

**EXHIBIT NO. ____ (KCH-1T)
DOCKET NOS. UE-170033/UG-170034
2017 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-170033
Docket No. UG-170034**

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

June 30, 2017

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1 economics. I joined Energy Strategies in 1995, where I assist private and public
2 sector clients in the areas of energy-related economic and policy analysis,
3 including evaluation of electric and gas utility rate matters.

4 Prior to joining Energy Strategies, I held policy positions in state and local
5 government. From 1983 to 1990, I was economist, then assistant director, for the
6 Utah Energy Office, where I helped develop and implement state energy policy.
7 From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County
8 Commission, where I was responsible for development and implementation of a
9 broad spectrum of public policy at the local government level.

10 **Q. Have you previously appeared as an expert witness?**

11 A. Yes. I have testified in six PSE general rate cases before this Commission, as
12 well as PSE's 2013 decoupling proceeding and the 2009 proceeding that
13 addressed the treatment of revenues from PSE's sales of Renewable Energy
14 Credits. Most recently, I provided testimony in support of a stipulation and
15 agreement reached in PSE's Schedule 451 proceeding. In addition, I have testified
16 in approximately 200 other proceedings on the subjects of utility rates and
17 regulatory policy before state utility regulators in Alaska, Arizona, Arkansas,
18 Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan,
19 Minnesota, Missouri, Montana, Nevada, New Mexico, New York, North
20 Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah,
21 Virginia, West Virginia, and Wyoming. I have also filed affidavits in proceedings
22 before the Federal Energy Regulatory Commission and prepared expert reports in
23 state and federal court proceedings involving utility matters.

1

2

II. RECOMMENDATIONS

3 **Q. What is the purpose of your testimony?**

4 A. My testimony addresses recovery of storm damage costs, revenue allocation
5 across customer classes (or rate spread), revenue decoupling, rate design for
6 Schedule 25, and PSE's proposed Electric Cost Recovery Mechanism. Absence
7 of comment on my part regarding a particular issue does not signify support (or
8 opposition) toward PSE's filing with respect to the non-discussed issue.

9 **Q. Please summarize your conclusions and recommendations.**

- 10 • To avoid likely over-recovery after the rate-effective year, \$6.6 million in deferral
11 costs associated with the December 13, 2006 wind storm could be moved out of
12 base rates into a temporary rider that would expire by its own terms 12 months
13 after the start of the rate effective period. This approach would allow PSE to fully
14 recover this deferred cost while avoiding a subsequent over-recovery from
15 customers that would ultimately have to be credited back.
- 16 • If \$8.1 million in post-test-year catastrophic storm costs are included in the storm
17 damage deferral balance, it should only be to the extent that these post-test-year
18 catastrophic storm costs put the Company's 2017 storm expense above the six-
19 year average storm expense of \$10.6 million, as base rates would already provide
20 recovery of this latter amount.
- 21 • PSE's rate spread proposal does not adhere closely enough to the principles of
22 cost causation. I recommend that the rate schedules needing a rate *decrease* to
23 achieve parity in PSE's cost-of-service study should receive no more than 35% of

1 the adjusted average increase, rather than 75% as proposed by PSE. In addition,
2 the General Service – Primary Voltage class, which warrants an increase less than
3 2% according to the cost-of-service study, should receive no more than 65% of
4 the adjusted average increase, rather than 75%.

- 5 • I recommend that the Commission reject PSE’s decoupling-related proposals to:
6 (1) expand revenue decoupling to include fixed power costs; (2) incorporate a
7 dead band into its earnings test; and (3) increase the soft cap used in the electric
8 rate test from 3% to 5%.
- 9 • PSE’s proposed rate design for Schedule 25 sets demand-related charges too low
10 and energy charges too high, resulting in intra-class subsidies. The Schedule 25
11 rate design should be modified to better align demand-related charges with
12 demand-related costs and energy charges with energy costs.
- 13 • PSE’s proposed Electric Cost Recovery Mechanism should be rejected.

14
15 **III. STORM DAMAGE COSTS**

16 **Q. Please describe how PSE proposes to recover its storm damage costs.**

17 A. In her direct and supplemental testimony, PSE witness Katherine J. Barnard
18 identifies a normal level of storm damage expense based on the average of the
19 past six years, which is approximately \$10.7 million.¹ In addition to the normal
20 level of storm damage expense, PSE proposes to recover the costs of catastrophic
21 storms, the costs of which have been deferred. PSE considers storm events that
22 exceed \$8 million as meeting the threshold for deferral of qualifying costs. The

¹ Direct testimony of Katherine J. Barnard, pp. 44-46; Supplemental direct testimony of Katherine J. Barnard, pp. 10-11.

