**EXHIBIT NO. JKP-25T**
**DOCKET NOS. UE-090704/UG-090705**
**2009 PSE GENERAL RATE CASE**
**WITNESS: JANET K. PHELPS**

**BEFORE THE**
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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|---|---|
| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,**<br><br>**Complainant,**<br><br>**v.**<br><br>**PUGET SOUND ENERGY, INC.,**<br><br>**Respondent.** | **Docket No. UE-090704**<br>**Docket No. UG-090705** |

# PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF JANET K. PHELPS ON BEHALF OF PUGET SOUND ENERGY, INC.

**DECEMBER 17, 2009**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF JANET K. PHELPS**

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**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF JANET K. PHELPS**

## I. INTRODUCTION

**Q. Are you the same Janet K. Phelps who provided in this proceeding prefiled direct testimony, Exhibit No. JKP-1T, on May 8, 2009, and prefiled supplemental direct testimony, Exhibit No. JKP-16T, on August 3, 2009, each on behalf of Puget Sound Energy, Inc. ("PSE")?**

A. Yes.

**Q. What is the purpose of your prefiled rebuttal testimony?**

A. I will respond to the following testimony with respect to PSE's gas and electric cost of service studies, rate spread and rate design:

1. the prefiled response testimony of Thomas E. Schooley, Exhibit No. TES-1T, on behalf of the Washington Utilities and Transportation Commission Staff ("Staff") with respect to gas and electric,

2. the prefiled response testimony of Glenn A. Watkins, Exhibit No. GAW-1T, on behalf of Public Counsel with respect to gas and electric,

3. the prefiled response testimony of Kevin C. Higgins, Exhibit No. KCH-2T, on behalf of the Kroger Company ("Kroger"),

4. the prefiled response testimony of Donald W. Schoenbeck, Exhibit No. DWS-1T, on behalf of Industrial Customers of Northwest Utilities ("ICNU"),

5. the prefiled response testimony of Kevin C. Higgins, Exhibit No. KCH-1T, on behalf of Nucor Steel Seattle, Inc. ("Nucor"), and

6. the prefiled response testimony of Donald W. Schoenbeck, Exhibit No. DWS-5T, on behalf of Northwest Industrial Gas Users ("NWIGU").

I also adopt the prefiled direct testimony and exhibits of David W. Hoff, Exhibit No. DWH-1T and Exhibit Nos. DWH-2 through DWH-6. Additionally, I adopt Mr. Hoff's prefiled supplemental testimony and exhibits, Exhibit Nos. DWH-7T and DWH-8, in this proceeding.

**Q. Please describe the testimony of Staff witness Thomas E. Schooley as it relates to electric and gas cost of service, rate spread and rate design.**

A. Mr. Schooley discusses the importance of cost of service, revenue allocation and rate design. He then accepts the Company's method to allocate plant and expenses, states that he considers the Company's cost of service studies and parity ratios a fair representation of the class contributions to the overall rate of return, and accepts the Company's rate design.

**Q. Do you agree with Mr. Schooley's conclusions?**

A. Yes.

**Q. Please describe the testimony of Nucor witness Mr. Kevin C. Higgins as it relates to gas cost of service, rate spread and rate design.**

A. Mr. Higgins expresses a difference of opinion regarding PSE's proposed allocation of distribution mains. However, he recognizes that the Company's approach is an attempt to compromise between the various positions that were expressed in PSE's 2007 general rate case and the subsequent Natural Gas Collaborative, and concludes that the company's rate spread proposal is reasonable. He also states that the Company's proposed rate design for non-residential customers is reasonable.

## II. GAS AND ELECTRIC COST OF SERVICE STUDIES

### A. Allocation of Gas Mains

**Q. Have you provided a summary of the Company's proposed allocation of the costs of gas mains?**

A. Exhibit No. JKP-12, provided with my direct testimony in this proceeding, contains an illustration of the Company's approach.

**Q. What criticism of PSE's cost of service study does NWIGU witness Mr. Donald Schoenbeck make?**

A. Mr. Schoenbeck argues that PSE's cost of service study assigns too much main investment to Schedule 85/85T, 87/87T and contract customers ("Large Users")

and recommends that no costs associated with mains less than four inches be assigned to Large Users.

**Q. Do you agree with his recommendation?**

A. No, as I will explain below

**Q. What categories of main are used in the cost of service study?**

A. In my prefiled direct testimony I categorized pipe four inches or greater in diameter as large main, two and three inch pipe as medium main, and pipe smaller than two inches in diameter as small main. In the test year, in 2008 dollars, approximately 55 percent of the plant costs were related to large main, 33 percent to medium main, and 12 percent to small main.

**Q. How is Mr. Schoenbeck's proposal different from PSE's proposal?**

A. It differs in the treatment of medium sized main, for both the portions designated as peak-related and average-related, and in the treatment of the peak-related small main. Both PSE and NWIGU allocate main plant costs based on two factors, peak and energy. With respect to the 67 percent of plant designated as peak-related, PSE allocated all sizes of main to all customer classes based on contributions to design day peak demand. Mr. Schoenbeck split this 67 percent of plant into small, medium and large diameter pipe, allocated the cost of large main to all classes consistent with the Company's allocation factor, and allocated the costs of the small and medium main to all classes except Large Users.

