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VIA ELECTRONIC MAIL AND OVERNIGHT MAIL

December 7, 2011

Mr. David E. Danner
Executive Director and 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-111048 and UG-111049

Dear Mr. Danner:

Enclosed please find the original and eighteen (18) copies of the PREFILED RESPONSE TESTIMONY AND EXHIBITS OF KEVIN C. HIGGINS on behalf of THE KROGER CO. filed 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,

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 parties listed on the attached Master Service List by regular U.S. mail and electronic mail (when available) this 7th day of December, 2011.

Kurt J. Boehm, Esq.

MASTER SERVICE LIST

As of: 12/7/2011 Docket: 111048

Original MSL Date: 6/14/2011

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EXHIBIT NO. ____(KCH-3T)
DOCKET NO. UE-111048/UG-111049
2011 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-111048** **Docket No. UG-111049**

PREFILED RESPONSE TESTIMONY OF
KEVIN C. HIGGINS
ON BEHALF OF THE KROGER CO.

December 3, 2011

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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 electric portion of this proceeding, UE-111048?

A. My testimony is being sponsored by The Kroger Co. ("Kroger") on behalf of its Fred Meyer Stores and Quality Food Centers divisions. Kroger is one of the largest retail grocers in the United States, and operates approximately 120 facilities in the state of Washington, approximately 65 of which are located in the territory served by Puget Sound Energy ("PSE"). These facilities purchase more than 140 million kWh annually from PSE, and are served on Electric Rate Schedules 24, 25, 26, and 40.

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 2009, 2007, 2006, 2004, and 2001 general rate cases and participated in the settlement discussions that resulted in partial settlement agreements pertaining to rate spread and rate design issues in those proceedings. I also testified in the 2009 proceeding that addressed the treatment of revenues from PSE's sales of Renewable Energy Credits ("RECs").

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

A. Yes. I have testified in approximately 135 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, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah, Virginia, West Virginia, and Wyoming.

Overview and Recommendations

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

A. My testimony addresses the following topics: (1) the recognition of revenues from PSE's sale of RECs in this case; (2) rate spread for PSE's electric service; (3) eligibility for Schedule 40 when customers make investments in energy efficiency; and (4) PSE's proposed Conservation Savings Adjustment rate.

Q. Please summarize your conclusions and recommendations.

(1) I have two recommendations concerning the treatment of REC revenues. First, REC proceeds should be amortized in rates based on the approved annual amortization factor applied to the sum of: (a) the estimated balance of the REC regulatory liability at the start of the rate year (May 2012), and (b) the amount of REC proceeds projected to occur in the rate year (May 2012 to April 2013). Second, I recommend that the five-year amortization period adopted in Docket UE-070725 be shortened to three years. Adoption of this recommendation will result in a reduction in PSE's revenue requirement of approximately $27.7 million, exclusive of the benefits to customers from the net reduction in rate base attributable to the average balance of the REC regulatory liability over the rate year.

(2) I recommend that PSE's rate spread proposal be adopted, with two exceptions: rates for Schedule 25 should be set at 50% percent of the uniform increase rather than 75% as proposed by PSE; and rates for Schedule 26 should be set at 75% percent of the uniform increase rather than 100% as proposed by PSE.

(3) I recommend that an amendment be made to the Schedule 40 eligibility provisions stating that a customer may remain on Schedule 40 if the customer experiences a decline in usage below the minimum threshold of 2 MWa, if the customer can demonstrate that the decline in usage below the threshold is directly attributable to investments in energy efficiency at the customer's Schedule 40 facilities.

(4) I recommend that PSE's proposed Conservation Savings Adjustment rate be rejected. However, given the choice between full revenue decoupling and a lost-revenue approach, I believe a lost revenue approach is preferable, so long as certain protections to customers are included. However, before subjecting customers to the Conservation Savings Adjustment rate, PSE should be required to investigate means through which its potential loss of fixed-cost recovery can be mitigated through rate design, including increasing its demand charges to better align with recovery of fixed costs.

If a lost revenue recovery mechanism is adopted by the Commission, several modifications should be made. First, a significant portion of costs that are recovered through demand charges, e.g., 75%, should be removed from PSE's calculation of per-kWh fixed-cost recovery that is subject to erosion through energy efficiency.

Second, PSE neglects to consider the effects of overall load growth on fixed cost recovery. If a "lost margins" approach is adopted by the Commission, then "lost margins" should be netted against "found margins." Specifically, I recommend that the kilowatt-hours used for measuring going-forward lost revenue recovery be limited to the <u>lesser</u> of energy efficiency improvements attributable to PSE programs or actual net reductions in retail kilowatt-hours sold relative to the retail kilowatt-hours used in setting base rates.

