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May 30, 2013

Steven V. King, Acting 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-130137/UG-130138 and UE-121697/UG-121705

Dear Mr. King:

Enclosed please find two originals and one (1) copy each of the POST HEARING BRIEF OF THE KROGER CO. for filing in the above-referenced matters. I also include an additional sixteen (16) copies for internal distribution at the Commission. Please note that we also e-filed the above in both dockets 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 Kyler Cohn, Esq.
BOEHM, KURTZ & LOWRY

MLKkew
Enclosures
cc: Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the parties listed on the attached Certificate of Service by regular U.S. mail and electronic mail (when available) this 30th day of May, 2013



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

**EXHIBIT NO. ____ (KCH-1T)
DOCKET NO. UE-130137/UG-130138
& UE-121697/UG-121705**

**2013 PSE EXPEDITED RATE FILINGS
& DECOUPLING PROPOSALS
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-130137
Docket No. UG-130138
Docket No. UE-121697
Docket No. UG-121705**

**POST-HEARING BRIEF OF
THE KROGER CO.**

I. INTRODUCTION

The Kroger Co. (“Kroger”), on behalf of its Fred Meyer Stores (“Fred Meyer”) and Quality Food Centers (“QFC”) divisions hereby submits this Post-Hearing Brief in support of its recommendation to the Washington Utilities and Transportation Commission (“Commission”). One of the largest commercial customers served by Puget Sound Energy, Inc. (“PSE” or “Company”), Kroger operates numerous grocery stores in the state of Washington that purchase millions of kWh of electricity from PSE annually.

II. ARGUMENT

In Docket Nos. UE-121697 and UG-121705, the Joint Parties submitted a rate plan and a pair of electric and gas decoupling proposals. The rate plan is a series of predetermined annual rate increases implemented through a metric that PSE calls the “K-factor.” The proposed rate plan would extend at least through March 2016 and possibly through March 2017. As part of its proposal, and subject to certain caveats, PSE would not file its next general rate case before April 1, 2015, but would file it no later than April 1, 2016, unless otherwise agreed to by the parties in the Company’s last general rate case.

The decoupling proposal envisions full revenue decoupling applied to fixed delivery costs for almost all electric and gas customer classes.¹ The revenue decoupling would be implemented through an “allowed revenue per customer” metric. The decoupling proposal is tied to the proposed rate plan in that each year’s allowed revenue per customer would be increased via the K-factor. Thus, the overall proposal should be viewed as a combination “predetermined rate increase/decoupling” package extending over a multi-year period.

For purposes of this discussion, it is useful to separate the K-factor component of the rate plan from the rest of the decoupling proposal. Even though these components are tied together in the Joint Parties’ proposal, decoupling does not require adoption of predetermined annual rate increases nor does a rate plan consisting of predetermined annual rate increases require decoupling. Indeed, the proposed K-factor scheme and the proposed decoupling mechanism are conceptually distinct, independent features that should be evaluated on their own merit.

¹ The proposed exceptions are gas lighting, gas water heater rental, electric lighting, and electric retail wheeling. The rates for these classes, however, would be subject to the proposed K-factor increases. Gas customers served under special contracts are also excluded from the decoupling proposal.

As explained below, Kroger believes that the K-factor and the full decoupling proposals are poorly constructed ratemaking devices and are not in the public interest. Kroger recommends that the Commission reject both the proposed K-factor and full decoupling.

1. The K-Factor Rate Increases Are Arbitrary And Unsubstantiated Rate Increases That Should Be Rejected By The Commission.

- a. The K-factor as originally filed in this docket has been transformed from a mechanism that attempted to capture the affects of energy conservation to a pure cost escalator.**

The Joint Parties' K-factor proposal has had an interesting recent history. In the Company's initial filing in this docket, the K-factor was structured as an adjustment that would account for changes in weather-normalized delivery revenue attributable to PSE-sponsored energy conservation.² Its sole purpose was to adjust allowed revenues-per-customer in the prior calendar year upward to account for energy conservation that was not otherwise captured in that period's billing determinants, because part of that period's billing determinants would also reflect underlying growth in usage-per-customer that would offset a portion of the energy conservation savings. PSE apparently believes it is entitled to capture the benefits of that underlying growth in usage-per-customer, even if full decoupling is implemented, and the K-factor was proposed as a means to allow the Company to do so. While the merits of PSE's initial K-factor arguments may be debatable, it was at least structured to capture the specific effects of energy conservation on its billing determinants.