**Q. How is Mr. Schoenbeck's proposal different from PSE's proposal with respect to the average portion of main?**

A. The difference in the average portion of main focuses on the treatment of medium main. Whereas PSE allocated 33 percent of medium main to all classes based on throughput and 67 percent to all classes except Schedule 87/87T and contracts, Mr. Schoenbeck allocated no medium main to any Large Users.

**Q. What reason does Mr. Schoenbeck give for his proposal?**

A. He argues that because most Large Users are physically connected to large main, they should not make any contribution to the cost of medium or small main.

**Q. What are your concerns about this approach?**

A. First, he dismisses the fact that several Schedule 85/85T customers are physically connected to medium main by stating that their throughput is only 15 percent of the volume of Large Users. Second, he ignores the nature of the gas system, that additions to medium main add capacity and reliability to the system that benefit all customers, regardless of the size of their service connections.

**Q. Address the argument that most Large Users are not connected to small or medium main.**

A. If Mr. Schoenbeck's position is that physical connections should be the basis for cost allocation, he must accept some assignment of these costs to Schedule 85/85T customers because they are physically connected to medium main. Cost

of service studies examine cost responsibility at the class level, and enough Schedule 85/85T customers are physically connected to 2-inch main that the class must accept some cost responsibility on both a peak and average basis. He dismisses this responsibility by stating that the volume of those Schedule 85 customers connected to medium or small main is only 15 percent of class volume. This does not justify complete exemption of Schedule 85/85T from these costs. He uses incorrect data for his argument. His workpapers indicate that his figures are based on the claim that only 12 Schedule 85 customers are connected to medium/small mains, when in fact there were 22 Schedule 85/85T customers connected to medium/small mains during the test year.

He also makes an inconsistent argument, arguing at page 8 that the true cost of serving customers is solely related to peak demand, while also arguing that certain customers should be eliminated from cost assignment because of their energy, rather than peak, usage.

**Q. Address Mr. Schoenbeck's statement on page eight of his testimony that "except for the limited customers connected to the medium and small mains, it would be impossible to serve the complete demand of Large Users from these facilities."**

A. Physical connections do not tell the whole story, as explained in detail on pages 27-29 of my direct testimony, Exhibit No. JKP-01T. The distribution system is an interconnected system, and both medium and large pipe create capacity and

reliability on the system that benefit all customers. Mr. Schoenbeck dismisses the benefits of the system by saying that the "Company's alleged benefit is really just a by-product of the physics of a network system." Capacity and reliability are not just by-products. The system is designed to provide them to all customers.

**Q. Comment on Mr. Schoenbeck's statement on page eight of his testimony that "a pure cost-based allocation approach based on design day peak demand would only assign about $11 million to these customers."**

A. Mr. Schoenbeck appears to define cost based on a flow analysis done as part of the Company's proposed cost of service study in its 2007 general rate case, in which the peak-related portion of main assigned to Large Users was $11 million. I have two concerns with this. First, by using this figure he defines cost as only the cost of pipe through which gas would flow on a design day peak hour when the temperature is 10 degrees, when all interruptible loads are curtailed, as modeled using the Company's planning software. This is a very narrow definition of cost that completely disregards the benefits of being connected to the system and ignores the average portion of the peak and average allocation method. My second concern is that the number is wrong. Workpapers I provided with my direct testimony in this proceeding indicate that the comparable figure for the 2008 test year was $13.8 million. While correcting for such error results in a difference that is small, such error illustrates the lack of foundation for Mr. Schoenbeck's proposal.

**Q. What is your overall assessment of Mr. Schoenbeck's gas cost of service study?**

A. As discussed above, NWIGU's proposed gas cost of service study severely limits the costs allocated to Large Users and should be rejected. In my direct and supplemental testimony, I presented three alternative gas cost of service studies in addition to PSE's proposed study. In the study most favorable to the Large Users, they received no allocation of costs associated with the average portion of small and medium sized main (the "0 Percent to Large Classes" study). Table 1, below, presents the parity ratios from 1) PSE's proposed study, 2) the "0 Percent to Large Classes" study, and 3) NWIGU's proposed study. Since the only difference between the studies is the treatment of medium and small main, this comparison indicates that Mr. Schoenbeck's proposal presents an extreme view of cost responsibility for mains. This is most evident in the parity percentages for Schedules 85/85T, 87/87T and contracts. Since Mr. Schoenbeck's revenue spread is dependent on his calculated parity ratios, his recommendations on rate spread should also be rejected.