1 costs of these storms are typically amortized over four years, but longer
2 amortizations are being used for exceptionally costly storm events.

3 The deferred costs for catastrophic storms that are pending approval in the
4 Company's supplemental filing total \$61.0 million.² An over-amortization of
5 prior deferral balances has resulted in a \$12.6 million credit to the account,
6 bringing the deferral balance to \$48.4 million. The balance from the most recent
7 of these storms was updated at the time of PSE's supplemental filing.

8 **Q. Do you have any concerns regarding PSE proposed recovery of storm
9 damage costs?**

10 A. Yes. I have two concerns. One concern is that the amortization expense includes
11 \$6.6 million in deferred costs associated with the December 13, 2006 wind storm
12 that is scheduled to amortize 10 months into the rate year. Since amortization
13 expense is being incorporated into base rates, recovery of this expense would
14 continue even after it is fully amortized, until the rate effective period of the
15 following rate case, whenever that occurs. While I expect that any resulting over-
16 amortization would be credited to customers in the next rate case, it seems
17 unnecessary in the first instance for this amortization expense to continue to be
18 recovered in rates after it is fully amortized.

19 **Q. Do you have a proposed solution for this concern?**

20 A. Yes. To avoid the likely over-recovery of this amortization expense, the \$6.6
21 million in deferral costs associated with the December 13, 2006 wind storm could
22 be moved out of base rates into a temporary rider that would expire by its own
23 terms 12 months after the start of the rate effective period. This approach would

² PSE Exhibit No. ___ (KJB-14).

1 allow PSE to fully recover this deferred cost while avoiding a subsequent over-
2 recovery from customers that would ultimately have to be credited back.

3 **Q. What is your second concern?**

4 A. My second concern pertains to \$8.1 million in 2017 storm costs that PSE added to
5 the catastrophic storm balance in its supplemental filing. If these late-added costs
6 are included in the deferral balance, it should only be to the extent that the \$8.1
7 million in costs associated with this specific storm puts the Company's 2017
8 storm expense above the six-year average storm expense of \$10.6 million, as base
9 rates would already provide recovery of this latter amount.

11 IV. RATE SPREAD

12 **Q. What general guidelines should be employed in spreading any change in**
13 **rates?**

14 A. In determining rate spread, or revenue apportionment, it is important to align rates
15 with cost causation, to the greatest extent practicable. Properly aligning rates with
16 the costs caused by each customer group is essential for ensuring fairness, as it
17 minimizes cross subsidies among customers. It also sends proper price signals,
18 which improves efficiency in resource utilization.

19 At the same time, it can be appropriate to mitigate the impact of moving
20 immediately to cost-based rates for customer groups that would experience
21 significant rate increases from doing so by employing the ratemaking principle of
22 gradualism. When employing this principle, it is important to adopt a long-term

1 strategy of moving in the direction of cost causation, and to avoid practices that
2 result in permanent cross-subsidies from other customers.

3 **Q. Please describe the results of PSE's cost-of-service study.**

4 A. In PSE's supplemental filing made on April 3, 2017, the Company is proposing
5 an increase in its overall base electric revenue requirement of \$144.0 million,
6 which is a 7.3% increase. After taking account of rider resets, this corresponds to
7 a net electric revenue increase of \$68.3 million.³

8 A summary of PSE's cost-of-service study supporting its supplemental
9 filing is presented in table KCH-1, below. The study indicates that the Secondary
10 Voltage and High Voltage classes warrant rate *reductions* at the Company's
11 overall requested revenue requirement. The study also indicates that, at the
12 Company's requested revenue requirement, the Lighting class would receive an
13 increase of 11.46% and the Residential class an increase of 12.73% if rates were
14 set equal to cost of service.

15

³ This is a decrease from PSE's direct filing made on January 13, 2017, which requested an overall base electric revenue requirement increase of \$149.1 million, corresponding to net electric revenue requirement increase of \$86.7 million.

