

Comparison of Cost of Service Study Results

PSE (As Filed)

	Current Earned Rate of Return	Base Curent Revenue	Rate Schedule Revenue Requirement @ Parity	Current Revenue to Cost Ratio	Parity Ratio	Revenue Increase/ (Decrease) Required to Achieve Parity	Percent Increase/ (Decrease) Required to Achieve Parity
Residential (16,23,53)	6.178%	$ 226,714,023	$ 262,693,487	0.86	1.01	$ 35,979,464	15.87%
Comm. & Indus. (31,36,51,61)	4.083%	65,386,783	86,096,724	0.76	0.89	20,709,941	31.67%
Large Volume (41)	15.965%	13,729,465	10,308,039	1.33	1.56	-3,421,426	-24.92%
Interruptible (85)	19.770%	6,557,084	4,452,266	1.47	1.72	-2,104,818	-32.10%
Limited Interruptible (86)	21.968%	3,542,875	2,212,765	1.60	1.87	-1,330,110	-37.54%
Non-Exclusive Interruptible (87)	4.971%	5,803,776	7,379,773	0.79	0.92	1,575,997	27.15%
Transport & Contracts	10.238%	3,908,922	3,739,512	1.05	1.22	-169,410	-4.33%
CNG Service (50)	-14.229%	28,932	160,208	0.18	0.21	131,276	453.74%
Rentals	-9.917%	7,788,789	13,188,899	0.59	0.69	5,400,110	69.33%
Total	5.983%	$ 333,460,649	$ 390,231,673	0.85	1.00	$ 56,771,024	17.02%

Nucor Modification to PSE Method

	Current Earned Rate of Return	Base Curent Revenue	Rate Schedule Revenue Requirement @ Parity	Current Revenue to Cost Ratio	Parity Ratio	Revenue Increase/ (Decrease) Required to Achieve Parity	Percent Increase/ (Decrease) Required to Achieve Parity
Residential (16,23,53)	5.960%	$ 226,714,023	$ 265,769,801	0.85	1.00	$ 39,055,778	17.23%
Comm. & Indus. (31,36,51,61)	3.876%	65,386,783	87,261,834	0.75	0.88	21,875,051	33.45%
Large Volume (41)	15.061%	13,729,465	10,659,316	1.29	1.51	-3,070,149	-22.36%
Interruptible (85)	32.053%	6,557,084	3,348,511	1.96	2.29	-3,208,573	-48.93%
Limited Interruptible (86)	20.693%	3,542,875	2,295,361	1.54	1.81	-1,247,514	-35.21%
Non-Exclusive Interruptible (87)	13.230%	5,803,776	4,878,605	1.19	1.39	-925,171	-15.94%
Transport & Contracts	20.015%	3,908,922	2,668,545	1.46	1.71	-1,240,377	-31.73%
CNG Service (50)	-14.201%	28,932	160,801	0.18	0.21	131,869	455.79%
Rentals	-9.917%	7,788,789	13,188,899	0.59	0.69	5,400,110	69.33%
Total	5.983%	$ 333,460,649	$ 390,231,673	0.85	1.00	$ 56,771,024	17.02%

Q. Do you have any additional evidence that Schedule 87 customers are being allocated costs for a portion of the distribution system that they fundamentally do not use?

A. Yes. In response to Nucor Data Request 002, PSE reran its cost-of-service study using the current configuration of rate schedules, i.e., without assuming that transportation service is re-configured pursuant to the Company's proposal along with the expected migration of today's Schedule 57 customers to Schedules 41,

85, and 87. As part of its Response, PSE showed the allocation of costs to various customer sub-groups, including today's Schedule 57 customers who would be expected to migrate to Schedule 87 under PSE's rate re-configuration proposal.

The Company's Response shows that the direct assignment of small mains to today's Schedule 57 customers who would be expected to migrate to Schedule 87 is negligible. In other words, these customers come very close to not using any part of the small main system whatsoever. Yet under the Company's cost-of-service study, in the allocation of average demand, these customers (as part of Schedule 87) are allocated the same share of system small main costs as they are of large main costs. As a consequence, the Company's study shows these customers warranting a 27.15 percent rate increase (as noted above) –and indeed PSE recommends an increase of 21.4 percent. This adverse rate impact is entirely driven by the unreasonable allocation of small main costs to these customers. As discussed above, correcting this problem shows these customers actually warrant a 15.94 percent rate *decrease*.