**Table 1: Summary of Gas Parity Ratios**

| Customer Class | Company Proposal | 0% to Large Classes | NWIGU Exhibit DWS-6 |
|---|---|---|---|
| Total System | 1.00 | 1.00 | 1.00 |
| Residential (Schedules 23, 16, 53) | 0.99 | 0.99 | 0.98 |
| Commercial & Industrial (Schedules 31, 61) | 0.97 | 0.96 | 0.96 |
| Large Volume (Schedules 41, 41T) | 1.32 | 1.29 | 1.29 |
| Interruptible (Schedule 85, 85T) | 1.20 | 1.55 | 1.68 |
| Limited Interruptible (Schedule 86) | 1.62 | 1.58 | 1.58 |
| Non-exclusive Interruptible (Schedule 87, 87T) | 0.96 | 1.08 | 1.15 |
| Special Contracts | 0.80 | 0.89 | 1.01 |
| Rentals (Schedules 71, 72, 74) | 0.80 | 0.80 | 0.80 |

**B. Income Taxes – Gas and Electric**

**Q. What criticism of the treatment of income taxes in the gas and electric cost of service studies was made?**

A. Public Counsel witness Glenn Watkins argues that PSE's allocation of income taxes on rate base was incorrect for both the gas and electric cost of service studies. He argues that allocation of income taxes based on rate base investment "has the potential to significantly distort individual class profitability at current rates and provide inaccurate information as to the adequacy, or inadequacy, of current rates." (Exhibit No. GAW-1T, page 7, lines 12-14).

**Q. Please address Mr. Watkins's statement that PSE's allocation of income taxes at current rates results in an error in the determination of class revenue requirements and attendant parity ratios (Exhibit No. GAW-1T, page 8, lines 13-15).**

A. PSE allocated income taxes correctly in both the electric and gas cost of service studies. However, with respect to PSE's electric cost of service study, there is a miscalculation of the revenue deficiency that results in misstated parity ratios. As I explain below, the remedy for this is not to change the treatment of income taxes but to change the calculation of the electric revenue deficiency. In the gas cost of service study there is no miscalculation of the revenue deficiency, and the gas parity ratios are correct.

**Q. What was the nature of the miscalculation in the electric cost of service study?**

A. The revenue conversion factor was misapplied to the electric rate classes. This factor is shown as line 27 on page one of Exhibit No. DWH-3. As originally presented, the factor was the same for all classes. Instead, the impact of the factor should have been allocated to the electric classes based on the underlying cost items that are impacted by revenue. This is the method applied in the gas cost of service study, presented on page one of Exhibit No. JKP-18.

**Q. Please explain the revenue conversion factor.**

A. This factor accounts for the fact that rates must be increased by an amount greater than the amount current rates are deficient because higher rates, with resulting higher revenues, mean the Company will also have higher costs based on those higher revenues, such as certain revenue-based taxes and federal income taxes. For the total system, the operating income deficiency is divided by the conversion factor to determine the revenue deficiency. The problem occurred in the electric study because the system conversion factor was applied as the same percentage to each rate class.

**Q. Why should the factor not be applied as the same percentage to each rate class?**

A. The Company does not incur these costs by class, but instead incurs them in aggregate. Applying the factor as the same percentage to each rate class results in parity ratios that are overstated for classes that are above parity, and understated for classes that are below parity. This is the issue identified by Mr. Watkins at page 8 of his testimony.

**Q. How should the revenue deficiency be calculated by class?**

A. For each class, the revenue deficiency should be calculated as the difference between 1) class revenue at existing rates and 2) class revenue requirement based on allocated costs and equal rates of return for all classes, as presented in the gas study in Exhibit No. JKP-18.

**Q. Has the miscalculation of the revenue deficiency been corrected in the electric cost of service study?**

A. Yes. Please see Exhibit No. JKP-27 for a revised summary of the electric cost of service study. The parity ratios for the Company's original revenue requirement (from Exhibit No. DWH-3, page 1) are shown below in Table 2, along with revised ratios from the orifinal revenue requirement and parity ratios for the proposed revenue requirement in the Company's rebuttal testimony with the correction to the revenue deficiency (from Exhibit No. JKP-27).

**Table 2: Original and Revised Electric Parity Ratios**

| Customer Class | Rate Schedule | Original | Revised Parity Ratios | Rebuttal |
|---|---|---|---|---|
| Residential | 7 | 0.95 | 0.97 | 0.97 |
| General Service, < 51 kW | 24 | 1.07 | 1.04 | 1.04 |
| General Service, 51 – 350 kW | 25/29 | 1.12 | 1.08 | 1.08 |
| General Service, > 350 kW | 26 | 1.05 | 1.03 | 1.03 |
| Primary Service | 31/35/43 | 1.09 | 1.06 | 1.06 |
| Campus Rate | 40 | 0.89 | 0.93 | 0.93 |
| High Voltage | 46/49 | 0.98 | 0.99 | 0.99 |
| Lighting Service | 50-59 | 1.09 | 1.06 | 1.05 |
| Choice Retail Wheeling | 448/449 | 0.94 | 0.92 | 0.92 |

**Q. How does this different calculation of the revenue deficiency by class address the concerns about parity ratios presented by Mr. Watkins in Tables 2-4 on pages 10-11 of Exhibit No. GAW-1T?**