1

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Table KCH-1

3

Summary of PSE Cost-of-Service Study Results ⁴

Voltage Level	Cost of Service		
	Cost-Based Rev. Req't	Cost-Based Increase	Cost-Based Percent Increase
Residential	\$ 1,202,358,458	\$ 135,730,996	12.73%
Secondary Voltage			
Demand <= 50 kW	\$ 263,929,046	\$ (3,015,214)	-1.13%
Demand > 50 kW but <= 350 kW	\$ 252,299,197	\$ (623,612)	-0.25%
Demand > 350 kW	\$ 151,609,366	\$ (225,377)	-0.15%
Total Secondary Voltage	\$ 667,837,609	\$ (3,864,203)	-0.58%
Primary Voltage			
General Service / Irrigation	\$ 102,804,802	\$ 1,161,908	1.14%
Interruptible Total Electric Schools	\$ 11,071,133	\$ 733,309	7.09%
Total Primary Voltage	\$ 113,875,935	\$ 1,895,217	1.69%
Campus Rate	\$ 51,240,362	\$ 3,403,725	7.12%
Total High Voltage	\$ 39,789,737	\$ (570,353)	-1.41%
Choice / Retail Wheeling	\$ 12,577,744	\$ 5,064,459	67.41%
Lighting	\$ 19,134,162	\$ 1,967,065	11.46%
Total Jurisdictional Retail Sales	\$ 2,106,814,008	\$ 143,626,907	7.32%
Firm Resale / Special Contract	\$ 721,532	\$ 405,139	128.05%
Total Sales	\$ 2,107,535,540	\$ 144,032,046	7.34%

4

5 **Q. Do you have any comments regarding the cost-of-service method used by**
6 **PSE in preparing its study?**

7 **A. Yes.** As explained by PSE witness Jon Piliaris, the Company allocated
8 production and transmission costs in accordance with a rate design settlement
9 agreement approved by the Commission in Docket No. UE-141368, which

⁴ Source: PSE Response to Kroger Data Request 5, Attachment A.

1 governs cost allocation in this case. I participated in the negotiation of the rate
2 design settlement agreement on behalf of Kroger. While I do not agree with a
3 number of the individual components used in the settlement, I supported – and
4 continue to support – the rate design settlement agreement as a compromise
5 package, including the use of the 25% demand/75% energy cost classification for
6 production and transmission costs used by Mr. Piliaris in the Company’s cost-of-
7 service study.

8 **Q. Please describe PSE’s proposed rate spread.**

9 A. As described by Mr. Piliaris in his direct and supplemental testimony,⁵ PSE
10 proposes to apply an “adjusted average” rate increase of 8.16% to retail classes
11 that are within five percent of full parity in the Company’s cost-of-service study.
12 The adjusted average rate increase is actually a target baseline increase calculated
13 by removing the increases for Schedule 40, Transportation, and Firm Resale, and
14 then accounting for the effect of several rate schedules that are proposed to
15 receive increases below the adjusted average increase. For the retail classes that
16 are more than five percent above full parity, the company proposes to apply a rate
17 increase of 6.12%, which is 75 percent of the adjusted average. The proposed
18 electric base rate increases, as revised in the Company’s supplemental filing are
19 shown in the Table KCH-2 below.⁶

20 Consistent with PSE’s last rate case, the rates for Schedule 40 are
21 calculated rather than based on a cost of service and rate spread analysis. This is
22 due to the fact that the rates are tied to the High Voltage Schedules, and therefore,

⁵ See direct testimony of Jon A. Piliaris, pp. 52-55; Supplemental direct testimony of Jon A. Piliaris, p. 12; PSE Exhibit No. __ (JAP-39).

⁶ Direct testimony of Jon A. Piliaris, p. 12.

1 are based on the production and transmission charges in the High Voltage
 2 Schedules, while the distribution charges are customer-specific. The Firm Resale
 3 class is moved to full parity to avoid any cross-jurisdictional subsidy.