Third, the time period proposed by PSE is overreaching. If a fixed-cost recovery program is adopted, it should be limited to truing up any net loss of fixed cost recovery attributable to actual program results starting in the rate-effective year.

As my recommendations are concentrated on a limited number of issues, absence of comment on my part regarding a particular issue does not signify support (or opposition) toward the Company's filing with respect to the non-discussed issue.

<u>Adjustment to Revenue Requirement for REC Sales</u>

Q. Generally, what role does the sale of RECs play in utility ratemaking?

A. The renewable energy attributes associated with the generation output of certain renewable generation facilities such as wind, solar, geothermal, and small hydro plants have come to be measured in units known as Renewable Energy Credits or RECs. RECs are actively traded in a developing bilateral market. The primary purchasers of RECs are parties, such as utilities, that are required to utilize specified proportions of renewable energy in serving retail customers pursuant to state statutes and regulations. Because REC sales by utilities are typically made using assets that are paid for by customers, the revenues from REC sales are appropriately treated as a revenue credit against the revenue requirement recovered from customers in rates.

Q. Has this Commission addressed the appropriate ratemaking treatment of REC sales by PSE?

A. Yes. The appropriate ratemaking treatment of REC sales by PSE was addressed by the Commission in Docket UE-070725, in which I participated as a witness for Kroger. In Order 03 issued May 20, 2010, the Commission allowed a one-time payment of $3.3 million to PSE (to recover a portion of a receivable on PSE's books associated with a disputed energy sale to California) and an additional one-time payment $4.6 million for low-income energy efficiency programs, while determining that all remaining REC revenues should be reserved for retail customers. The general thrust of the Commission's determination was that, but for resolving certain one-time claims, 100 percent of REC revenues should accrue to the benefit of customers. Specifically, the Commission found that all REC proceeds received by PSE after November 30, 2009 would be booked to a regulatory liability account and returned to customers using a ten-year amortization recommended by Staff. [Order 03 at ¶ 96]

Order 03 was amended by the Commission in Order 06, issued October 26, 2010, in response to a petition from three parties to the case (which did not include Kroger) recommending that a portion of REC proceeds received after November 30, 2009 be used to offset the surplus amount of Production Tax Credit ("PTC") that had been credited to customers through PSE's PTC Tracker. The Commission approved this amendment, along with a provision specifying that after the PTC balance is reduced to zero, the remainder of the REC proceeds received by PSE after November 30, 2009, would be treated as a regulatory liability and be used to reduce PSE's rate base for ratemaking purposes; the Commission further amended Order 03 to allow the regulatory liability to be amortized over five years, rather than the ten-year amortization set forth in Order 03. [Order 06 at ¶ 9, 15]

Order 06 goes on to require that:

> In future general or power cost only rate case filings, and after completion of the REC/PTC offset period, the Company will offset the REC liability against rate base and amortize the balance of RECs at the beginning of a given rate year over five years as a credit to cost of service. The rate base impact of the REC liability will be calculated using the same methodology used for regulatory assets related to production. [Order 06 at ¶ 17]

Q. In its direct filing in this case, has PSE proposed to recognize a credit against it revenue requirement for amortization of REC proceeds?

A. No. PSE witness John H. Story touches briefly on this issue in his direct testimony, stating:

> RECs have not been included as a regulatory liability at the time of this filing as the REC/PTC offset period is not expected to end until the beginning of 2012. During the course of this proceeding, as the rate year balance of the REC liability becomes more certain, PSE will include the known and measurable AMA balance in electric production rate base as appropriate. [p. 37]

From this statement, it appears that PSE is preparing to calculate the offset against rate base that will be attributable to the REC liability, but the Company gives no indication that there will be any material amortization flowed through to customers in the rate year for this case.

Q. Do you have any recommendations for the Commission regarding the appropriate amortization of REC proceeds in this case?

A. Yes. I have two recommendations. First, REC proceeds should be amortized in rates based on the approved annual amortization factor applied to the sum of: (a) the estimated balance of the REC regulatory liability at the start of the rate year (May 2012), and (b) the amount of REC proceeds projected to occur in the rate year (May 2012 to April 2013). Second, I recommend that the five-year amortization period adopted in Docket UE-070725 be shortened to three years.

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

A. Yes. Assume the REC liability at the start of the rate year is $18 million and the projected REC revenues for the ensuing twelve months is $60 million. In this example, the REC revenues recognized in rates would be 33.3% x ($18 million + $60 million) or $26 million. This benefit to customers would be in addition to any benefits associated with the offset to rate base attributable to the average balance of the REC liability during the rate year.

Q. Why should the annual amortization factor be applied to the amount of REC proceeds *projected to occur in the rate year* and not just applied to the balance of RECs at the beginning of the rate year?