A. Exhibit No. JKP-26 contains the hypothetical example presented in Mr. Watkins's Tables 2-4, plus modified versions of the same tables using the alternative

calculation of revenue deficiency by class. These tables illustrate that the solution to the problem he identifies (a distortion of class revenue requirements and parity ratios) lies in the calculation of revenue deficiency by class rather than the allocation of income taxes. Tables A1, B1 and C1 on the left of Exhibit No. JKP-26 replicate Tables 2-4 presented by Mr. Watkins. Tables A2, B2 and C2 use the same example to demonstrate that the distortion of class revenue requirements and parity ratios does not exist if the revenue deficiency is calculated correctly, as it is in PSE's gas cost of service study. In Table A2, the revenue deficiency is calculated as the difference between revenue requirement and revenue at existing rates at the class level instead of based on the conversion factor. Revenue to cost ratios are less extreme than in Table A1. Tables B2 and C2 illustrate that developing rates based on the revenue requirement in Table A2 results in equal rates of return for both classes. In the gas cost of service study presented in Exhibit No. JKP-18, the deficiency was calculated as it is in Table A2.

**Q. How does Mr. Watkins suggest income taxes be assigned to classes?**

A. He suggests they should be calculated at the class level based on pre-tax earnings by class.

**Q. Would the results of PSE's gas cost of service study be different if income taxes were calculated as Mr. Watkins proposes?**

A. At PSE's proposed revenue requirement, if the revenue deficiency is calculated correctly and equal rates of return are assumed for all classes, the parity ratios

will be the same whether income taxes are allocated on rate base or calculated at the class level as Public Counsel proposes.

Mr. Watkins himself states at page 8, lines 2-4 of his testimony that "it is perfectly acceptable to allocate income taxes on the basis of rate base if the exercise is to determine class tax responsibilities at equal, and required rates of return; i.e., full cost of service." Since the cost of service study does just that, PSE's allocation of income taxes on rate base is appropriate.

**Q. Does this revision affect conclusions stated in Exhibit No. DWH-1T regarding rate spread?**

A. Yes. The revision directly affects the proposed rate spread of Schedules 24 and 25/29. The parity ratios of these classes were overstated in the Company's initial filing. Application of the Company's original rule regarding parity ratios and rate increases results in a larger share of the total increase being assigned to these two classes given the new cost of service results. The parity ratio of Schedule 24 moves from 1.07 (which resulted in a relative rate increase of 75% of average) to 1.04 (which would indicate a relative rate increase of 100% of average). The parity ratio of Schedules 25/29 moves from 1.12 (which resulted in a relative rate increase of 50% of average) to 1.08 (which would indicate a relative rate increase of 75% of average). Since both of these schedules are receiving a larger portion of the increase based on the revised calculations than originally proposed, other rate classes receive slightly smaller portions of the increase. The Company's

revised rate spread proposal is summarized later in my testimony and in Exhibit No. JKP-28.

## C. Electric Demand Allocator

**Q. Please describe the testimony of ICNU witness Donald W. Schoenbeck as it relates to electric cost of service, rate spread and rate design.**

A. ICNU proposes a change in the coincident peak ("CP") demand allocation factor used to allocate demand-related electric production and transmission costs from contributions to the 75 highest load hours to the 16 highest load hours and proposes a change in the peak credit calculation. ICNU also recommends a rate spread that incorporates the results of these proposals. I will discuss the peak demand allocation factor, and Jon A. Piliaris will discuss the change in the peak credit calculation in Exhibit No. JAP-5T.

**Q. Discuss ICNU's proposal to change the peak demand allocation factor.**

A. As with many other cost of service elements, there is no one right or wrong answer to this issue. The demand allocation factor has changed over time. While the Company's proposal is consistent with recent practice, Mr. Schoenbeck raises important issues that should be considered by the Commission.

**Q. How has this demand allocation factor changed over time?**

A. Table 3, below, lists the hours included in the demand allocation factor over the past 25 years.

**Table 3: History of Electric Demand Allocation Factor**

| GRC Docket | CP Demand Allocation Factor |
|---|---|
| U-85-53, U-89-2688T | Average of Top 12 Hours |
| UE-921262, UE-011570 & UE-040641 | Average of Top 200 Hours |
| UE-060266, UE-072300 & UE-090704 | Average of Top 75 Hours |

**Q. Please explain the reasons why the CP demand allocation factor has changed over the years.**

A. These changes reflected arguments made at the time. In general, witnesses representing classes of customers with lower load factors, such as the residential class, argue for a demand allocation factor that includes more hours, while witnesses for classes with higher load factors argue the opposite. The allocation factors listed above reflect Commission decisions based on parties' arguments or compromises resulting from settlement negotiations

## III. GAS AND ELECTRIC RATE SPREAD

**Q. What modifications to the Company's proposed gas rate spread have been proposed?**

A. NWIGU and Public Counsel propose changes to the revenue assignment to

rentals, and NWIGU proposes other changes in addition to the revenue assignment of rentals.

## A. NWIGU Gas Proposal

**Q. What is the appropriate rate spread in this proceeding?**

A. With the exception of NWIGU, all parties in this case have indicated a willingness to accept PSE's proposed gas cost of service study as the basis for determining gas revenue allocation. As I have discussed, NWIGU's proposal is at one extreme and should be rejected. The widespread acceptance of PSE's proposal indicates that the Company's proposed gas rate spread is reasonable and should be accepted.

