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**VIA ELECTRONIC MAIL AND
OVERNIGHT MAIL**

July 2, 2008

Commission Secretary
Washington Utilities and Transportation Commission,
P.O. Box 47250
1300 S. Evergreen Park Drive, S.W.
Olympia, Washington 98504-7250

Re: Docket No. UE-072300, et. al.

Dear Ms. Washburn:

Please find enclosed the original and twelve (12) copies of the PREFILED CROSS ANSWER TESTIMONY AND EXHIBITS OF KEVIN C. HIGGINS FILED ON BEHALF OF THE KROGER CO., ON BEHALF OF ITS FRED MEYER STORES AND QUALITY FOOD CENTERS in the above-referenced matter. Please note that we also filed the above via electronic mail on same date.

By copy of this letter, all parties listed on the Certificate of Service have been electronically served. Please place this document of file.

Very Truly Yours,



Michael L. Kurtz, Esq.

Kurt J. Boehm, Esq.

BOEHM, KURTZ & LOWRY


MLKkew

Enclosures

cc: Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing on all parties by regular U.S. mail and electronic mail (when available) this 2nd day of June, 2008 upon the parties listed below.



Kurt J. Boehm, Esq.

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**EXHIBIT NO. ____ (KCH-3T)
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**

**PREFILED CROSS ANSWER TESTIMONY OF
KEVIN C. HIGGINS
ON BEHALF OF THE KROGER CO.**

July 3, 2008

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1 (2) I recommend the Commission reject Mr. Watkins' proposed reduction
2 to the fixed combustion turbine ("CT") costs used to determine the demand
3 classification of production costs in accordance with the peak credit method. The
4 premise of the peak credit method is that demand-related costs are captured in the
5 costs of a CT. The fixed cost of providing production capacity are not somehow
6 reduced if a particular utility happens to use CTs in non-peak periods in a
7 particular year, as Mr. Watkins claims. Mr. Watkins' reduction to the fixed costs
8 of a CT understates the cost of capacity (demand) relative to energy and is
9 inappropriate.

10 (3) I recommend that Mr. Watkins' rate spread proposal be rejected by the
11 Commission, as it does not adequately balance the objectives of gradualism and
12 cost causation. His proposal would increase the subsidies paid by Schedule 25
13 and 26 customers relative to PSE's proposal, and does not allow these customers
14 to advance sufficiently toward cost-of-service.

15 (4) Mr. Watkins' rate spread proposal for Schedule 40 is inconsistent with
16 the design of the rate and should be rejected. Schedule 40 was designed to be
17 derived formulaically based on the rates for High Voltage service and the cost of
18 distribution facilities used to serve the Schedule 40 customers' campuses. Mr.
19 Watkins simply assigns Schedule 40 a rate increase as part of his overall spread
20 proposal, ignoring the inherent structure of the rate.

1 **Response to Mr. Watkins**

2 **Q. What topics in Mr. Watkins' response testimony do address?**

3 A. I address aspects of Mr. Watkins' testimony on the topics of cost-of-
4 service and rate spread. I do not address all of the issues raised by Mr. Watkins
5 on these topics. Lack of commentary on part does not constitute concurrence with
6 positions to which I do not respond. In particular, lack of commentary does not
7 imply a change in the recommendations in my response testimony.

8 **Q. With respect to class cost-of-service, do you have any comments on Mr.**
9 **Watkins' testimony regarding the allocation of class responsibility for**
10 **income taxes?**

11 A. Yes. On pages 6-8 of his response testimony, Mr. Watkins disagrees with
12 PSE's approach to allocating class cost responsibility for income taxes. PSE
13 allocates income tax cost responsibility to classes based on rate base, whereas Mr.
14 Watkins argues that class income tax responsibility should be calculated based on
15 the taxable income generated by each class.

16 Mr. Watkins is correct on this point. Even though it may be intuitive to
17 allocate income taxes to classes as PSE has done, the proper way to apportion cost
18 responsibility to classes for income taxes is to calculate them based on taxable
19 income attributed to the class. Otherwise, when each class's revenue deficiency
20 (or sufficiency) is calculated, class cost responsibility will be understated for the
21 classes that are over-earning in relation to the overall average, and overstated for
22 the classes that are under-earning in relation to the overall average.

1 **Q. In your response testimony you indicated that Kroger is served under rate**
2 **schedules 24, 25, 26 and 40. What is the general impact on these rate**
3 **schedules of adopting Mr. Watkins' correction on this point?**

4 A. As shown on page 8 of his response testimony, Mr. Watkins' correction
5 increases the allocation of costs to these rate schedules. Although this correction
6 increases the allocation of costs to Kroger, I recommend its adoption because it is
7 methodologically appropriate.

8 **Q. Do you have any comments on Mr. Watkins' proposed changes to PSE**
9 **calculation of demand-related costs using the peak-credit method?**

10 A. Yes. The peak credit method used by PSE in its generation cost-of-service
11 analysis classifies electric production costs as either demand-related or energy-
12 related based on the ratio of the cost of a simple cycle turbine ("CT") to a
13 combined-cycle combustion turbine. In his response testimony, Mr. Watkins
14 proposes to reduce the CT costs in the numerator by one-half, thereby cutting the
15 demand classification in half. The basis of Mr. Watkins' adjustment is his
16 contention that PSE uses its CTs as often (or even more often) during non-peak
17 periods as during peak periods.