A. Limiting the recognition of the amortization of REC revenues in rates to the balance of RECs at the beginning of the rate year would unduly deprive today's customers of the benefits produced by the REC-producing assets that customers pay for in rates. There is simply no good public policy reason to delay recognition of this benefit in rates by failing to include a portion of projected rate-year REC sales in the determination of the rate year revenue requirement.

As it is, treating the REC benefit as a regulatory liability that is amortized over several years – instead flowing through 100% of the REC benefit each year – is an extremely conservative approach compared to how REC proceeds are treated in other major REC-exporting jurisdictions in the West. Moreover, recognizing the projected REC proceeds in the rate year is consistent with PSE's proposed recovery of power costs.

Q. Are you personally familiar with the ratemaking treatment of REC revenues in other major REC-exporting jurisdictions?

A. Yes. I have been directly involved as a witness in proceedings to determine the ratemaking treatment of RECs in Utah, Wyoming, and Colorado.

Q. Do any of these other jurisdictions require that REC revenues be amortized over a multiyear period?

A. No. In 2010, PacifiCorp sold over $100 million in RECs. Both Utah and Wyoming flow through 100% of their respective jurisdictional shares of PacifiCorp's *annual* REC proceeds. In both Utah and Wyoming, the annual REC credit in rates is based on projected test period REC revenues, with a provision for a subsequent true-up to actual.

Public Service Company of Colorado is also a major exported of RECs, with $46 million in REC margins earned between November 2009 and March 2011. In Colorado, the split of REC benefits between utility and customers is currently being considered in an open docket, but no party has proposed that the customers' share of REC proceeds be amortized over a multiyear period.

Q. Why should the amortization period for REC revenues be reduced from five years to three?

A. As I described above, the use of any multiyear period for amortizing the benefit of RECs in rates is extremely conservative. The only reason for amortizing RECs over a multiyear period at all is to hedge against the risk that year-to-year REC revenues could be subject to some volatility. An amortization scheme can mitigate against volatility by smoothing out the recovery level. A three-year amortization period is more than sufficient for this purpose: it balances the need for speedy recognition of the REC benefit in customer rates with the desirability of rate stability. A five-year amortization period is quite simply excessive in that it unduly delays recognition of REC benefits in rates.

Q. Shouldn't the fact that RECs are produced by long-lived assets lend support to the argument that RECs should be amortized over a longer time period?

A. No, not at all. The assets that produce RECs are indeed long-lived, but the production of RECs themselves is repeated continuously: each year brings forth a new crop of RECs. The argument that RECs credited in rates must be drawn out over a long time period because the assets used to produce them are long-lived is akin to arguing that revenue credits in rates for off-system sales margins should be spread out over several years because the assets used to make the sales are long-lived. This reasoning simply does not hold up to scrutiny.

Q. Have you calculated an estimated revenue requirement impact from amortizing REC revenues in rates in accordance with your recommendation?

A. Yes. This adjustment is presented in Kroger Exhibit No.__(KCH-4). I calculated this estimate using 2011 REC sales of $59.5 million as a proxy for the sales level in the rate year, and an estimated starting balance of $19.8 million in May 2012. This adjustment would reduce PSE's revenue requirement by $27.7 million. This estimate of the benefit does not take account of any benefits to customers from the net reduction in rate base attributable to the average balance of the REC regulatory liability over the rate year.

<u>Rate Spread</u>

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 by employing the ratemaking principle of 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 practices that result in permanent cross-subsidies from other customers.

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

As described by PSE witness Piliaris, PSE is proposing to move rates in the direction of cost-of-service. Mr. Piliaris suggests that classes should receive rate increases within a range of 75 percent to 125 percent of a uniform percentage increase based on each class's parity percentage. Each class's parity percentage, along with PSE's proposed percentage of uniform increase and recommended rate increase, is summarized in Table KCH-1, below.

Table KCH-1

Summary of PSE Rate Spread Proposal

Voltage Level	Schedule	Current Parity Percent	Percent of Uniform Increase	PSE Proposed Increase	PSE Percent Increase
Residential	7	98%	100%	$86,701	8.0%
Secondary Voltage					
Demand <= 50 kW	24	103%	100%	$19,666	8.0%
Demand > 50 kW but <= 350 kW	25/29	106%	75%	$15,520	6.0%
Demand > 350 kW	26	104%	100%	$12,772	8.0%
Total Secondary Voltage				$47,959	7.2%
Primary Voltage					
General Service/ Irrigation	31/35		100%	$8,398	8.0%
Interruptible Total Elec. Schools	43		100%	$1,015	8.0%
Total Primary Voltage		103%	100%	$9,413	8.0%
Campus Rate	40	94%		$3,357	6.5%
Total High Voltage	46/49	99%	100%	$2,916	8.0%
Choice/ Retail Wheeling	448/449	88%	125%	$704	10.0%
Lighting	50-59	95%	100%	$1,359	8.0%
Total Jurisdictional Retail Sales				$152,407	7.7%
Firm Resale/Special Contract		73%		$591	48.6%
Total Sales				$152,999	7.7%