## B. Gas Rentals

**Q. What proposals have been made in this proceeding with respect to the allocation of revenue responsibility to the rental class?**

A. PSE proposed to give these schedules a 2.5 percent increase, which is the system average increase requested by PSE in its initial filing when gas costs are included in the denominator. The system margin increase was 7.5 percent in PSE's supplemental filing (and 7.1 percent based on the rebuttal revenue requirement). NWIGU recommends an increase that is 200 percent of the system average margin increase, or 15.9 percent based on the revenue requirement in the

Company's supplemental filing. Public Counsel proposes an increase that is 125 percent of the average margin increase, which would be approximately 9.7 percent based on the proposed revenue requirement in the Company's supplemental filing.

**Q. Why did the Company propose a smaller than average margin increase to this class?**

A. With respect to rentals, the cost of service results are distorted by accelerated depreciation of rental plant, which lowers the parity ratio.

**Q. Why is the depreciation expense of gas rental plant accelerated?**

A. In its 2001 general rate case, Docket Nos. UE-0115740 et al., the Company filed a new depreciation study that showed that water heaters and conversion burner rental equipment had been significantly under depreciated for a number of years. As a result, charges to rental customers had been artificially low. New, higher depreciation rates were established going forward, and in addition, a minimum depreciation expense for rentals was established by the Commission to accelerate depreciation and reduce or eliminate the depreciation deficiency that had developed because depreciation rates had been too low. The Company books depreciation based on this minimum, which in the test year resulted in higher depreciation expense than the current depreciation rates would have caused. The adjusted test year depreciation expense in this proceeding reflects the current required minimum.

**Q. What was the test year depreciation expense?**

A. Test year depreciation expense for rentals was $7,664,300, which is the minimum annual expense required by the Commission in PSE's last general rate case, Docket No. UG-072301. Rental customers' total depreciation expense responsibility in the cost of service study also includes an allocation of depreciation expense related to other distribution plant. Total depreciation allocated to rentals is $8,021,896.

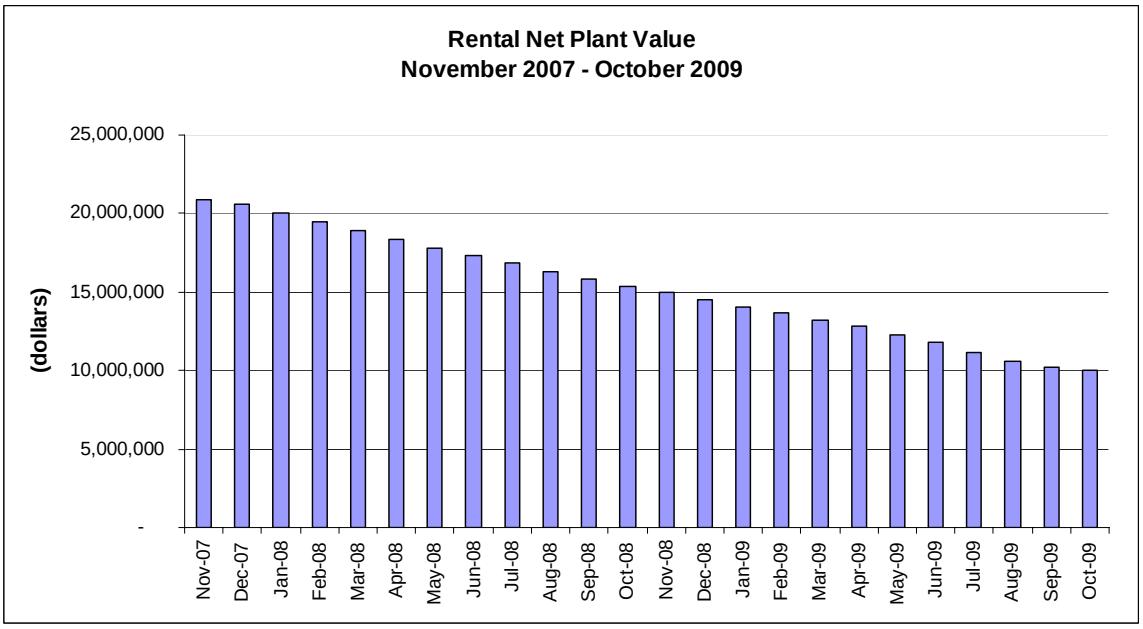
**Q. What would be the impact of using depreciation rates from the most recent depreciation study on test year depreciation expense and cost of service results, instead of using the minimum amount?**

A. If the depreciation rates developed in the depreciation study from the 2007 general rate case were used, test year depreciation of gas rental plant would decline by $545,898. The rental parity percentage would move from 80 percent to 84 percent. However, the depreciation rates are catch-up rates that continue to compensate for the under-depreciation that took place in previous years, so they are high.

**Q. How has rental plant in service changed over time?**

A. Figure 1 presents net plant for rentals from November 2007 through October 2009. This indicates that the plant value has been cut in half in two years.