This initial conceptualization behind the K-factor has now been completely abandoned by the Joint Parties in favor of a pure cost escalator. The rationale for the "new" K-factor bears no resemblance to the initial proposal. The only thing the new and old K-factors have in common is

² Direct testimony of Jon A. Piliaris, p. 15.

that they are each a means of increasing rates to customers. In his initial direct testimony, Mr. Piliaris calculated electric system K-factors of 1.016880 (non-residential) and 1.017231 (residential) for calendar year 2011.³ The “new” electric K-factor of 1.03 escalates costs at a 75 percent faster rate, and consequently will produce rate impacts on customers that are about 75 percent greater than the original formulation.⁴

b. The “new” K-factor does not even attempt to track energy conservation and will escalate rates 75% faster than the K-factor as originally filed.

The “new” K-factor proposal is an attempt to introduce an automatic, predetermined cost escalator into rates. The proposed K-factor for electric service is 1.03 and would apply to all revenue requirements except power costs and property taxes. Essentially, the K-factor hardwires a 3 percent annual cost increase into the applicable cost components, which would then automatically flow into customer rates. Extended over the potential term of the proposed rate plan (which could extend beyond the start of 2017), the revenue requirement for the affected electric cost components would increase 15.9 percent.⁵

The proposed K-factor rate increases are not known and measurable adjustments presented in the context of a rate proceeding. They are arbitrary and unsubstantiated rate increases. PSE justifies the proposed level of these factors by referencing a calculation prepared by Ms. Barnard that results in an electric K-factor of 1.0406 measured over the period 2006-2011.⁶ Ms. Barnard’s calculation was prepared using rate base and depreciation expense increases over that time period combined with a projection of O&M inflation that includes a small productivity adjustment. However, a trend line of past cost increases (blended with an

³ PSE Decoupling Exhibit No. __ (JAP-5).

⁴ Prefiled Response Testimony of Kevin C. Higgins, pp. 12-13

⁵ Prefiled Response Testimony of Kevin C. Higgins, p. 9.

⁶ Supplemental direct testimony of Katherine J. Barnard, p. 7.

inflation forecast) does not constitute a reasonable basis for locking in broadly applicable rate increases in the future, particularly over a multi-year period.⁷

Moreover, Ms. Barnard's K-factor results are very sensitive to the time period selected. Selecting a time period that starts just one year later (2007-2011) reduces her calculation of the electric K-factor from 1.0406 to 1.0329.⁸ In addition, her measurement of the growth in rate base does not take into account that rate base in 2011 was skewed upward because the Company could not fully reflect the accumulated deferred income tax ("ADIT") that would have otherwise applied in that year. ADIT, which in this context is an offset to rate base, was truncated in 2011 because PSE registered a net operating loss for tax purposes that year and therefore could not fully utilize the bonus tax depreciation deduction otherwise available to the Company. The depreciation deduction can be carried forward for up to twenty years; thus PSE will ultimately realize this tax benefit – but customers did not see the benefit of the offset to rate base in 2011 associated with the carried forward amount. The upshot is that had ADIT not been truncated in 2011 due to the artifact of PSE's net operating loss, rate base would have been lower, and Ms. Barnard's K-factor would have been lower as a result. Adjusting for this circumstance further reduces Ms. Barnard's K-factor to 1.0322 over the 2007-2011 period. This calculation is presented in Kroger Exhibit No. __ (KCH-2).⁹ The point here is not to quibble over the math behind the K-factor, but rather to observe that any "concession" PSE is making in proposing an electric K-factor of 1.03 is more apparent than real.¹⁰

⁷ Prefiled Response Testimony of Kevin C. Higgins, pp. 9-10.

⁸ This can be calculated from the information in PSE Exhibit No. __ (KJB-3). A similar impact occurs for the gas K-factor calculated by Ms. Barnard which would be reduced to 1.0299.

⁹ This exhibit also presents a comparable recalculation of the K-factor for gas (pp. 3-4).

¹⁰ Prefiled Response Testimony of Kevin C. Higgins, p. 10.