Q. What is your assessment of PSE's proposed approach to rate spread?

A. In my opinion, Mr. Piliaris's proposal is generally reasonable, but I believe it can be improved with two modifications. According to Mr. Piliaris's proposal, rate schedules with parity percentages between 95% and 105% would receive a uniform percentage increase. The one rate schedule with a parity percentage greater than 105% (Schedule 25) would receive a rate increase that is 75% of the uniform increase. Similarly, the rate schedule with a parity percentage less than 95% (Schedule 448/449) would receive a rate increase that is 125% of this uniform increase.

As shown in Table KCH-1, Schedule 25 has a parity percentage of 106%. At PSE’s proposed overall revenue increase, the Company’s spread proposal would result in an increase to this rate schedule that is only 2.0 percentage points below the uniform increase; at a smaller revenue requirement, this differential would be even smaller. This will leave Schedule 25 in the upper end of the parity range. I believe a more concerted effort to bring this rate schedule closer to cost is warranted. Consequently, I am recommending that the rate increase for Schedule 25 be set at 50% of the uniform increase.

Schedule 26 has a parity percentage of 104%, at the upper end of Mr. Piliaris’s suggested range of uniform increase. I believe that Mr. Piliaris’s rate spread proposal can be improved if the Schedule 26 increase were set at 75% of the uniform increase. This modification would recognize that Schedule 26 is producing revenues that are materially above parity, and better align its rates with cost of service.

These two modifications to the PSE rate spread are shown in Kroger Exhibit No.__(KCH-5) using the revenue requirement proposed by PSE. The results are summarized in Table KCH-2, below.

Table KCH-2

Kroger Proposed Rate Spread @ PSE Proposed Revenue Increase

Voltage Level	Schedule	Current Parity Percent	Percent of Uniform Increase	Proposed Increase	Percent Increase
Residential	7	98%	100%	$91,857	8.5%
Secondary Voltage					
Demand <= 50 kW	24	103%	100%	$20,835	8.5%
Demand > 50 kW but <= 350 kW	25/29	106%	50%	$10,962	4.2%
Demand > 350 kW	26	104%	75%	$10,149	6.4%
Total Secondary Voltage				$41,947	6.3%
Primary Voltage					
General Service/ Irrigation	31/35		100%	$8,897	8.5%
Interruptible Total Elec. Schools	43		100%	$1,076	8.5%
Total Primary Voltage		103%	100%	$9,973	8.5%
Campus Rate	40	94%		$3,357	6.5%
Total High Voltage	46/49	99%	100%	$3,090	8.5%
Choice/ Retail Wheeling	448/449	88%	125%	$745	10.6%
Lighting	50-59	95%	100%	$1,439	8.5%
Total Jurisdictional Retail Sales				$152,407	7.7%
Firm Resale/Special Contract		73%		$591	48.6%
Total Sales				$152,999	7.7%

Schedule 40 Eligibility and Investments in Energy Efficiency

Q. What are the size eligibility criteria for Schedule 40?

A. To be transferred to Schedule 40, a customer must have 3 MWa of load for six of the twelve months of a test year used in a general rate case. To remain on Schedule 40, a customer must maintain an average of 2 MWa over the entire test year. Schedule 40 provides that customers that do not retain this amount of load will be removed from the rate schedule.

Q. Does Kroger take service under Schedule 40?

A. Yes. Kroger is currently served under Schedule 40 for two of its facilities.

Q. Do you have any concerns regarding the criteria for remaining on Schedule 40?

A. Yes. Customers who take actions to improve their energy efficiency and whose Schedule 40 usage declines below the threshold of 2 MWa as a direct result of those efforts, should not be penalized through higher rates by forced removal from Schedule 40.

The State of Washington has adopted policies encouraging improvements in energy efficiency. Specifically, RCW 19.285.020 provides the following declaration of policy:

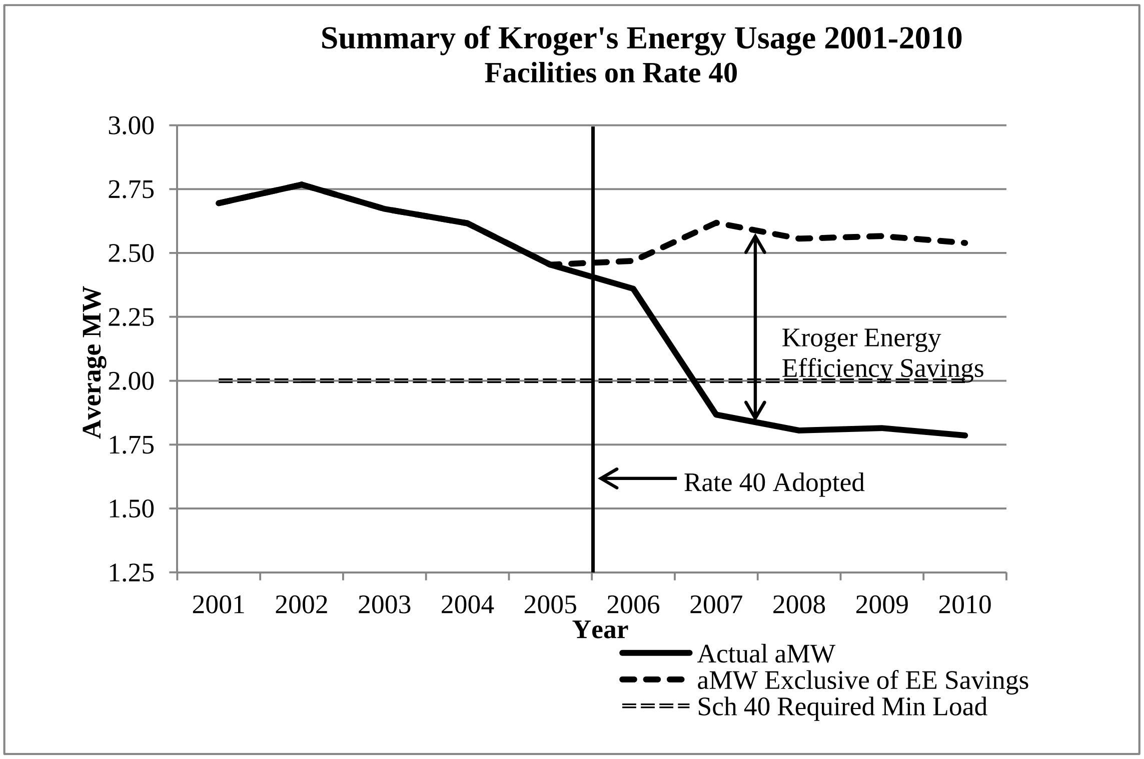
> Increasing energy conservation and the use of appropriately sited renewable energy facilities build on the strong foundation of low-cost renewable hydroelectric generation in Washington state and will promote energy independence in the state and the Pacific Northwest region. Making the most of our plentiful local resources will stabilize electricity prices for Washington residents, provide economic benefits for Washington counties and farmers, create high-quality jobs in Washington, provide opportunities for training apprentice workers in the renewable energy field, protect clean air and water, and position Washington state as a national leader in clean energy technologies.

It is not reasonable for customers who take actions in furtherance of this state policy to be penalized through significantly higher rates. This situation specifically applies to Kroger, which faces an increase of over $100,000 per year in rates as a result of its pending removal from Schedule 40 that is solely attributable to Kroger's vigorous pursuit of energy efficiency in its Schedule 40 facilities. This type of penalty is unjust and perverse, and should be prevented by a modification to the tariff that allows a customer to remain on Schedule 40 if the customer can demonstrate that the reduction in its usage below the Schedule 40 minimum threshold is directly attributable to its investment in energy efficiency.

Q. Please describe Kroger's experience with its Schedule 40 facilities.

A Kroger is committed to implementing cost-effective energy efficiency investments in its facilities nationwide, including its facilities in the State of Washington. In support of these efforts, Kroger maintains a corporate energy department that provides equipment specification, energy "best practices," and technical services.

Among the facilities to benefit from Kroger's energy efficiency efforts are its facilities on Schedule 40. Kroger's engineering team has documented that between 2005 and 2007, three major efficiency investments reduced the energy consumption at Kroger's larger Schedule 40 facility by 6.6 million kWh per year. While increased operations at the facility have offset some of these savings, the net result is that Kroger's Schedule 40 usage has declined by about 5.1 million kWh per year, which translates into a net reduction in Schedule 40 demand from 2.45 MWa in 2005 to 1.79 MWa in 2010, just below the Schedule 40 threshold, as shown in Figure KCH-1, below.



Q. Have you estimated what Kroger's average Schedule 40 demand would have been absent its significant energy efficiency efforts?

A. Yes. Had Kroger not invested in three major efficiency projects between 2005 and 2007, its Schedule 40 load would be approximately 2.54 MWa in 2010, which is comfortably above the Schedule 40 minimum.

Q. Has Kroger invested in energy efficiency at its Schedule 40 facilities since 2007?

A. Yes. Kroger has continued to invest in energy efficiency at its Schedule 40 facilities since 2007. However, I have not included the savings from these more recent investments in the analysis above. Consequently, the 2.54 MWa figure presented above is a conservative number.