4 **Table KCH-2**

5 **PSE Proposed Rate Spread⁷**

Voltage Level	PSE Proposal				
	Percent of Uniform Increase	Proposed Revenue Increase (%)	Proposed Revenue Increase (\$)	Proposed Revenue	Parity Percentage
	E	F	G = B x F	H = B + G	
Residential	100%	8.16%	\$ 87,073,909	\$ 1,153,701,371	96%
Secondary Voltage					
Demand <= 50 kW	75%	6.12%	\$ 16,343,954	\$ 283,288,214	107%
Demand > 50 kW but <= 350 kW	75%	6.12%	\$ 15,485,475	\$ 268,408,284	106%
Demand > 350 kW	75%	6.12%	\$ 9,296,248	\$ 161,130,991	106%
Total Secondary Voltage			\$ 41,125,677	\$ 712,827,489	107%
Primary Voltage					
General Service / Irrigation	75%	6.12%	\$ 6,223,197	\$ 107,866,091	105%
Interruptible Total Electric Schools	100%	8.16%	\$ 843,926	\$ 11,181,750	101%
Total Primary Voltage			\$ 7,067,123	\$ 119,047,841	105%
Campus Rate		8.44%	\$ 4,036,751	\$ 51,873,388	101%
Total High Voltage	75%	6.12%	\$ 2,471,091	\$ 42,831,181	108%
Choice / Retail Wheeling		6.00%	\$ 450,940	\$ 7,964,225	63%
Lighting	100%	8.16%	\$ 1,401,432	\$ 18,568,529	97%
Total Jurisdictional Retail Sales		7.32%	\$ 143,626,923	\$ 2,106,814,024	100%
Firm Resale / Special Contract		128.05%	\$ 405,143	\$ 721,536	100%
Total Sales		7.34%	\$ 144,032,066	\$ 2,107,535,560	100%

6
 7 **Q. What is your assessment of PSE' spread proposal?**

8 **A.** PSE's rate spread proposal does not adhere closely enough to the principles of
 9 cost causation. According to the Company's cost-of-service study, the Secondary

⁷ Source: PSE Supplemental Exhibit No. __ (JAP-39).

1 Voltage and High Voltage classes deserve rate *decreases*, even at the Company's
2 full requested revenue requirement increase. Yet the Company proposes that
3 these rate schedules receive 75% of the adjusted average increase. This is
4 unreasonable.

5 **Q. What is your recommended rate spread?**

6 A. I recommend that the rate schedules needing a rate decrease to achieve parity in
7 PSE's cost-of-service study should receive no more than 35% of the adjusted
8 average increase, rather than 75%. In addition, the General Service – Primary
9 Voltage class, which warrants an increase less than 2% according to the cost-of-
10 service study, should receive no more than 65% of the adjusted average increase,
11 rather than 75%. My recommended rate spread at PSE's requested revenue
12 requirement (supplemental) is presented in Kroger Exhibit No. __ (KCH-2) and is
13 summarized in Table KCH-3 below. Kroger Exhibit No. __ (KCH-2) also
14 presents a direct comparison to PSE's proposed rate spread. Under my proposal,
15 at the Company's requested revenue requirement, the Secondary Voltage and
16 High Voltage classes would receive rate increases of 3.46%, instead of 6.12%
17 under the Company's proposal. While my proposal would still subject these
18 classes to an increase when none is warranted, it is a more reasonable increase
19 than that proposed by the Company, and better balances the ratemaking principles
20 of gradualism and cost causation.

21

Table KCH-3

Kroger Proposed Rate Spread at PSE's Requested Revenue Requirement

Voltage Level	Kroger's Recommended Spread at PSE's Supplemental Requested Revenue Increase				
	Percent of Uniform Increase	Proposed Revenue Increase (%)	Proposed Revenue Increase (\$)	Proposed Revenue	Parity Percentage
	E	F	G = B x F	H = B + G	
Residential	100%	9.87%	\$ 105,298,295	\$ 1,171,925,757	97%
Secondary Voltage					
Demand <= 50 kW	35%	3.46%	\$ 9,223,531	\$ 276,167,791	105%
Demand > 50 kW but <= 350 kW	35%	3.46%	\$ 8,739,058	\$ 261,661,867	104%
Demand > 350 kW	35%	3.46%	\$ 5,246,235	\$ 157,080,978	104%
Total Secondary Voltage			\$ 23,208,824	\$ 694,910,636	104%
Primary Voltage					
General Service / Irrigation	65%	6.42%	\$ 6,522,273	\$ 108,165,167	105%
Interruptible Total Electric Schools	100%	9.87%	\$ 1,020,558	\$ 11,358,382	103%
Total Primary Voltage			\$ 7,542,831	\$ 119,523,549	105%
Campus Rate		8.44%	\$ 4,036,751	\$ 51,873,388	101%
Total High Voltage	35%	3.46%	\$ 1,394,533	\$ 41,754,623	105%
Choice / Retail Wheeling		6.00%	\$ 450,940	\$ 7,964,225	63%
Lighting	100%	9.87%	\$ 1,694,749	\$ 18,861,846	99%
Total Jurisdictional Retail Sales		7.32%	\$ 143,626,923	\$ 2,106,814,024	100%
Firm Resale / Special Contract		128.05%	\$ 405,143	\$ 721,536	100%
Total Sales		7.34%	\$ 144,032,066	\$ 2,107,535,560	100%