More generally, the Commission should be concerned about regulatory pricing formulations such as the K-factor proposal that reinforce inflation. This occurs when projections of inflation are built into formulas that are used to set administratively-determined prices, such as utility rates. Such pricing mechanisms help to make inflation a self-fulfilling prophecy. Regulators should use extreme caution before approving prices that guarantee inflation before it occurs.¹¹

A related, but distinct, concern involves the building of a K-factor “cost cushion” into the Company’s base period costs. The cost increases represented by escalation factors may or may not come to fruition. In any case, PSE should be expected to strive to improve the efficiency of its operations on a continuous basis, and thereby lessen the net impact of inflation on its costs. It is not reasonable to gross up the Company’s base period costs by an arbitrary escalation factor and pass these costs on to customers. There is nothing inherent in revenue decoupling that calls for this type of underlying cost escalation. If the Commission is inclined to approve revenue decoupling (Kroger’s opposition notwithstanding), the K-factor portion of the Company’s filing can be readily excised and discarded.¹²

In sum, the K-factors proposed by the Joint Parties in the decoupling proceeding would introduce an automatic, predetermined cost escalator into rates. The proposed K-factor rate increases are not known and measurable adjustments presented in the context of a rate proceeding. Rather they are arbitrary and unsubstantiated rate increases that should be rejected by the Commission.

¹¹ Prefiled Response Testimony of Kevin C. Higgins, p. 11.

¹² Prefiled Response Testimony of Kevin C. Higgins, p. 11.

2. **The Joint Parties' Proposal Is A One-Sided Proposition That Burdens Customers With The Negative Characteristics Of Full Revenue Decoupling Without Providing The Key Benefits That The Commission Stressed In Its Report And Policy Statement.**

In the Commission's Report and Policy Statement ("Report") issued in Docket No. U-100522 the Commission stated that it:

"...will consider a full decoupling mechanism for electric and natural gas utilities, which will allow a utility to either recover revenue declines related to reduced sales volumes or, in the case of sales volume increases, refund such revenues to its customers." [Report at Par. 28]

However, in reaching this determination, the Commission identified two significant concerns. First, the Commission recognized that relatively few other state commissions have adopted any form of decoupling for electric utilities, and that only some of those mechanisms were full decoupling mechanisms. [Report at Par. 25] This condition is still true today. If the Commission were to adopt full revenue decoupling for PSE's electric service, the Commission would be in the company of a relatively small minority of commissions nationwide.

Second, the Commission expressed concern that full revenue decoupling, particularly in combination with an energy cost recovery mechanism that reduces an electric utility's financial risk due to changes in power costs, could cause a utility to lose some of its incentive to manage itself in a manner that constantly looks to reduce costs. [Report at Par. 26]

In light of these concerns, the Commission's willingness to consider full revenue decoupling places significant weight on the expectation that full revenue decoupling: (1) would benefit customers by *reducing utility equity costs* and (2) would include proper recognition of "found margin." A cornerstone finding in the Commission's Report holds as follows:

“...while a close call, we believe that a properly constructed full decoupling mechanism that is intended, between general rate cases, to balance out both lost and found margin from any source can be a tool that benefits both the company and its ratepayers. By reducing the risk of volatility of revenue based on customer usage, both up and down, such a mechanism can serve to reduce risk to the company, and therefore to investors, which in turn should benefit customers by reducing a company’s debt and equity costs. This reduction in costs would flow through to ratepayers in the form of rates that would be lower than they otherwise would be, as the rates would be set to reflect the assumption of more risk by ratepayers.” [Report at Par 27. Footnotes omitted.]

The proposal by the Joint Parties fails to deliver on this key attribute of revenue decoupling identified by the Commission. The proposal fails to reduce the cost of PSE’s equity that flows through to customers in exchange for the assumption of greater ratepayer risk and does not provide for full recognition of found margin to offset the lost margin that would be charged to customers, and thus, is deficient in fully providing this offset that is emphasized in the Commission’s Report. In short, the Joint Parties’ proposal is a one-sided proposition that burdens customers with the negative characteristics of full revenue decoupling without providing the key benefits that the Commission stressed in its Report.¹³

At the most fundamental level, decoupling is as much a “revenue assurance” mechanism as it is a “conservation enabling” mechanism. As such, it is sure to capture a much wider range of effects than just customer responses to utility-sponsored energy efficiency programs, even though the latter constitutes the underlying justification for its adoption. 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 full revenue decoupling, if customers respond to utility rate hikes by reducing their electricity, fixed

¹³ Prefiled Response Testimony of Kevin C. Higgins, pp. 14-15.