**Figure 1: Gas Rentals Net Plant**




**Q. How does the accelerated depreciation expense affect the cost of service results?**

A. Approximately $8.0 million of the $11.1 million revenue requirement is related to depreciation. The accelerated depreciation reduces the parity ratio of the rental class below what it would be, given a lower depreciation amount.

**Q. What increases have been assigned to the rental schedules in recent rate cases?**

A. Rentals have received increases higher than the system margin increase in the last four general rate cases in an effort to bring the class to parity, as indicated in Table 4.

**Table 4: Gas Rental and System Rate Increases 2002-2008**

| | 9/1/2002 | 3/4/2005 | 1/13/2007 | 11/2/2008 |
|---|---|---|---|---|
| Rental Increase | 17.3% | 14.5% | 10.6% | 14.8% |
| System Margin Increase | 15.5% | 9.5% | 9.8% | 14.5% |

**Q. What is an appropriate revenue responsibility for rentals in this proceeding?**

A. Even though cost of service results do not yet indicate parity, it does not make sense to give these schedules inordinately large increases at this time. Good ratemaking requires both movement toward cost of service and recognition that such movement should be gradual rather than abrupt if abrupt changes are harmful to customers. The high costs allocated to the rental class in the cost of service are related to accelerated depreciation of rental plant due to under-depreciation in previous years, and cost of service results are expected to be different should the accelerated depreciation come to an end. The increase proposed by the Company, is reasonable. Proposals by Public Counsel and NWIGU to allocate a larger portion of the revenue deficiency to rentals should be rejected.

## C. Electric Rate Spread

**Q. Please describe the testimony of Kroger witness Kevin C. Higgins as it relates to electric cost of service, rate design and rate spread.**

A. Mr. Higgins finds the Company's approach to rate spread generally reasonable, with some recommended "fine tuning". Kroger also recommends the use of "revenue apportionment" in spreading rates, in the event the Commission approves a rate increase that is less than the amount requested by the Company. Finally, Kroger suggests a modest change to PSE's proposed rate design of Schedule 26.

**Q. What is your view on the "fine tuning" of electric rate spread recommended by Mr. Higgins?**

A. Mr. Higgins states that the parity percentages of Schedule 24, at 1.07, and Schedule 26, at 1.05, are similar, but the Company recommends that one class (Schedule 26) receive an average increase while the other (Schedule 24) receive an increase that is 75 percent of average. He believes the difference in parity between the two classes does not warrant the difference in the increase amount, and he advocates an increase that is 85 percent of the average for both. Because the Company has revised its cost of service study to reflect an improved calculation of the revenue deficiency, the concern addressed by Mr. Higgins has been resolved. The Schedule 24 parity ratio moved from 1.07 to 1.04, which increased its revenue assignment from 75 percent of the uniform increase to 100 percent. The Schedule 26 parity ratio moved from 1.05 to 1.03, so its revenue assignment remains at the originally proposed 100 percent of the uniform increase. The two classes are now assigned the same percentage increase, so Mr. Higgins's adjustment is not necessary. Table 5 presents PSE's originally

proposed and revised parity percentages and revenue assignments.

**Table 5: Original and Revised Electric Parity Ratios and Revenue Assignments**

| Customer Class | Rate Schedule | Original Parity Ratio | Original Rate Impact | Revised Parity Ratio | Revised Rate Impact |
|---|---|---|---|---|---|
| Residential | 7 | 0.95 | 8.37% | 0.97 | 5.94% |
| General Service, < 51 kW | 24 | 1.07 | 6.28% | 1.04 | 5.94% |
| General Service, 51 – 350 kW | 25/29 | 1.12 | 4.19% | 1.08 | 4.45% |
| General Service, > 350 kW | 26 | 1.05 | 8.37% | 1.03 | 5.94% |
| Primary Service | 31/35/43 | 1.09 | 6.28% | 1.06 | 4.45% |
| Campus Rate | 40 | 0.89 | 8.68% | 0.93 | 6.36% |
| High Voltage | 46/49 | 0.98 | 8.37% | .99 | 5.94% |
| Lighting Service | 50-59 | 1.09 | 6.28% | 1.05 | 5.94% |
| Choice Retail Wheeling | 448/449 | 0.94 | 8.37% | 0.92 | 7.42% |
| Firm Resale / Special Contract | 5 | 0.88 | 22.35% | 0.90 | 16.83% |
| **Total Sales** | | **1.00** | **7.41%** | **1.00** | **5.67%** |

**Q. Describe Kroger's proposal for the spreading of a rate increase that is less than that proposed by the Company, described on page 10 of Exhibit No. KCH-2T?**

A. Mr. Higgins would spread this rate increase in a manner that preserves the same percentage responsibility for the total retail revenue requirement as proposed in Kroger's reply testimony. For instance, based on the Company's initial proposed revenue requirement and Kroger's proposed rate spread, 56 percent of the new total revenue requirement (revenue at existing rates plus the increase) would be the responsibility of the residential sector. Mr. Higgins would then spread a rate increase of a lesser amount in proportion to each class's contribution to this total revenue requirement.