V. REVENUE DECOUPLING

Q. Please described the Company's current electric decoupling mechanism.

A. As described in the direct testimony of Mr. Pilaris, PSE's decoupling mechanisms are intended to remove the "throughput incentive" that would otherwise incentivize the Company with greater revenues for increased sales. Currently, the electric decoupling mechanism pertains to the recovery of delivery costs, but not the costs of supply. The mechanism sets an allowed delivery revenue per

1 customer and allowed delivery revenue per month, based on the number of
2 customers. PSE tracks monthly deferrals, which are calculated as the difference
3 between its allowed delivery revenue and actual delivery revenue. The deferral
4 amounts are trued up in the Company's annual Schedule 142 rate filing. PSE's
5 delivery revenue per customer has grown annually by a "K-factor," which is 3.0
6 percent for electric customers.⁸

7 The electric decoupling mechanism has four rate groups: (i) Residential,
8 (ii) Schedules 12 and 26, (iii) Schedules 10 and 31, and (iv) a group comprised of
9 Schedules 8, 11, 24, 25, 29, 40, 43, 46 and 49. Schedules 10, 12, 26, and 31 use
10 demand charges as the basis for determining deferrals, while the other schedules
11 utilize energy charges for that purpose.

12 There are three key components that are currently part of the decoupling
13 mechanism. First, there is an earnings test that requires PSE to share 50% of the
14 amount that it earns above its authorized 7.77% rate of return. There is also a rate
15 test that limits the rate increase to no more than 3% in a single year. If the
16 decoupling mechanism results in amounts that cannot be recovered due to the rate
17 test, then those amounts are eligible to be recovered in a subsequent rate period.
18 Further, there is additional assistance and weatherization funding for low-income
19 customers and a commitment for PSE to utilize a third-party to review its
20 decoupling mechanism.

21 **Q. Is PSE proposing any changes to its electric decoupling mechanism?**

⁸ Direct testimony of Jon A. Piliaris, pp. 106-109

1 A. Yes, PSE is proposing several changes to its mechanism. First, the Company is
2 proposing to include fixed power costs, in addition to delivery costs, in the
3 mechanism. Secondly, it is proposing a change to the earnings test that would
4 include a dead band around its authorized return within which no sharing of
5 excess earnings with customers would occur. PSE is also proposing changes to
6 the rate test and the alignment of the decoupling rate groups.

7 **Q. Please describe PSE’s proposal to move fixed power costs into its electric**
8 **decoupling mechanism.**

9 A. As described above, currently only delivery costs are included in the electric
10 decoupling mechanism. PSE’s new proposal stems from Power Cost Adjustment
11 (“PCA”) settlement stipulation in Docket UE-130617, in which the signatory
12 parties agreed that if the electric decoupling mechanism continues after the review
13 of this general rate case, the mechanism would be expanded to include fixed
14 power costs. PSE, Staff and Public Counsel are parties to the settlement, while
15 Industrial Consumers of Northwest Utilities opposed the settlement.⁹ Kroger is
16 not a party to the PCA settlement stipulation.

17 Consistent with the PCA settlement, PSE proposes to add fixed costs to
18 the electric decoupling mechanism starting January 1, 2017 and has filed an
19 accounting petition to request deferral of revenue variances associated with the
20 recovery of fixed power costs. PSE has included the fixed power costs in the
21 decoupling mechanism in its filing, but the costs have been kept in a separate
22 category from the delivery costs for the allowed revenue per customer
23 calculations.

⁹ Docket UE-130617, Order 11 at 2.

1 **Q. What is your assessment of PSE’s proposal to expand the decoupling**
2 **mechanism to include fixed power costs?**

3 A. I recommend against adoption of this provision. Expansion of the decoupling
4 mechanism to include fixed generation costs unreasonably shifts additional risks
5 from the Company to customers.

6 At the most fundamental level, decoupling is as much a “revenue
7 assurance” mechanism as it is a “conservation enabling” mechanism. As such, it
8 captures a much wider range of effects than just customer responses to utility-
9 sponsored energy efficiency programs, even though the latter constitutes the
10 underlying justification for its adoption. For example, decoupling provides
11 unwarranted insulation to the utility from the effects of price elasticity.