18 I disagree with Mr. Watkins' reduction to the fixed CT costs in the
19 numerator of the ratio PSE uses to determine the demand classification of
20 production costs. Whether or not PSE uses CTs during non-peak periods is
21 irrelevant to the fixed cost of providing generation capacity. The very premise of
22 the peak credit method is that demand-related costs are captured in the costs of a
23 CT. Under this approach, the provision of "pure" capacity requires that – at a

1 minimum – the fixed costs of a combustion turbine be incurred. The fixed cost to
2 the utility (or to society for that matter) of providing a megawatt of production
3 capacity are not somehow cut in half if that particular utility happens to use CTs
4 in non-peak periods in a particular year. If the utility needs to provide increased
5 production demand to its customers, the per-kW fixed cost of a CT (at a
6 minimum) must be incurred. Diluting the fixed cost of a CT by cutting it in half
7 in the determination of demand-related costs understates the cost of demand
8 relative to energy.

9 If Mr. Watkins' adjustment is adopted it would suggest that the fixed cost
10 of production capacity somehow gets less expensive during periods of high
11 market prices – when utilities are more likely to run their CTs at a greater
12 frequency – even though high market prices may be an indicator of capacity
13 scarcity. This is fundamentally unreasonable and is an ad hoc departure from the
14 underlying premise of the peak credit method. For these reasons, I recommend
15 that the Commission reject Mr. Watkins' proposed reductions in the fixed cost of
16 CTs in the application of the peak credit method.

17 **Q. Do you have any objections to Mr. Watkins' proposed rate spread?**

18 A. Yes. In my opinion, Mr. Watkins' proposed treatment of Schedules 25
19 and 26 is unreasonable. I also disagree with his proposed treatment of Schedule
20 40.

21 **Q. Please explain your objections to Mr. Watkins' proposed treatment of**
22 **Schedules 25 and 26.**

1 A. There is no disagreement that rates for Schedules 25 and 26 are
2 significantly above parity. This is the case even under Mr. Watkins' cost-of-
3 service analysis (which includes the unwarranted reduction in demand-related
4 costs discussed above).

5 PSE proposes that Schedules 25 and 26 receive 50 percent of the average
6 percentage rate increase. Staff concurs. In my response testimony, I also concur
7 with this spread as a starting point, but also propose that the percentage revenue
8 apportionment that results from PSE's rate spread be applied to whatever final
9 revenue requirement is approved by the Commission, which would have the effect
10 of moving all rate schedules closer to cost-of-service to the extent the revenue
11 requirement requested by the Company is reduced. In concurring with PSE's
12 proposed rate spread as a starting point, I am conceding that Schedules 25 and 26
13 would be required to subsidize other rate schedules on the grounds of gradualism.

14 Mr. Watkins proposes to make this subsidy even bigger. He proposes that
15 Schedule 25 receive 75 percent of the average rate increase and Schedule 26
16 receive 85 percent of the average rate increase. In my opinion, this proposed
17 spread does not adequately balance the objectives of gradualism and cost
18 causation. Mr. Watkins' proposal does not allow Schedule 25 and 26 customers
19 to advance sufficiently toward cost-of-service and sets them up to be perpetual
20 subsidizers of other customers. Under the Company's cost-of-service analysis,
21 both Schedules 25 and 26 deserve rate *decreases*. And, as shown in Exhibit KCH-
22 4, even if the PSE/Staff/Kroger proposed spread were applied to Mr. Watkins'
23 cost-of-service study, Schedules 25 and 26 would be paying rates that were above

Comparison of PSE/Staff/Kroger vs Public Counsel Rate Spread Proposal Impacts on ROR Index
Using Public Counsel's Recommended Cost-of-Service Study
at PSE's Initially Requested \$174.8M Increase

	PSE/Staff/Kroger Recommended Spread				Public Counsel Recommended Spread				
	Current Revenue	Proposed Increase	Percent Increase	Proposed Rate of Return	Proposed ROR Index	Proposed Increase	Percent Increase	Proposed Rate of Return	Proposed ROR Index
Residential Sch 7	984,090,380	115,972,986	11.78%	8.51%	98.91%	101,002,871	10.26%	8.02%	93.26%
Sec. Voltage Sch 24	225,492,780	21,259,081	9.43%	8.59%	99.84%	21,444,363	9.51%	8.62%	100.18%
Sec. Voltage Sch 25	260,900,473	12,298,629	4.71%	9.85%	114.52%	18,602,204	7.13%	10.83%	125.91%
Sec. Voltage Sch 26	159,068,093	7,498,336	4.71%	8.72%	101.43%	12,852,702	8.08%	10.16%	118.12%
Prim. Voltage Sch 31/35/43	112,324,775	10,589,792	9.43%	8.30%	96.50%	10,682,086	9.51%	8.33%	96.85%
Campus Sch 40	38,977,060	1,947,000	5.00%	5.39%	62.66%	4,264,090	10.94%	7.82%	90.94%
High Voltage Sch 46/49	31,895,957	3,007,097	9.43%	6.40%	74.43%	3,792,429	11.89%	7.43%	86.45%
Transportation Sch 449/459	8,667,094	817,118	9.43%	7.48%	86.97%	824,240	9.51%	7.49%	87.14%
Street & Area Lighting	15,450,314	1,092,472	7.07%	10.02%	116.51%	1,101,607	7.13%	10.04%	116.76%
Firm Resale	1,142,380	336,605	29.47%	10.11%	117.57%	252,526	22.11%	8.60%	100.00%
Total	1,838,009,306	174,819,116	9.51%	8.60%	100.00%	174,819,118	9.51%	8.60%	100.00%

Note: Analysis was derived from Mr. Watkins cost of service worksheets, which were based on PSE's initial proposed revenue increase of \$174.8 million.