Q. Does adoption of your recommended alternative cost-of-service approach have a significantly adverse impact on any customer groups?

A. No. Table KCH-2 shows that Residential customers move from a parity ratio of 1.01 under the Company's approach to 1.00 under my approach. This is a very small change. There are also small reductions in the parity ratios for Commercial & Industrial customers, Schedule 41, and Schedule 86.

Q. Please summarize your recommendation to the Commission with respect to gas cost-of-service.

A. I recommend that the Commission adopt my modification to Step 5 of PSE's allocation of distribution main costs, in which the allocation of small mains to Schedules 85, 87, 57, and special contract customers is constrained by the amount of small main costs directly assigned to these customers in the allocation of peak demand. This modification will produce a more reasonable and equitable allocation of costs to customer classes.

Rate Spread

Q. What general guidelines should be employed in spreading any change in rates?

A. In determining rate spread, or revenue apportionment, it is important to align rates with cost causation, to the greatest extent practicable. Properly aligning rates with the costs caused by each customer group is essential for ensuring fairness, as it minimizes cross-subsidies among customers. It also sends proper price signals, which improves efficiency in resource utilization.

At the same time, it can be appropriate to mitigate the impact of moving immediately to cost-based rates for customer groups that would experience significant rate increases from doing so. This principle of ratemaking is known as "gradualism." When employing this principle, it is important to adopt a long-term strategy of moving in the direction of cost causation, and to avoid approaches that result in permanent cross-subsidies from other customers.

Q. What general approach to rate spread does PSE recommend?

A. PSE recommends moving in the direction of cost-of-service, but not in a single step. This is consistent with my statement of principle above.

Q. What rate spread has PSE proposed?

A. PSE's proposed rate spread is presented in its supplemental Exhibit No.__(JKP-16), p. 1. The results are also summarized in Table KCH-3, below. Note, for purposes of comparing inter-class rate impacts, I will refer to the rate impact excluding gas revenues, as that is the component of rates that is at issue in this proceeding. It is also the proper basis for making a rate impact comparison between transportation and sales service customers.

Table KCH-3
PSE Proposed Increase by Customer Class
Excluding Gas Revenues

Customer Class	Schedule	Revised Present Revenues	PSE Proposed Change	PSE Percent Change
Residential	23	$226,714,023	$39,565,099	17.5%
Commercial & Industrial	31, 61	65,386,783	16,547,389	25.3%
Large Volume	41	13,729,465	127	0.0%
Compressed Natural Gas	50	28,932	5,186	17.9%
Interruptible	85	6,557,084	(146)	0.0%
Limited Interruptible	86	3,542,875	(309,162)	-8.7%
Non-Exclusive Interruptible	87	5,803,776	1,272,247	21.9%
Transportation	57	2,319,556	570,577	24.6%
Contracts	SC	1,589,366	0	0.0%
Rentals	71, 72, 74	7,788,789	414,142	5.3%
Other Revenue		6,291644	0	0.0%
System Total		$339,752,292	$58,065,460	17.1%

Q. Do you have specific objections to PSE's proposed rate spread?

A. Yes. Generally, PSE's rate spread was guided by the results of its cost-of-service study. But as I discussed in the previous section, the Company's cost-of-service study over-allocates costs to several rate schedules, in particular

Schedules 85, 87, and 57. Fairness requires that this over-allocation be corrected prior to determining rate spread. This can be accomplished by adopting the modification to PSE's cost-of-service study I recommend in the previous section of this testimony. I recommend that the rate spread adopted in this proceeding reflect the results of my modification to the Company's cost-of-service study.

In addition, the Company's rate spread proposal includes an inordinately low rate increase for Rentals (Schedules 71, 72, and 74) and CNG (Schedule 50) compared to their respective costs-of-service. This results in an unwarranted subsidy from other customers.

Q. What approach to rate spread do you recommend?

A. In addressing this question, I will start by assuming that the Company's requested revenue increase of $58.1 million is adopted. This will allow a direct comparison between my recommended rate spread and that of PSE.

At a revenue increase of $58.1 million, I recommend the following:

(a) There should be no rate change from current rates for those rate schedules with parity ratios greater than 1.30 [41, 85, 86, 87, Transport & Contracts].