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.¹⁴

Further, to the extent that customers reduce usage in response to economic conditions or otherwise practice self-funded energy conservation, these behaviors will be captured in the decoupling adjustment and unduly increase rates to customers. The increase in rates to customers from these actions that would accompany full revenue decoupling is a further example of a transfer of utility business risk to customers, which is a negative characteristic of full revenue decoupling from a customer perspective.¹⁵

Full revenue decoupling also suffers from the infirmities of single-issue ratemaking, which occurs when utility rates are adjusted in response to a change in a single cost or revenue item considered in isolation. Single-issue ratemaking ignores the multitude of other factors that otherwise influence rates, some of which could, if properly considered, move rates in the opposite direction from the single-issue change. To consider some costs or revenues in isolation might cause a commission to increase rates to remedy the single issue of concern without recognizing counterbalancing savings in another area. For this reason, single-issue ratemaking, absent a compelling public interest, is generally not sound regulatory practice.¹⁶

3. If Full Revenue Decoupling Is Approved By The Commission, The Proposal By The Joint Parties Should Be Modified In Three Ways.

In light of the drawbacks highlighted above, if full revenue decoupling is imposed on customers. Kroger suggests the following three modifications to the Joint Parties' decoupling proposal.

¹⁴ Prefiled Response Testimony of Kevin C. Higgins, p. 15.

¹⁵ Prefiled Response Testimony of Kevin C. Higgins, pp. 15-16.

¹⁶ Prefiled Response Testimony of Kevin C. Higgins, p. 16.

- a. **The ROE applicable to electric and gas delivery rate base should be reduced by 25 basis points in the ERF to reflect the reduction in PSE's risk.**

The Joint Parties' proposal contains no adjustment in the Company's ROE to reflect full revenue decoupling. Rather, the Joint Parties propose to allow PSE to continue to earn the 9.8% ROE ordered by the Commission in Docket Nos. UE-111048 and UG-111049, subject to an earnings test. The earning test would allow PSE to earn up to 25 basis points above its overall rate of return on rate base before rebating to customers 50 percent of the earnings in excess of this level.¹⁷ Kroger's proposal is consistent with other state commissions which typically require reductions in allowed ROE between 10 basis points and 50 basis points when adopting revenue decoupling.

For example, the Public Service Commission of Maryland reduced the ROE for Potomac Electric Power Company ("Pepco") by 50 basis points upon approval of a Bill Stabilization Adjustment ("BSA"), a form of decoupling, stating the following in its July 19, 2007 order:

*"The BSA, which the Commission has approved, will provide insurance that Pepco will achieve its level of revenue approved in this case. Thus, Pepco is less risky with the BSA than without it. In response to this decline in risk, all parties recognize the appropriateness of reducing Pepco's return on equity by some amount... Given that approval of the BSA will result in improved cost recovery by Pepco, the Commission shall reduce Pepco's ROE by 50 points, to 10 percent."*¹⁸

Concurrent with its decision in the Pepco rate case, the Public Service Commission of Maryland also applied a 50 point reduction to Delmarva Power & Light Company's ROE due to approval of a BSA.¹⁹

¹⁷ Supplemental direct testimony of Jon A. Piliaris, p. 19.

¹⁸ Order No. 81517, Case No. 9092, *In the Matter of the Application of Potomac Electric Power Company for Authority to Revise its Rates and Charges for Electric Service and for Certain Rate Design Changes*. Order at 72.

¹⁹ Order No. 81518, Case No. 9093, *In the Matter of the Application of Delmarva Power and Light Company for Authority to Revise its Rates and Charges for Electric Service and for Certain Rate Design Changes*. July 19, 2007.

Pepco received the same 50 basis point ROE reduction in the Washington D.C. jurisdiction, when the District of Columbia Public Service Commission approved a BSA in its September 28, 2009 order, stating:

“Given the positive financial implications associated with the implementation of the BSA as discussed by Pepco Witness Morin, OPC Witness Larkin and AOBA Witness Oliver, the Commission finds that a 50 basis point adjustment to the return on equity is reasonable. A 50 basis point reduction in ROE as part of the approval of the BSA balances the ledger by providing a benefit to consumers in exchange for the benefit to the Company and shareholders of reaping lowered business risk.”²⁰

The Tennessee Regulatory Authority decided upon a 25 basis point ROE reduction for Chattanooga Gas Company as a result of approving a decoupling mechanism in its November 8, 2010 order, stating:

“...[T]he panel found that the evidence presented by the parties made clear that decoupling impacts the return on equity by reducing risks, although both parties presented different views on both the direction and magnitude of the required adjustment. Having carefully reviewed the record, the panel voted unanimously to adopt the conservative estimate of a twenty-five basis point reduction to equity return based upon the rate design adopted by the panel.”²¹

Similarly, in 2009, the Public Utilities Commission of Nevada reduced Southwest Gas Company’s ROE by 25 basis points due to approval of a decoupling provision.²²

In 2007, the New York State Public Service Commission ordered a 10 basis point reduction to the allowed ROE of National Fuel Gas Distribution Corporation (“NFG”) as a result of adopting a decoupling mechanism, stating:

²⁰ Order No. 15556, Formal Case No. 1053, *In the Matter of the Application of the Potomac Electric Power Company for Authority to Increase Existing Retail Rates and Charges for Electric Distribution Service*. Order at 9.

