EXHIBIT NO. _____ (SDW-3)
DOCKET NO. UG-040640 & UE-040641
2004 PSE GENERAL RATE CASE
WITNESS: STEVEN D. WEISS

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UG-040640** **Docket No. UE-040641**

SECOND EXHIBIT TO PREFILED DIRECT TESTIMONY OF STEVEN D. WEISS ON BEHALF OF NW ENERGY COALITION

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Excerpt from

CHARGING FOR DISTRIBUTION UTILITY SERVICES: ISSUES IN RATE DESIGN

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through their effects (reduced public health, acid deposition, etc.).[67] Put another way, the marginal environmental costs of generation, which are largely associated with fuel consumption and therefore are directly correlated to kilowatt-hour production, are not reflected in current prices for electricity.

Because generation markets do not internalize all the costs of production, it falls to regulators and policymakers to correct the failure. Volumetric pricing for distribution services, appropriate for the reasons already stated, is also justified on the ground that there are incremental kilowatt-hour costs that commodity prices fail to capture; in this way, the mark-up on usage-based distribution charges needed to cover the embedded revenue requirement serves as a proxy for some portion of the environmental damage costs of production. Whether the mark-up is sufficient to "cover" those damage costs and whether additional mitigation efforts are warranted remain, of course, questions policymakers must grapple with.

4. Practical Considerations

Usage-based rates are well-understood by consumers. They are, for the most part, uncomplicated and can be easily administered. Fixed prices share these attributes.

5. Other Issues

a. Customer Charges

One kind of fixed charge has long been a fixture of utility pricing: the monthly (or daily) customer charge. In most jurisdictions, recurring periodic rates designed to cover at least the costs of metering and billing serve to generate a stream of revenues that does not vary with usage and thereby provides some measure of financial risk mitigation for the utility. For residential customers, these charges range from as little as a dollar to ten dollars or more per month. For commercial and industrial customers, they can be considerably greater.[68]

The current debate about pricing for distribution services really comes down to a simple question: should customer charges be increased and usage charges decreased (or even eliminated) and, if so, by how much? Our inquiry concludes that, for the most part, the answer is no, and even suggests that it may be appropriate in certain cases to reduce customer charges. Of course, decisions taken by regulatory commissions will be based on the particular facts of each case; our

67. Competitive commodity markets for electricity do not capture these costs in prices; nor are they typically reflected in marginal cost studies in those states where the industry remains vertically integrated.

68. One variation of the customer charge is the "minimum bill" approach, such as that used by Central Maine Power (see Section II.C.3.), which requires payment of a monthly charge, but with it also comes a specified number of "free" kilowatt-hours of delivery service. Delivery in excess of the allowance is billed on a per-unit (kWh) basis.

intention here is to examine the various policy considerations and potential consequences of different actions.

We do not foresee an outright elimination of customer charges, although, as competition in the industry grows and alternatives to grid-provided power become more cost-effective, we believe that they will become less and less tenable. The rate-making principles that counsel against the imposition of fixed charges also discourage radical and immediate changes in rate design. Nominal customer charges have been around a long time. They are well-understood by consumers, and they provide some revenue stability for utilities. Any change in rate design should be deliberate, to minimize potentially deleterious impacts on customers and companies.

In evaluating proposals for redesign of distribution rates, commissions may be asked to consider structures that call for some blend of customer and usage charges, weighted so as to increase the revenue share of the fixed rate elements (in relation to historical allocations). Although much of the discussion in this paper has been cast in "either-or" terms (usage-based vs. fixed rates), its general prescriptions apply no less to any intermediate proposal: the magnitude of a shift from usage-based to fixed rate elements will have predictable effects on consumer demand, utility revenues, and long-term dynamic efficiency. As one moves along the continuum of rate designs from usage-based to fixed, the benefits of the former give way more and more to the difficulties of the latter. This is the kind of trade-off that commissions are often faced with balancing: our analysis concludes that the balance strongly favors a rate structure that allows consumers to avoid charges, when there cost-effective alternatives that they value more highly. Usage-based rates fit this bill; so do "hook-up fees" (see the following section).

b. Customer Costs and Hook-Up Fees

In recognition of the dedicated nature of customer-related facilities (meters and service drops), regulators might consider an alternative rate structure for recovering their costs. As discussed earlier, marginal customer investment costs can be distinguished from other utility marginal costs of service, insofar as they are only avoidable at the time that the facility is installed or replaced. In a competitive market, a customer would pay the prevailing price of purchasing the hook-up at the time of installation, which would approximate marginal cost. This is the way in which consumers purchase many durable goods which are affixed to their premises and have no other uses apart from the premises (curtains, ceiling insulation, etc.). Consequently, it may be more economically efficient to recover the costs of access equipment in the form of a customer "hook-up" fee.

The revenue impacts of this charge should be carefully considered . If hook-up fees are to be implemented, it is critical that double-counting of costs be avoided. Regulators must be careful to assure that these costs, if recovered in a hook-up fee, are not also included in other distribution charges.