12 Generally, all sellers of goods face a risk that price increases will reduce sales.
13 But, under PSE’s decoupling program, if customers respond to utility rate hikes
14 by reducing their electricity, fixed charges are increased to compensate the
15 Company for any resultant reduction in per-customer usage. Such an increase
16 reflects an undue transfer of risk from Company shareholders to customers.
17 While this transfer of risk has already occurred under the existing decoupling
18 program, inclusion of fixed production costs exacerbates this risk transfer.

19 Further, to the extent that customers reduce usage in response to economic
20 conditions or otherwise practice self-funded energy conservation, these behaviors
21 are captured in the decoupling adjustment and unduly increase rates to customers.
22 The increase in rates to customers from these actions that accompany revenue
23 decoupling is a further example of a transfer of utility business risk to customers,

1 which would be increased if the mechanism is expanded to include fixed
2 production costs.

3 **Q. Please explain PSE's proposal to incorporate a dead band into its earnings**
4 **test.**

5 A. As explained in the Direct Testimony of Daniel Doyle,¹⁰ PSE's current earnings
6 test requires that 50% of earnings above its authorized rate of return, currently
7 7.77%, be shared with its customers. Mr. Doyle asserts that this kind of sharing
8 mechanism creates an asymmetrical earnings profile for the Company because the
9 upside earnings are shared but the downside risk of under earning is not.

10 To address this issue, PSE is proposing to institute a "dead band" of 25
11 basis points, whereby there would be no sharing of earnings within 25 basis points
12 of PSE's authorized rate of return. PSE would begin sharing 50% of potential
13 over earnings after those earnings exceed 25 basis points above the authorized
14 rate of return.

15 **Q. What is your response to the Company's proposal to incorporate a dead**
16 **band into its earning test?**

17 A. I recommend that the proposed dead band be rejected. There should be no
18 presumption that an earnings test adopted in conjunction with a decoupling
19 mechanism should be symmetrical. The approval of PSE's current revenue
20 decoupling mechanism transferred risk from the Company to customers. It was
21 an asymmetrical transfer to the benefit of PSE. If, in partial mitigation of that
22 transfer, an earnings test was adopted, it is not necessary for the earnings test
23 itself to be symmetrical since it was adopted to partially mitigate the effects of a

¹⁰ Direct testimony of Jon A. Piliaris, pp. 21-25.

1 ratemaking change that itself was not symmetrical. Thus, the “problem” that PSE
2 is trying cure is not a problem in the first place, at least not from a public interest
3 perspective.

4 The Commission previously rejected a prior dead band proposal advanced
5 by the Company and should do so again.

6 **Q. What change is PSE proposing for the electric rate test?**

7 A. PSE is proposing to increase the soft cap for the electric rate test from 3% to 5%.
8 As explained by Mr. Piliaris, even though the 3% rate test has been sufficient
9 heretofore, if fixed power costs are included in the decoupling mechanism as
10 proposed by PSE, it will put additional upward annual pressure on electric rates.¹¹

11 **Q. What is your recommendation regarding PSE’s proposal to increase the**
12 **electric rate test to 5%?**

13 A. I recommend that the increase to the electric rate test be rejected. If fixed power
14 costs are excluded from the decoupling mechanism, as I recommend, the increase
15 to the soft cap in the rate test is unnecessary.

16 **Q. What is PSE proposing with respect to reclassification?**

17 A. PSE is proposing to disaggregate some of the customer groupings. I see no
18 reason to object to this.

19 **Q. Do you have any other observations regarding the operation of the**
20 **decoupling mechanism?**

21 A. Yes. As discussed by Mr. Piliaris, decoupling deferrals for Schedules 29 and 31
22 are calculated based on actual delivery revenue recovered from demand charges

¹¹ Id., p. 136.

1 rather than energy sales.¹² A demand-charge-based deferral makes sense for these
2 rate schedules. If the decoupling mechanism is continued, the calculation of the
3 deferral for these rate schedules should continue to be tied to demand charge
4 revenues.

6 VI. DESIGN OF SCHEDULE 25

7 **Q. What is your assessment of PSE's proposed rate design for Schedule 25?**

8 A. PSE's rate design for this rate schedule should be improved. As shown in Kroger
9 Exhibit No. __ (KCH-3), p. 3, PSE's proposed demand-related charges under-
10 recover demand-related costs by \$19.7 million for this rate schedule. At the same
11 time, the proposed energy charges over-recover energy costs by \$35.7 million,
12 \$16.1 million of which funds the subsidy that Schedule 25 would pay to other
13 customer classes under PSE's rate spread proposal.