**Q. What is your view of Kroger's proposal?**

A. The Company opposes this proposal. The many components of the revenue requirement are still being considered in this case, as is the cost of service analysis. Changes to the revenue requirement and the cost of service analysis could result in changes to the revenue responsibility of the customer classes, and final rates should reflect these changes. Otherwise, all arguments regarding cost of service, other than the Company's initial proposal and Kroger's, would be moot.

**Q. What are ICNU's recommendations for electric rate spread?**

A. ICNU recommends that after considering cost based rate levels for special contracts, firm resale, retail wheeling and Schedule 40, Residential Schedule 7 receive the rest of the increase and all other classes receive no increase to achieve the overall residual increase approved by the Commission in this proceeding.

**Q. What is the Company's response to ICNU's recommendations for electric rate spread?**

A. ICNU's electric rate spread proposal is based on its cost of service study, both of which the Company oppose. The Company's revised electric rate spread proposal is provided as Exhibit No. JKP-28.

## IV. GAS AND ELECTRIC RATE DESIGN

### A. Gas Demand Charge

**Q. What is the Company's proposal regarding the gas demand charge?**

A. The Company proposed to 1) increase the Schedule 87/87T demand charge by an equal percentage to $1.19 based on the Schedule 87/87T increase, 2) increase the demand charge for Schedules 41, 85/85T and 86 to the same $1.19 level, and 3) modify other rate components of Schedules 41, 85/85T and 86 to compensate for this increase to the demand charge.

**Q. Please describe NWIGU's proposal regarding the demand charge for Schedules 85/85T, 86 and 87/87T.**

A. NWIGU proposes to leave the demand charge at the current $1.10 level per therm of contract demand. Mr. Schoenbeck points out on page 13 of his testimony that the Company's proposal would result in intra-class impacts to Schedule 86 customers even though the class would not receive an increase in total.

**Q. Do you agree with NWIGU's proposal?**

A. No.

**Q. What is the basis for the demand charge proposed by the Company?**

A. The cost of service study presented in Exhibit No. JKP-18 includes a unit cost analysis. The total demand-related revenue requirement for Schedules 41, 85/85T, 86 and 87/87T of $24.3 million divided by the total annual billing determinants of 6.1 million yields a combined cost of about $4.00 per therm of demand. PSE's current $1.10 and proposed $1.19 rates are still far below this level. There is no justification to exempt the demand charge from the equal percentage increase proposed by the Company.

**Q. Why does NWIGU argue the demand charge should be maintained at the current level?**

A. At page 13 of Exhibit No. DWS-5T, Mr. Schoenbeck refers to the recent addition of five new transportation tariffs as the reason to leave the demand charge unchanged. He appears to argue that because the Company has new transportation schedules, no changes should be made to the rate structure of Schedule 86.

**Q. Please respond to NWIGU's reasoning.**

A. The addition of transportation tariffs at the end of 2008 did include a new transportation tariff, Schedule 86T, that is parallel to sales Schedule 86.

However, no Schedule 86 sales customers were affected by the addition of new tariffs or the closure of Schedule 57. To date, no customers have elected to take service on Schedule 86T. Schedule 86 customers have not been impaired by the new tariffs, so the new tariffs are no reason to leave the Schedule 86 demand charge unchanged. The addition of new transportation tariffs is also no reason to exempt the demand charge for interruptible customers from the equal percentage increase proposed by the Company. Further, it does not outweigh the cost of service reasons for increasing the demand charge that were discussed earlier in my testimony.

Mr. Schoenbeck expresses concern about changing the relationship between components of Schedule 86 rates. In fact, the Company's proposed changes to the components of Schedule 86 rates would result in very small customer impacts. On an annual basis, changes to customer bills would range from -0.2 percent to 1.0 percent. Mr. Schoenbeck fails to mention that his proposal, to increase energy charges and basic charges by a greater percentage than demand charges, changes that relationship for Schedules 85/85T and 87/87T. It was the Schedule 85/85T and 87/87T customers who were impacted by the new tariffs, rather than the Schedule 86 customers. PSE's proposal to increase the demand charge by an equal percent of the Schedule 87/87T increase is appropriate.

**B. Electric Schedule 26**

**Q. What is Kroger's recommendation regarding the design of the Schedule 26 rate?**

A. Kroger would link both the demand and energy charges of Schedules 26 and 31 such that the differential between the demand and energy charges of the two schedules is equalized. This would result in percentage increases in demand, energy and basic charges that are more equal than under the Company's proposal, and individual customer increases that are also more equal than under the Company's proposal. Kroger's recommendation is an acceptable alternative to the Company's rate design for Schedule 26.

**C. Gas and Electric Basic Charges**

**Q. What arguments have been made by interveners with respect to the residential basic charge?**

A. Public Counsel argues that the gas basic charge should remain at the current level of $10.00 and that customer-related costs are only $8.21, compared with the $19.91 supported by the Company's gas cost of service study (Exhibit No. JKP-18).

Public Counsel argues that the electric basic charge should remain at the current level of $7.00 and that customer-related costs are only $3.61, compared with the $9.01 supported by the Company's electric cost of service study (Exhibit

No. DWH-3).

