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**VIA ELECTRONIC MAIL AND
OVERNIGHT MAIL**

March 16, 2012

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 BRIEF OF THE KROGER CO. for filing 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.

Jody M. Kyler, Esq.

BOEHM, KURTZ & LOWRY

MLKkew
Enclosures
cc: Certificate of Service

**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

BRIEF OF KROGER CO.

I. INTRODUCTION

Comes now, Kroger' Co. ("Kroger") and submits the following Brief in support of its recommendations that the Washington Utilities and Transportation Commission ("the Commission") adopt the Electric Rate Spread Settlement Agreement filed on January 17, 2012; and reject Puget Sound Energy, Inc.'s ("PSE" or "the Company") proposed Conservation Savings Adjustment ("CSA") rate; or in the alternative refine the CSA proposal in order to limit its scope.

II. ARGUMENT

1. Kroger Supports the Electric Rate Spread Settlement Agreement filed on January 17, 2012.

Kroger signed and supports the adoption of all of the provisions contained in the January 17, 2012 Electric Rate Spread Settlement Agreement. The two settlement issues discussed below are of particular importance to Kroger.

a. **The proposed revision to the Schedule 40 eligibility rules is reasonable.**

The Settlement addresses Kroger's concerns regarding the treatment of Schedule 40. Through the pre-filed Testimony of its witness Kevin Higgins, Kroger argued that the eligibility rules for Schedule 40 should be amended in order to remain consistent with the State of Washington's policies encouraging improvements in energy efficiency.¹

The current Schedule 40 tariff contains the provision that Schedule 40 customers that do not maintain an average of 2 aMW over the entire test year will be removed from the rate schedule. This provision has the effect of penalizing customers that fall below the 2 aMW threshold due to their energy efficiency efforts by moving them to a less favorable rate. The existing language of Schedule 40 may provide a disincentive for customers served under Schedule 40 to pursue energy efficiency. The Settlement Agreement recommends that this potential disincentive be removed by allowing customers that can document that their usage fell

¹ 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."

below the 2 aMW threshold due to their own energy efficiency efforts be permitted to remain on Schedule 40. Paragraph 14 of the Settlement states that the “Settling Parties” agree that the following language should be added to the end of Section 1.b. of Schedule 40:

“However, a Customer whose Schedule 40 usage falls below 2 aMW shall remain on Schedule 40 if the Customer has a designated energy manager and can document to the Company that the reduction in its energy usage below 2 aMW is directly attributable to energy efficiency investments undertaken by the Customer during the time the Customer has been served on Schedule 40.”

This revision to the Schedule 40 tariff will remove the conservation disincentive that Schedule 40 customers face due to the 2 aMW threshold while maintaining that threshold for customers for customers that have fallen off the rate due to non-conservation reasons.

b. The new Renewable Energy Credit Tracker will benefit all customers.

Paragraph 16 of the Settlement provides for a new renewable energy credit (“REC”) tracker that will flow the benefits of REC revenue collected by the Company to its customers. The appropriate ratemaking treatment of REC sales by PSE was previously addressed by the Commission in Docket UE-070725. In Order 03 issued May 20, 2010, and Order 06 issued October 26, 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 (in Order 06) 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 5-year amortization and that the rate case impact of the REC liability will be calculated using the same methodology used for regulatory assets related to production. [Order 06 at ¶ 17]

The tracker proposed in the Settlement is consistent with the Commission's previous Orders, but contains the further benefit that REC proceeds be flowed through to customers through a more expedited 3-year amortization schedule. As explained in Mr. Higgins' response testimony on page 10, the use of a drawn-out period for amortizing the benefit of RECs in rates is extremely conservative and harmful to customers. The only reason for amortizing RECs over a multi-year 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.²

2. The Company's CSA Proposal Is Unreasonable And Should Be Rejected.

As described in the direct testimony of Company witness 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

² Response Testimony of Kevin Higgins at 10.

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 2011.³

Kroger's primary objection to the Company's CSA proposal is that it does not merely seek to hold the utility harmless from its conservation efforts, but is in fact a "revenue assurance" mechanism that captures 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 and has nothing to do with conservation. 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.⁴

a. The loss of fixed-cost recovery can and should be mitigated through rate design.

The premise for the CSA (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,

³ *Id.* at 19-20.

⁴ *Id.* at 20-21.

all other things being equal, fixed cost recovery from conserving customers on these rate schedules declines.⁵

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.⁶

Unfortunately, PSE's demand charges are not particularly well-aligned with recovery of PSE's fixed costs. This misalignment may have 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.⁷

Before subjecting customers to the CSA 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. A settlement agreement that proposes to do this very thing is currently under consideration by the Arizona Corporation Commission. In 2011, Arizona's largest public utility, Arizona Public Service Company ("APS"), filed a general rate case and proposed to implement, as part of its filing, full revenue decoupling. APS' proposal for full revenue decoupling was opposed by the

⁵ *Id.* at 22.

⁶ *Id.* at 22-23.

⁷ *Id.* at 23.

Arizona Corporation Commission Staff, AARP, the industrial and commercial customer intervention group, and several customers intervening on their own behalf, including Kroger.