Q. Are there characteristics of Schedule 40 that make your argument particularly applicable to this rate schedule?

A. Yes. While there are size requirements for many rate schedules, good rate design provides for smooth transitions when customers cross from one rate schedule to another. That is not the case with Schedule 40, which is a unique "campus rate" that directly assigns site-specific distribution costs to customers. As a result, the rate impact of being forced off of Schedule 40 is much more punitive than a normal rate schedule transition. This circumstance warrants a specific provision that ensures that customers who take socially beneficial actions in furtherance of state policy are not penalized for doing so. Such a penalty makes no sense whatsoever.

Q. What is your recommendation to the Commission on this issue?

A. I recommend that the eligibility criteria for Schedule 40 be modified to specify that a customer whose Schedule 40 usage falls below 2 MWa shall remain on Schedule 40 if the customer can document that the reduction in its demand below the minimum threshold is directly attributable to energy efficiency investments undertaken by the customer during the time the customer has been on Schedule 40.

<u>Conservation Savings Adjustment Rate</u>

Q. What has PSE proposed with respect to a Conservation Savings Adjustment rate?

A. As described in the direct testimony of Mr. Piliaris, PSE is proposing the adoption of a Conservation Savings Adjustment rate, which is structured as a form of "lost revenue" recovery. To implement this mechanism, PSE estimates the per-kWh fixed cost recovery in rates for broad classes of customers, and proposes that this unit cost be applied to the energy savings attributed to PSE's energy conservation programs. Customers would then be charged for the "loss" of this fixed cost recovery multiplied by the savings attributed to PSE's energy conservation programs. The initial estimate of this charge to customers is based on PSE's estimated accumulated energy savings starting in 2010 and extending through the end of 2011.

Q. Have you reviewed the Commission's policy statement on decoupling issued in Docket U-100522?

A. Yes, I have.

Q. Do interpret PSE's proposal to be a full decoupling mechanism as discussed by the Commission in that docket?

A. No, it is not.

Q. Do you recommend the adoption of a full decoupling mechanism in this proceeding?

A. No, I do not. At the most fundamental level, decoupling is as much a "revenue assurance" mechanism as it is a "conservation enabling" mechanism. As such, it is sure to capture a much wider range of effects than just customer responses to utility-sponsored energy efficiency programs. For example, decoupling provides unwarranted insulation to the utility from the effects of price elasticity. Generally, all sellers of goods face a risk that price increases will reduce sales. But, with decoupling, if customers respond to utility rate hikes by reducing their electricity, fixed charges are increased to compensate the utility for any resultant reduction in per-customer usage. Such an increase reflects an undue transfer of risk from utilities to customers.

Further, to the extent that customers reduce usage in response to economic conditions or otherwise practice self-funded energy conservation, these behaviors will be captured in the decoupling adjustment and unduly increase rates to customers.

Moreover, maintaining a constant "revenue per customer" or "fixed-cost recovery per customer" – as typically incorporated into a decoupling regime – is not an appropriate rate design objective for classes of customers that have few customers, have heterogeneous populations, and/or whose class composition shows a wide range of usage levels, such as occurs with larger non-residential customers. The fixed-cost recovery per customer of these classes will be very sensitive to the *composition* of these customers. In short, given the tremendous diversity among non-residential customers, attempting to attribute to utility-sponsored energy conservation projects changes in "average fixed-cost recovery per customer" of non-residential customers is meaningless. The concept of an "average" non-residential customer for this purpose is without merit as a ratemaking mechanism.

Changes in the overall economy are far more likely to influence fixed-cost recovery per customer for non-residential customers than energy conservation programs. Application of decoupling to these customers would result in undue changes in rates in response to factors that are unrelated to energy conservation.

This would be particularly unfortunate since the primary objectives of decoupling can be accomplished for these customers through rate design, as I discuss below.

Q. Given your recommendation not to adopt full revenue decoupling in this proceeding, are you supportive of PSE's proposal?

A. No. As a general proposition, I recommend against adoption of such single-issue ratemaking mechanisms. However, given the choice between full revenue decoupling and a lost-revenue approach, I believe a lost revenue approach is preferable, so long as certain protections to customers are included. Unfortunately, PSE's proposal lacks many of the necessary protections. PSE also fails to consider the mitigation against lost fixed-cost recovery that can be achieved through rate design, particularly for non-residential customers.

Q. How can loss of fixed-cost recovery be mitigated through rate design?

A. The premise for the Conservation Savings Adjustment (as well as decoupling) is to insulate the utility from the loss of fixed-cost recovery when customers conserve energy by participating in utility-sponsored energy efficiency programs. This erosion of fixed-cost recovery may occur because a portion of fixed cost is recovered through the volumetric energy charge. Thus, if energy consumption declines, all other things being equal, fixed cost recovery from conserving customers on these rate schedules declines.