**Q. Do you agree with Public Counsel's adjustments to the customer costs?**

A. No. Mr. Watkins's adjustments are based on a flawed cost of service analysis and mischaracterization of PSE's line extension policy.

**Q. What is the basis for Mr. Watkins' adjustment to the customer costs?**

A. Mr. Watkins argues that inclusion of the costs of services, meters and other expenses in the monthly basic charge results in double counting of costs because the Company has a line extension policy, by which certain customers pay costs in addition to those included in general rates in order to initiate service.

**Q. Do higher monthly charges cause double charging, as stated by Mr. Watkins at page 24 of his testimony?**

A. No. The rate base presented in this proceeding includes a credit for customer advances related to line extensions, and the revenue requirement is offset by revenue received from customers from the new customer charges mentioned by Mr. Watkins. The costs charged to customers through customer advances and new customer rates through the line extension policy are separate from those costs included in general rates. Thus, line extension costs are not included in this proceeding and are not included in the Company's proposed charges. Mr. Watkins seems to claim that because the Company has a line extension policy, under which new customers directly pay certain extraordinary costs associated

with line extensions, the normal costs new customers do not directly pay should not be classified as customer costs. This is unreasonable.

**Q. Does the Company's line extension policy recognize that revenue contributions should be a function of usage, as stated by Mr. Watkins at page 33, lines 3-4 of his testimony?**

A. No. When PSE conducts a Facilities Investment Analysis to determine whether a prospective gas customer will need to make a contribution to the costs of being added to the system, revenues are projected based on estimated usage. This is simply recognition of the fact that most revenue is recovered through volumetric rates due to the existing rate structure, in order to develop good estimates of future revenue. It is not a philosophical position that revenue should be based on consumption.

**Q. How do Mr. Watkins's customer-related costs differ from the Company's?**

A. For gas, Mr. Watkins excludes all capital costs except those in meters and regulators. The biggest items he excludes from customer-related costs are Account 380, services, and general plant and administrative and general ("A & G") costs. For electric, Mr. Watkins removes all capital costs except the cost of meters from customer-related costs.

**Q. Do you agree with Mr. Watkins's definition of customer-related costs?**

A. No. Service lines are commonly considered customer-related costs. Both the

American Gas Association's Gas Rate Fundamentals (page 142) and the NARUC's Gas Rate Design (pages 28-29) indicate that gas services costs are customer-related. NARUC's Electric Utility Cost Allocation Manual (page 87) indicates that electric service line costs are customer-related. Because general plant and A&G costs are typically allocated based on other items, inclusion of a portion of them as customer-related is also customary. The customer-related costs included in PSE's cost of service studies are appropriate to include in monthly basic charges. The $3.61 for electric and $8.21 for gas that Public Counsel presents as customer-related costs are artificially low and should not be considered in setting basic charges in this proceeding.

**Q. What is the consequence to a customer if a basic charge is set below the cost of providing customer services to that customer?**

A. Because rate design is a "zero sum game," if a basic charge is set below the cost of providing basic service, then other charges must be set above their cost of service. For residential customers, the only other charge is a charge per unit of energy consumed, or volumetric charge. Moving recovery of customer-related costs from the basic charge to the volumetric rate results in variations in the amount of customer-related costs actually paid by a customer. The amount of customer costs recovered from an individual customer will vary depending on the amount of energy that customer consumes in a month, even though customer costs do not vary in the month. This has several consequences:

1. It results in customers paying more or less customer costs than their neighbors, even when their customer costs are the same as their neighbors'.

2. It results in almost all customers paying more customer costs in the winter, even though their customer costs are not higher in the winter.

3. It results in almost all customers paying less customer costs in the summer, even though their customer costs are not lower in the summer.

4. It results in customers paying more customer costs when it is cold, even though customer costs do not vary with temperature.

5. It results in the amount of customer costs a customer pays being unpredictable, even though customer costs are actually very predictable.

6. It provides an incentive for the utility to encourage consumption of natural gas or electricity.

**Q. What is the appropriate residential basic charge in this proceeding?**

A. The basic charge should be based on an equal percentage increase of all rate components, as proposed by the Company.

## V. CONCLUSION

**Q. Please summarize your conclusions.**

A. My conclusions are as follows:

1. The Company's gas cost of service is the best indicator of class level costs and should be accepted as the basis for determining class revenue responsibility. The Company's proposed gas rate spread and rate design should be accepted.

2. The Company's treatment of income taxes in both the gas and electric cost of service studies is appropriate. The disparity in parity percentages identified by Mr. Watkins applies only to the electric cost of service study and is correctly resolved by changing the calculation of the class revenue deficiency in the electric cost of service study as presented in Exhibit No. JKP-27.

3. The revised electric rate spread presented in Exhibit No. JKP-28 is appropriate.

4. Reduced levels of customer-related costs as presented by Public Counsel related to both the gas and electric cost of service studies should be rejected, and the basic charges as presented by the Company are reasonable and should be accepted.

5. The Company's proposed gas demand charge is below cost of service levels, and should not be reduced as proposed by NWIGU.

**Q. Does that conclude your prefiled rebuttal testimony?**

A. Yes.