In January 2012, APS joined a multi-party settlement agreement in which the utility abandoned its proposal for full revenue decoupling in favor of a narrowly-tailored Lost Fixed Cost Recovery (“LFCR”) mechanism applicable only to customers with demands below 400 kW. The APS settlement agreement includes an opt-out rate design for residential customers who choose not to participate in the LFCR. For customers with demands of 400 kW or greater, the APS settlement agreement addresses the concerns over fixed cost recovery through rate design, i.e., properly-designed customer and demand charges, the same approach that Kroger recommends be explored in this case. (*“These rate schedules shall be modified... to address unrecovered fixed costs through changes in rate design with enhanced distribution demand and BSC charges (Basic Service Charges) and a corresponding adjustment to energy charges.”* See Arizona Corporation Commission, Case No. E-01345A-11-0224, Proposed Settlement Agreement of January 6, 2012, p. 11).

b. If a lost revenue recovery mechanism is adopted by the Commission, several modifications to PSE’s proposal should be made.

If the Commission approves a lost revenue recovery mechanism, it should modify the Company’s proposal in order to limit the program’s scope. First, the Company’s calculation of per-kWh “lost” fixed-cost recovery includes costs that are recovered through demand charges, which as stated above, 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.⁸

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, Kroger recommends 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.⁹

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.¹⁰

⁸ *Id.* at 23-24.

⁹ *Id.* at 24.

¹⁰ *Id.*

c. The Commission should reject the full revenue decoupling proposal being advanced by NW Energy Coalition witness Ralph C. Cavanagh.

Although Kroger does not support PSE's CSA proposal for the reasons cited above, given the choice between full revenue decoupling, as recommended NW Energy Coalition witness Ralph C. Cavanagh, and a lost-revenue approach, a lost revenue approach is preferable, so long as the protections to customers described above are included.

Mr. Cavanagh opposes adoption of PSE's proposed CSA rate, and recommends instead that a full revenue decoupling mechanism be adopted for PSE's electric rates. Mr. Cavanagh proposes targeting "average usage per customer" and attempting to maintain a constant "revenue per customer" or "fixed-cost recovery per customer." This is not an appropriate rate design objective for larger non-residential customers. The fixed-cost recovery per customer of these classes will be very sensitive to the *composition* of these customers. 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.¹¹ 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.¹²

At least two major utilities have recently changed their position regarding their support for a decoupling mechanism for larger non-residential customers based on "average usage per customer." In a recent Detroit Edison rate case, Case No. U-16472, Detroit Edison witness Don

¹¹ Cross Answering Testimony of Kevin Higgins at 3.

¹² *Id.*

M. Stanczak testified that the usage-per-customer-based revenue decoupling mechanism (“RDM”) approved by the Michigan Public Service Commission for Detroit Edison was subject to the very shortcomings Kroger warns about here and failed to accomplish its intended purpose, particularly for larger customers. As described by Mr. Stanczak:

“Edison’s current RDM compares average actual electric use per customer by customer class to the level of average electric use per customer used to set Edison’s base rates in the last rate case, Case No. U-15768. Increases, if any, in average energy use per customer will be multiplied by the average per kWh revenue, from the last rate case, for each class; this total amount will result in customer credits. Similarly, any reductions in average energy use per customer will be multiplied by the average per kWh revenue from the last rate case, with the total being surcharged to customers...”

Edison’s pilot RDM has been in operation since February of 2010. Based on our experience, it is clear that Edison’s current RDM does not meet the requirements of a well designed RDM. Edison’s current RDM is highly sensitive to changes in the number of customers, particularly relative to Commercial and Industrial (C&I) customer classes, which have far fewer absolute numbers of customers than the residential class. More specifically, small changes in numbers of customers, due to such things as plant closing, customer additions, migration among customer classes, including migration to Electric Choice, and the like, have a huge impact on changes in average use per customer. As I indicated earlier, this is particularly true for the C&I customer classes which tend to have relatively low customer counts and high average electric use per customer.

...[G]iven the sensitivity to customer counts, Edison’s current RDM could result in Edison improperly being required to issue refunds to customers even though Edison’s [energy optimization (“EO”)] programs are producing the planned sales reductions and or even if Edison’s sales are declining on an absolute basis. Similarly, the RDM could as likely result in Edison surcharging customers even though its EO programs are not producing the planned energy reductions. In summary, the current Edison RDM is not accomplishing its intended purpose.”¹³

The Detroit Edison full decoupling mechanism described by Mr. Stanczak had been initiated by Detroit Edison and adopted by the Michigan Public Service Commission against


¹³ Michigan Public Service Commission, Case No. U-16472. Pre-filed direct testimony of Don M. Stanczak, pp. 14-16, October 29, 2010.

Kroger's recommendations (and the recommendations of others) in 2009.¹⁴ Yet by late 2010, Detroit Edison was proposing to abandon it in favor of a lost-revenues approach because of the problems and shortcomings described above by the utility's witness. Additionally, as described above, in January of 2012, the Arizona Public Service Company joined a multi-party settlement agreement in which the utility abandoned its proposal for full revenue decoupling in favor of a narrowly-tailored Lost Fixed Cost Recovery mechanism applicable only to customers with demands below 400 kW.

The Commission should reject the full revenue decoupling proposal being advanced by Mr. Cavanagh. If the Commission determines that some type of fixed-cost recovery mechanism is warranted, there are better alternatives, as stakeholders in Michigan and Arizona have concluded.

DATED this 16th day of March, 2012

Respectfully submitted,



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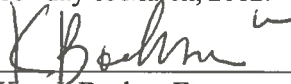
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COUNSEL FOR THE KROGER CO.

¹⁴ Michigan Public Service Commission, Case No. U-15768.

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 16th day of March, 2012.

A handwritten signature in black ink, appearing to read "K. Boehm", with a small flourish at the end.

Kurt J. Boehm, Esq.
Jody M. Kyler, Esq.

MASTER SERVICE LIST

As of: 12/7/2011

Docket: 111048

Original MSL Date: 6/14/2011

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