14 **Q. Why is it important for rate design to be representative of underlying cost
15 causation?**

16 A. Cost should be borne by those who cause the costs to be incurred, and aligning
17 rate design with underlying cost causation improves efficiency because it sends
18 proper price signals. For example, setting demand charges below the cost of
19 demand understates the economic cost of demand-related assets, which in turn
20 distorts consumption decisions, and calls forth a greater level of investment in
21 fixed assets than is economically desirable.

22 At the same time, aligning rate design with underlying cost causation is
23 important for ensuring equity among customers, because properly aligning

¹² Id., p. 112.

1 charges with costs minimizes cross-subsidies among customers. If demand
2 charges are understated in utility rates, the costs are made up elsewhere –
3 typically in energy rates, which is the case here.

4 **Q. From a customer's perspective, why should it matter if a rate design does not**
5 **closely align demand-related costs with demand charges?**

6 A. If a utility's demand charges are not aligned closely with the cost of demand, the
7 utility is going to seek to recover its class revenue requirement by over-recovering
8 its costs in another area, most typically through levying an energy charge that is
9 above unit energy costs, as we can see. For a given rate schedule, such as
10 Schedule 25, when demand charges are set below demand-related cost, and
11 energy charges are set above energy cost, those customers with relatively higher
12 load factors, i.e., those customers that use fixed assets relatively efficiently
13 through relatively constant energy usage, are forced to pay the demand-related
14 costs of lower-load-factor customers. This amounts to a cross-subsidy that is
15 fundamentally inequitable.

16 The subsidy consists of the net increase in rates paid by these customers as
17 a result of setting energy charges above energy costs and demand charges below
18 demand-related costs.

19 **Q. What rate design modification are you recommending?**

20 A. I recommend setting the Schedule 25 demand-related charges and energy charges
21 much closer to cost. This can be implemented by keeping the tail-block energy
22 charge unchanged in this case, and recovering any revenue requirement increase
23 apportioned to this rate schedule by: (a) increasing the basic charge as proposed

1 by PSE, and (b) increasing the demand-related charges to recover the revenue
2 requirement balance. For Schedule 25, the demand-related charges consist of the
3 demand charge, as well as the portion of the initial energy block rate in excess of
4 the tail-block rate. As shown in Exhibit No. __ (KCH-3), p. 2, the alignment of
5 costs and charges under my proposal is improved by \$11 million.¹³

6 **Q. Why do you consider the portion of the initial energy block rate that is in**
7 **excess of the tail-block rate to be a demand-related charge?**

8 A. In the case of Schedule 25, there is no demand charge levied on the first 50 kW of
9 demand. The energy tail-block generally corresponds to the consumption level at
10 which the demand charge becomes applicable; therefore, it properly represents the
11 purely energy-related component of the overall rate. The initial energy blocks,
12 which are higher than the tail-block rate, have an implied demand component that
13 is equal to the difference between the initial-block energy charge and the tail-
14 block energy charge. In my proposed rate design, when I increase demand-related
15 charges, I increase the demand charge and the demand-related portion of the
16 initial energy block by the same percentage.

17 **Q. Does Exhibit No. __ (KCH-3) illustrate your recommended Schedule 25 rate**
18 **design?**

19 A. Yes. For the purpose of illustrating my rate design modification, I am using
20 PSE's proposed rates, recognizing that these are subject to change based on the
21 outcome of this proceeding. Exhibit No.__(KCH-3), p. 1, shows these
22 calculations. The rate design approach I am recommending can be applied to any
23 final revenue requirement determination for this rate schedule.

¹³ This can be seen by comparing the final row on page 3 of the exhibit with the final row on page 2.