However, the loss of fixed cost recovery can be significantly reduced through the adoption of demand charges for non-residential customers that are well-aligned with a utility's fixed costs. Because demand charges are levied based on a customer's monthly peak usage, rather than average usage, their recovery tends to be more stable than recovery of energy charges.

Unfortunately, PSE's demand charges are not particularly well-aligned with recovery of PSE's fixed costs. I make this statement based on my experience in PSE cases over the past decade. I believe this misalignment has its origins in the use of the Peak Credit method for determining production cost of service, a methodology that significantly under-weights the proportion of costs classified as capacity or "demand-related" relative to more commonly-used methods in the United States. The weightings used in this classification have implications for rate design, resulting in demand-charges that are relatively low in comparison to the Company's energy charges.

Before subjecting customers to the Conservation Savings Adjustment rate, PSE should be required to investigate means through which its potential loss of fixed-cost recovery can be mitigated through rate design, including increasing its demand charges to better align with recovery of fixed costs.

Q. Notwithstanding your recommendations, if a lost revenue recovery mechanism is adopted by the Commission, what modifications should be made to PSE's proposal?

A. Several modifications should be made. First, the Company's calculation of per-kWh "lost" fixed-cost recovery includes costs that are recovered through demand charges, which as I have stated, tend to be more stable than costs recovered through energy charges. Consequently, a significant portion of costs that are recovered through demand charges, e.g., 75%, should be removed from

PSE's calculation of per-kWh fixed-cost recovery that is subject to erosion from energy efficiency.

Second, PSE's proposal focuses on the sales impact of energy efficiency in isolation and neglects to consider the effects of overall load growth on fixed cost recovery. In practice, the implementation of energy efficiency programs does not imply that a utility will be unable to fully recover its fixed costs. In general, when load grows above the level of the billing determinants used in setting rates, the fixed-cost recovery that occurs as a function of volumetric sales increases. This inures to the benefit of the utility. In traditional ratemaking, utilities are not required to return this incremental fixed-cost recovery to customers. This incremental fixed-cost recovery can be thought of as "found" margins. If a "lost margins" approach is adopted by the Commission, then "lost margins" should be netted against "found margins." Specifically, I recommend that the kilowatt-hours used for measuring going-forward lost revenue recovery be limited to the lesser of energy efficiency improvements attributable to PSE programs or actual net reductions in retail kilowatt-hours sold relative to the retail kilowatt-hours used in setting base rates.

Third, the time period proposed by PSE is overreaching. A lost recovery mechanism is intended to be a vehicle that is used *in-between* rate cases. In contrast, PSE builds "lost revenues" directly into its rate case based on program activity going back to the beginning of 2010. If a fixed-cost recovery program is adopted, it should be limited to truing up any net loss of fixed cost recovery attributable to actual program results starting in the rate-effective year.

Q. Does this conclude your response testimony?

A. Yes, it does.

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

Docket No. UE-111048
Docket No. UG-111049

PUGET SOUND ENERGY, INC.,

Respondent.

AFFIDAVIT OF KEVIN C. HIGGINS

STATE OF UTAH)
)
COUNTY OF SALT LAKE)

Kevin C. Higgins, being first duly sworn, deposes and states that:

1. He is a Principal with Energy Strategies, L.L.C., in Salt Lake City, Utah;

2. He is the witnesses who sponsors the testimony entitled "Prefiled Response Testimony of Kevin C. Higgins";

3. Said testimony was prepared by him;

4. If inquiries were made as to the facts in said testimony and exhibits he would respond as therein set forth; and

5. The aforesaid testimony and exhibits are true and correct to the best of his knowledge, information and belief.

Kevin C. Higgins

Subscribed and sworn to or affirmed before me this 6th day of December, 2011, by Kevin C. Higgins.

Danika Holmes

Notary Public

My Commission Expires: 2/7/2015

Notary Public
DANIKA HOLMES
Commission #606101
My Commission Expires
February 07, 2015
State of Utah

Kroger Recommended Approach to Reflect
Pro Forma REC Revenues in PSE's Rate Year

(Amounts shown are for Illustrative Purposes Only)

Line No.		FERC Acct	Pro Forma Adjustment	Source
1	**Adjustment to Revenues:**			
2	Other Electric Revenues	456	$26,463,320	= Ln. 5

