BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	:	
	:	**Docket No. UE-060266**
Complainant,	:	**Docket No. UG-060267**
v.	:	
	:	
PUGET SOUND ENERGY, INC.,	:	
	:	
Respondent.	:	

INITIAL BRIEF OF THE KROGER CO., ON BEHALF OF FRED MEYER STORES

I. INTRODUCTION

On February 15, 2006 Puget Sound Energy, Inc. ("PSE") filed its Application with the Washington Utilities and Transportation Commission ("Commission") in the above-caption matter requesting an electric rate increase. The Kroger Co., on behalf of Fred Meyer Stores ("Fred Meyer"), as well as several other PSE customers and interested parties, filed and were granted, petitions to intervene. Fred Meyer sponsored the testimony of Kevin Higgins, an expert in public utility rate regulation who has testified in over sixty proceedings in nineteen states. Mr. Higgins recommended that the Commission approve the Partial Settlement Agreement regarding electric rate spread, rate design, and low-income energy assistance which was filed on July 25, 2006; and that the

Commission reject PSE's proposed depreciation tracker. In addition to its support for the recommendations of its witness, Fred Meyer also supports the recommendations of Staff, Public Counsel and the Industrial Customers of Northwest Utilities (herein referenced as the "Joint Parties") with respect to PSE's proposed changes to the Power Cost Adjustment ("PCA") mechanism.

II. ARGUMENT

1. The Commission Should Reject PSE's Proposal To Institute A Deprecation Tracker.

PSE is proposing that any increased expense associated with growth in depreciation for electric and natural gas transmission and distribution plant investments be recovered using a depreciation tracker mechanism that would be collected through a surcharge. The surcharge would be based on the incremental depreciation expense of natural gas and electric transmission and distribution investment over and above the depreciation expense reflected in existing rates. The surcharge design would take into account growth in revenues associated with increased load.

As also noted in the testimony of Staff witness James Russell,[1] this depreciation tracker proposed by PSE is a flawed ratemaking concept that would result in an unreasonable cost burden for customers that should be rejected by the Commission. The depreciation tracker is unreasonable because 1) it is "single-issue ratemaking" that looks at a single cost/revenue item in isolation of all others; 2) PSE already gets the benefit of other mechanisms that recovery "single issues" costs; and 3) the depreciation tracker

[1] Russell Testimony, Exhibit No. __T(JMR-1T) pp. 24-30.

proposed by the Company fails to acknowledge savings in other areas that are directly related to depreciation expenses.

First, the depreciation tracker is unreasonable because it is single-issue ratemaking, which is generally bad regulatory policy. Single-issue ratemaking occurs when utility rates are adjusted in response to a change in a single cost item considered in isolation. When regulatory commissions determine the appropriateness of a rate or charge that a utility seeks to impose on its customers, the standard practice is to review and consider all relevant factors, rather than just a single factor. In some states, this is even required by law. To consider some costs in isolation might cause a commission to allow a utility to increase rates to recover higher costs in one area without recognizing counterbalancing savings in another area. For this reason, single-issue ratemaking is generally not sound regulatory policy.[2]

There are certain types of cost increases that regulatory commissions have come to allow without the benefit of conducting a general rate case. However, due to the fact that such exceptions constitute a form of single-issue ratemaking it is not unusual for regulatory commissions to identify criteria that must be met for such treatment to be allowed, such as whether the costs in question exhibit volatility and/or whether the costs are largely outside the utility's control. In light of such criteria, the single-issue adjustments most commonly adopted are commodity and power cost adjustment mechanisms. The Purchased Gas Adjustment mechanism and PCA are examples of such adjustment mechanisms that this Commission has approved for PSE.[3]

[2] Higgins Testimony, Exhibit No.__(KCH-1T) p. 5 lines 19-23; p. 6 lines 1-4.
[3] Id. p. 6 lines 7-15.

Although some forms of single-issue ratemaking may be reasonable because they are expenses that are outside the utility's control or are extremely volatile, transmission and distribution depreciation expenses due not fit into these categories. Incremental depreciation expense is directly within the utility's control and any volatility in these costs would invariably be the result of utility management decisions.[4]

The inequity of allowing single-issue ratemaking for an expense that is not outside the utility's control and is not inherently volatile, such as transmission and distribution depreciation expenses, is demonstrated in PSE Exhibit No.__ (JHS-12). That exhibit presents the trended attrition analysis referenced by PSE witness Mr. Story in his testimony. It shows the expense due to amortization of property loss declined $1.4 million between the rate year ending September 2003 and the rate year ending September 2005. If the Commission were to approve an adjustment mechanism that simply isolated increases in transmission and distribution depreciation expense, it would fail to acknowledge this kind of offsetting reduction in expense. This example illustrates the hazard of adopting a policy that would allow rates to be increased based on a cost change in a single item.[5]

The electric trended attrition analysis also shows that the biggest non-production cost drivers between the 2003 general rate case and the current rate case were customer service expenses and A&G expense. A&G expense was also a major cost driver in the gas trended attrition analysis presented in PSE Exhibit No.__ (KRK-6). Taken together, these results do not support the case for a depreciation tracker.[6]

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[4] Id. p. 6 lines 18-22.
[5] Id. p. 7 lines 1-13.
[6] Id. p. 7 lines 14-21.

Allowing a “stand-alone” rate adjustment for incremental depreciation expense is an example of single-issue ratemaking, in which a single item is permitted to impact rates in isolation from all other rate considerations. Unless it can be shown to involve a compelling public interest, single-issue ratemaking is generally not sound regulatory policy. Single-issue ratemaking ignores the multitude of other factors that otherwise influence rates, some of which could move rates in the opposite direction from the single-issue change. The appropriate forum for establishing rates to recover prudently incurred utility investment is not through a tracker that allows the recovery of a single-cost, but a general rate proceeding in which all cost and revenue information can be considered.