(b) The rate increase for Residential customers should be the same as recommended by PSE. [17.5%]

(c) The percentage rate increase for Rentals (Schedules 71, 72, and 74) and CNG should be set equal to the percentage rate increase for Commercial & Industrial (excluding gas) to better reflect cost-of-service.

(d) The rate increase for Commercial & Industrial should remain approximately the same as recommended by PSE [25.3%].

This proposal is presented in Nucor Exhibit No.__ (KCH-2) and summarized in Table KCH-4, below.

Table KCH-4
Nucor Proposed Rate Spread @ PSE Requested Revenue Requirement
Excluding Gas Revenues

Customer Class	Schedule	Revised Present Revenues	Nucor Proposed Change	Percent Change
Residential	23	$226,714,023	$39,565,099	17.5%
Commercial & Industrial	31, 61	65,386,783	16,524,654	25.3%
Large Volume	41	13,729,465	0	0.0%
Compressed Natural Gas	50	28,932	7,312	25.3%
Interruptible	85	6,557,084	0	0.0%
Limited Interruptible	86	3,542,875	0	0.0%
Non-Exclusive Interruptible	87	5,803,776	0	0.0%
Transportation	57	2,319,556	0	0.0%
Contracts	SC	1,589,366	0	0.0%
Rentals	71, 72, 74	7,788,789	1.968,395	25.3%
Other Revenue		6,291644	0	0.0%
System Total		$339,752,292	$58,065,460	17.1%

Q. What do you recommend if the revenue requirement approved by the Commission is less than that requested by PSE?

A. PSE's overall rate increase request is 17.1 percent (excluding gas). If the Commission reduces this overall increase by up to 5.0 percentage points to 12.1 percent, then the reduction in rates should be applied pro-rata to the rate schedules experiencing an increase pursuant to my recommendation above. If the Commission reduces the Company's requested increase by more than 5.0 percentage points, then the incremental percentage reduction beyond 5.0 percent should be applied to each rate schedule.

Q. Do you have an example of how this would work?

A. Yes. An example is presented in Nucor Exhibit No.__ (KCH-3). Assume PSE's requested increase was reduced from 17.1 percent to 9.1 percent, or 8.0 percentage points. The first 5.0 percentage point reduction would reduce the rate increase pro rata for the rate schedules receiving a rate increase [Residential, Commercial & Industrial, CNG, Rentals]. In this first step, the rate increase for Residential customers would be reduced from 17.1 percent to 12.3 percent.[1] Similarly, Commercial & Industrial, CNG, and Rentals would receive a pro-rata reduction from PSE's requested increase. In the second step, the next 3.0 percent reduction from the Company's requested increase would be applied to each customer class as a 3.0 percent reduction of class revenue requirement. Thus, Residential would receive an ultimate rate increase of 9.3 percent [12.3% - 3.0%], and the rate schedules that would receive zero change under the Company's proposed revenue requirement would each receive a 3.0 percent rate reduction.

The purpose behind this two-step approach is to recognize both gradualism and cost-of-service considerations. The first step emphasizes gradualism by reducing first the rate impact for the classes receiving an increase. The second step emphasizes cost-of-service by recognizing that at some point it is reasonable to offer a rate reduction to those classes that are paying rates well above parity. This becomes more feasible as the overall level of the rate increase moderates.

[1] This results in a first-step rate increase of $28 million = (12.1/17.1) x 58.1 million x 68.1%.

Rate Design for Schedules 57 and 87

Q. What do you recommend with respect to rate design for Schedules 57 and 87?

A. PSE is recommending a disproportionate increase in the demand charge for these rate schedules as part of the Company's overall proposed rate increase for these rate schedules of over 20 percent. However, as I am recommending no revenue change for these rate schedules at PSE's requested revenue requirement, then in the interest of rate stability I am also recommending no change to the relationship between the demand and volumetric charges. If rates are reduced, then PSE's objective of a relative increase in demand charges relative to volumetric charges can be achieved by applying the rate reduction to the volumetric charge. If, notwithstanding my recommendation for no rate increase for these rate schedules, a rate increase is assigned to these rate schedules, then I recommend a proportionate increase in the demand and volumetric charges.

Q. Does this conclude your response testimony?

A. Yes, it does.