Line No.	**Derivation of Pro Forma REC Revenues**	Amount	Source
3	Annual REC Revenues Collected ($)	$79,389,959	Illustrative Amount[1]
4	Recommended REC Amortization Period (Yrs)	3	Kroger Recommendation
5	Test Year REC Pro Forma REC Revenues ($)	$26,463,320	= Ln. 3 ÷ Ln. 4
6	Federal Income Tax Expense @ 35%	$9,262,162	= 35% x Ln. 5
7	Net Operating Income Change	$17,201,158	= Ln. 5 - Ln. 6
	Estimated Revenue Requirement Impact		
8	Net Operating Income Change	$17,201,158	= Ln. 7
9	PSE Conversion Factor	0.6207490	PSE Exhibit No. ___ (JHS-7), p. 3 of 3.
10	Estimated Income Statement Revenue Requirement Impact	$\boxed{\$27,710,327}$	= Ln. 8 ÷ Ln. 9

1. Data Source: Illustrative amount derived from 2010 REC revenue information provided in UE-101581/UE-070725 REC/PTC Offset Filing , Oct 2011 monthly update from Tom Deboer (filed November 30, 2011).

Note: This illustrative approach does not include the *net* regulatory liability that would be included in PSE's allowed rate base nor the associated rate base revenue requirement impact.

Kroger Recommended Spread at PSE's Revised Requested Revenue Increase
Twelve Months ended December 2010

Line No.	Voltage Level	Schedule	kWh	Proforma Revenue	Percent of Total w/o Schedule 40, Firm Resale & Special Contract	Percent of Uniform Increase	Proposed Revenue Increase (%)	Proposed Revenue Increase ($)	Proposed Revenue
			A	B	D	E	F	G = B x F	H = B + G
1	Residential	7	10,732,747,750	$ 1,083,315,596	56.27%	100%	8.48%	$ 91,856,975	$ 1,175,172,570
2									
3	Secondary Voltage								
4	Demand <= 50 kW	24	2,594,865,426	$ 245,723,262	12.76%	100%	8.48%	$ 20,835,475	$ 266,558,738
5	Demand > 50 kW but <= 350 kW	25 / 29	2,932,110,481	$ 258,565,574	13.43%	50%	4.24%	$ 10,962,203	$ 269,527,777
6	Demand > 350 kW	26 / 26P	1,991,174,729	$ 159,589,468	8.29%	75%	6.36%	$ 10,148,986	$ 169,738,454
7	Seasonal Irrigation & Drainage Pumping	29	Included with Sch. 25			50%	4.24%	$ -	$ -
8	Total Secondary Voltage	25/25/26/29	7,518,150,636	$ 663,878,305			6.32%	$ 41,946,664	$ 705,824,969
9									
10	Primary Voltage								
11	General Service / Irrigation	31 / 35	1,322,986,305	$ 104,925,648	5.45%	100%	8.48%	$ 8,896,902	$ 113,822,550
12	Seasonal Irrigation & Drainage Pumping	35	Included with Sch. 35			100%	8.48%	$ -	$ -
13	Interruptible Total Electric Schools	43	148,958,013	$ 12,686,207	0.66%	100%	8.48%	$ 1,075,694	$ 13,761,901
14	Total Primary Voltage	31/35/43	1,471,944,318	$ 117,611,855			8.48%	$ 9,972,596	$ 127,584,451
15									
16	Campus Rate	40	755,105,598	$ 52,013,002			6.45%	$ 3,356,647	$ 55,369,649
17									
18	Total High Voltage	46 / 49	576,524,279	$ 36,438,105	1.89%	100%	8.48%	$ 3,089,676	$ 39,527,780
19									
20	Choice / Retail Wheeling	448 / 449	1,954,913,504	$ 7,033,519	0.37%	125%	10.60%	$ 745,487	$ 7,779,006
21									
22	Lighting	50-59	81,494,849	$ 16,975,574	0.88%	100%	8.48%	$ 1,439,400	$ 18,414,974
23									
24	Total Jurisdictional Retail Sales		23,090,880,935	$ 1,977,265,955			7.71%	$ 152,407,445	$ 2,129,673,400
25									
26	Small Firm Resale		See Firm Resale/Special Contract				48.57%		
27	Special Contract		See Firm Resale/Special Contract				48.57%		
28	Firm Resale / Special Contract		7,332,574	$ 1,217,755			48.57%	$ 591,462	$ 1,809,217
29									
30	Total Sales		23,098,213,509	$ 1,978,483,710	100.00%		7.73%	$ 152,998,907	$ 2,131,482,617
31									
32									

Line No.		
33	Total Proposed Increase	$ 152,998,907
34	Average Increase Including Schedule 40, Firm Resale + Special Contract	7.733%
35	Average Increase Excluding Schedule 40, Firm Resale + Special Contract	7.742%
36	Adjustment to Average Increase for Unequal Allocation of Increase	1.095243375
37	Average Increase Excluding Schedule 40, Firm Resale + Special Contract adjusted for Unequal Allocation of Increase	**8.479%**

Source: Piliaris Supplemental Exhibit JAP-23, p. 1, Rate Spread.