Next, the depreciation tracker proposal is unreasonable in light of the other single-issue trackers that PSE already has at its disposal. The Commission has already put in place mechanisms that mitigate the Company’s earnings risks in commodity costs on the gas side and power costs on the electric side, which are its most vulnerable areas. On the gas side, PSE has the PGA Mechanism, which allows for 100 percent pass-through of prudent natural gas purchases costs. On the electric side, PSE has the PCA mechanism and the ability to file a Power Cost Only Rate Case. These existing mechanisms already address PSE’s most critical cost recovery risks between general rate cases. In seeking a depreciation tracker, PSE is not proposing to roll-back any portion of the benefits conveyed to it by these existing adjustment mechanisms; instead, PSE request a depreciation tracker in addition to the current mechanisms.[7] The existing adjustment mechanisms already place customers at risk for rate increases between general rate cases;

[7] Id. p. 8 lines 9-19.

the depreciation tracker would add to that customer burden without a corresponding benefit. This is not a reasonable result for PSE's ratepayers.

Finally, PSE's proposed depreciation tracker does not recognize that incremental depreciation expense may be associated with decreased expenses. PSE indicates that some of its non-generation investment will be directed towards replacing aging infrastructure. Often, replacement of older facilities results in associated reductions in operations and maintenance expenses. Under the Company's proposal, these cost savings would not be reflected in the tracker calculation. Thus, even if concerns about single-issue ratemaking were waived to allow a depreciation tracker, the rate adjustment would likely be overstated.[8]

PSE's proposed depreciation tracker should be rejected because 1) it is "single-issue ratemaking" that looks at a single cost/revenue item in isolation of all others; 2) PSE already gets the benefit of other mechanisms that recovery "single issues" costs; and 3) the depreciation tracker proposed by the Company fails to acknowledge savings in other areas that are directly related to depreciation expenses.

2. Kroger Supports The Recommendation Of The Joint Parties With Respect To PSE's Proposed Changes To The PCA Mechanism.

PSE is proposing several changes to the PCA mechanism. PSE proposes to 1) eliminate the $20 million dead band; 2) impose a smaller sharing requirement in order to shift about half the power cost risk to customers, 3) eliminate Exhibit E in the original PCA in order to limit increases in power contracts from flowing through to the PCA

[8] Id. p. 9 lines 8-13.

without a Power Cost Only Rate Case, and 4) establish a new category of costs as an allowable PCA expense in order to hedge power supply costs.[9] The Joint Parties support PSE's inclusion of hedging costs as an allowable PCA expense, but recommend that the Commission reject the other aspects of PSE's PCA proposal.[10] Fred Meyer agrees.

As explained in detail by the Joint Parties, PSE's proposal to include hedging costs as a PCA expense is reasonable. The purpose of hedging is to manage the exact categories of cost that the PCA was designed to track. If the hedging program is successful, it will ultimately reduce fuel expenses. It would be inequitable to require PSE to track the fuel cost savings through the PCA, but not also allow it to track the hedging expenses through the PCA.[11]

PSE's other recommendations with regard to the PCA mechanism are not reasonable and should be rejected. PSE's proposal to remove the dead band from the PCA mechanism is in direct conflict with recent Commission findings in which the Commission stressed the importance of dead bands in power cost mechanisms as a means to allocate risk and motivate management to reasonably manage or reduce power costs.[12] The same rationale holds true in this proceeding.[13]

PSE's proposal to impose a smaller sharing requirement in order to shift power cost risk to customers is unreasonable because this type of risk is best managed by the utility. The Company has the ability to choose generation supplies that best reduce

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[9] Joint Testimony of Jim Lazar, Donald Schoenbeck and Yohannes Mariam, Exhibit No.__T(JOINT-19T) p. 21 lines 4-12.
[10] Id. p. 21 lines 15-25, p. 22 lines 1-3.
[11] Id.
[12] See Docket No. UE-050684, Order No. 4, p. 96 (April 17, 2006)
[13] Joint Testimony of Jim Lazar, Donald Schoenbeck and Yohannes Mariam, Exhibit No.__T(JOINT-19T) p. 25 lines 1-22.

power cost fluctuations, consumers do not.[14] It is sound policy to leave the risk of power cost variations in the hand of the party that control the decisions that effect exposure to such risk. That party is PSE, not its customers.

Finally, PSE proposes to limit increases in power contracts from flowing through to the PCA without a Power Cost Only Rate Case by eliminating Exhibit E in the original PCA. This proposal benefits the Company without a corresponding benefit to ratepayers. As the Joint Parties explained, the return on rate base associated with Company-owned generation tends to decrease over time, as the investment is depreciated. The PCA holds these constant between general rate cases or Power Cost Only Rate Cases. Eliminating the existing Exhibit E simplifies the mechanism, but benefits the Company to the detriment of consumers.[15]

III. CONCLUSION

Fred Meyers recommends that the Commission reject PSE's proposal to institute a new depreciation tracker. This proposal is unreasonable because 1) a depreciation tracker is "single-issue ratemaking" that looks at a single cost/revenue item in isolation of all others; 2) PSE already gets the benefit of other mechanisms that recovery "single issues" costs; and 3) the depreciation tracker proposed by the Company fails to acknowledge savings in other areas that are directly related to depreciation expenses. Fred Meyer also supports the recommendations of the Joint Parties with respect to PSE's Power Cost Adjustment Mechanism proposal.

[14] Id. p. 24 lines 17-22.
[15] Id. p. 22 lines 17-23. p. 23 lines 1-5.

DATED this 30th day of October, 2006.

Kurt J. Boehm, Esq.

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