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VII. PROPOSED ELECTRIC COST RECOVERY MECHANISM

3

Q. What is PSE proposing regarding an Electric Cost Recovery Mechanism (“ECRM”)?

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A. As explained in the direct testimony of Catherine A. Koch, PSE is proposing to implement an Electric Reliability Plan and associated ECRM focused on distribution reliability improvements. Specifically, the plan concentrates on improving PSE’s worst performing circuits and accelerating the replacement of deteriorating underground direct-bury high-molecular-weight cable.¹⁴

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According to the direct testimony of Ms. Barnard, the proposed ECRM would include the return on incremental plant investment and depreciation expense, grossed up for income taxes and revenue sensitive items. The applicable plant investment would be net of accumulated depreciation and accumulated deferred income taxes.¹⁵

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Based on PSE’s proposed 2017 program year expenditures of \$76.4 million and requested rate of return, the initial ECRM revenue requirement projected in PSE’s direct filing is \$10.5 million. PSE proposes an annual cap for program year expenditures of \$110 million per year, corresponding to an incremental revenue requirement of \$16.1 annually, or a 0.7% annual increase to overall rates.¹⁶

21

Q. How does PSE propose to allocate and collect ECRM costs?

¹⁴ Direct Testimony of Catherine A. Koch, pp. 2-5.

¹⁵ Direct testimony of Katherine J. Barnard, p. 74.

¹⁶ Direct Testimony of Catherine A. Koch, pp. 74-83; Exhibit No. ___ (KJB-9).

1 A. As explained in the direct testimony of Mr. Piliaris, PSE proposes to categorize
2 the ECRM revenue requirement as overhead or underground investment, and
3 allocate these cost categories to customer classes based on the load-weighted line
4 miles for facilities being replaced. This means that customer classes with higher
5 load concentrations on the replaced circuits would be allocated a higher
6 proportion of costs. Lighting customers would be excluded from this allocation.
7 PSE proposes to design the ECRM rates as a per-kWh charge based on the
8 allocated costs for each class.¹⁷

9 **Q. What is your recommendation regarding the proposed ECRM?**

10 A. The Commission should reject PSE's ECRM proposal, which is an example of
11 unwarranted single-issue ratemaking. Investing in and maintaining the
12 distribution system are fundamental responsibilities for a utility company. In
13 carrying out this responsibility, utilities are entitled to an opportunity to recover
14 their prudently-incurred costs, but it is neither necessary nor desirable to introduce
15 single-issue ratemaking for specific costs incurred in the ordinary course of
16 business. Rather than relying on the introduction of a new single-issue cost
17 recovery mechanism such as the ECRM, to the extent that the incurrence of
18 incremental distribution investment causes PSE to under-earn, the PSE can
19 consider filing a general rate case.

20 **Q. Do you have any additional concerns regarding the ECRM?**

21 A. Yes. Notwithstanding my primary recommendation that the ECRM be rejected, if
22 some form of the ECRM is approved by the Commission, it should be designed as
23 a demand charge for demand-billed schedules. PSE's proposed per-kWh rate

¹⁷ Direct Testimony of Jon A. Piliaris, pp. 147-151.

1 design is inconsistent with the manner in which these costs would be incurred and
2 PSE's proposed demand-based allocation method using load-weighted line miles.

3 **Q. Does this conclude your response testimony?**

4 **A.** Yes, it does.

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

Docket No. UE-170033

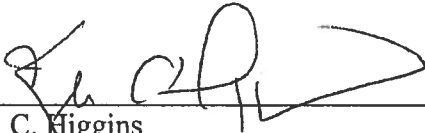
Docket No. UG-170034

AFFIDAVIT OF KEVIN C. HIGGINS

STATE OF UTAH)
)
COUNTY OF SALT LAKE)

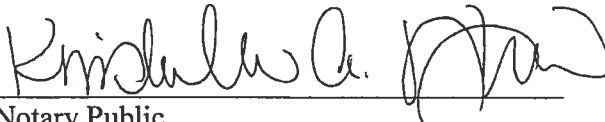
Kevin C. Higgins, being first duly sworn, deposes and states that:

1. He is a Principal with Energy Strategies, L.L.C., in Salt Lake City, Utah;
2. He is the witness who sponsors the testimony entitled "Response Testimony of Kevin C. Higgins on Behalf of the Kroger Co.";
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 is true and correct to the best of his knowledge, information and belief.

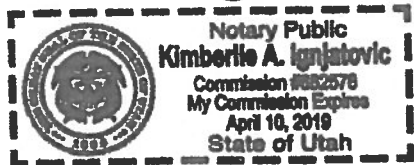


Kevin C. Higgins

Subscribed and sworn to or affirmed before me this 29th day of June, 2017, by Kevin C. Higgins.

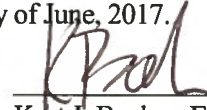


Notary Public



CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the parties listed on the attached Certificate of Service by regular U.S. mail and electronic mail (when available) this 30th day of June, 2017.



Kurt J. Boehm, Esq.
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