²¹ Docket No. 09-00183, *Petition of Chattanooga Gas Company for a General Rate Increase, Implementation of the EnergySMART Conservation Programs and Implementation of a Revenue Decoupling Mechanism*. Order at 45.

²² Docket No. 09-04003, *Opening findings of fact and conclusions of law, Application of Southwest Gas Corporation for authority to increase its rates and charges for natural gas service for all classes of customers in Southern and Northern Nevada*. November 3, 2009.

*“Given that the revenue decoupling mechanism we are adopting may reduce NFG’s earnings volatility, that most of the companies in Staff’s proxy group do not have revenue decoupling mechanisms, and that the effects of revenue decoupling mechanisms have long been considered by investors and factored into the financial market data for natural gas firms, we will apply a 10 basis points reduction to NFG’s 9.20% cost of equity and will set its allowed return on equity at 9.10%.”*²³

The New York State Public Service Commission also approved a settlement that reduced St. Lawrence Gas Company’s ROE by 10 basis points due to the adoption of a decoupling mechanism on December 18, 2009.²⁴

In its February 5, 2008 order, The Illinois Commerce Commission similarly ordered a 10 basis point ROE reduction for North Shore Gas Company and The Peoples Gas Light & Coke Company upon approval of a Volume Balancing Adjustment (“VBA”), a pilot decoupling program:

*“The Commission finds that Rider VBA will lessen the Utilities’ risk associated with their cash flow. Moreover, we agree with Staff’s recommendation that there should be a downward adjustment to the cost of common equity to account for the reduced risk associated with the accepted riders...Overall, we find the record to support a downward adjustment, and in the absence of an exact calculation we find it reasonable to reduce the return on common equity by ten (10) basis points for the duration of the pilot program.”*²⁵

In its January 31, 2011 order, the Massachusetts Department of Public Utilities set an ROE of 9.60% for Western Massachusetts Electric Company (which had requested an ROE of 10.50%), and stated the following:

²³ Case 07-G-0141, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of National Fuel Gas Distribution Corporation for Gas Service*. Order at 40-41. December 21, 2007.

²⁴ Case 08-G-1392, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of St. Lawrence Gas Company, Inc. for Gas Service*.

²⁵ Docket No. 07-0241, *North Shore Gas Company: Proposed general increase in natural gas rates*; Docket No. 07-0242, *The Peoples Gas Light and Coke Company: Proposed general increase in natural gas rates* (Consolidated). Order at 99.

*“In sum, we find that the revenue decoupling mechanism that we have approved in this case will reduce the variability of the Company’s revenues and, accordingly, reduce its risks and its investors’ return requirement.”*²⁶

In the Northwest, the Public Utility Commission of Oregon reduced the ROE for Portland General Electric Company (“PGE”) 10 basis points to reflect the reduction in PGE’s risk attributable to the approval of a decoupling mechanism.²⁷ It is important to note, however, that PGE’s full revenue decoupling mechanism applies only to residential customers and small commercial customers with billing demands of 30 kW or less. Customers with demands between 30 kW and 1000 kW are subject to a lost fixed cost recovery mechanism, but not full revenue decoupling. Customers with billing demands greater than 1000 kW are not subject to any lost fixed cost recovery mechanism at all.

A 25 basis point reduction in PSE’s ROE is reasonable in light of the mitigation of earnings volatility that the mechanism would provide for PSE. Kroger witness, Kevin Higgins examined the volatility of PSE’s usage per customer over the period 2002-2011 and measured the ROE impact of this volatility using the ERF volumetric delivery revenue applied to the Company’s proposed ERF rate base for electric and gas delivery services. This analysis is presented in Kroger Exhibit No. ___ (KCH-3), pages 4-7. Mr. Higgins’ analysis shows that the deviations in PSE’s usage per customer over this period produces impacts of up to 75 basis points (with an average of 33 basis points absolute value) for the electric delivery system and up to 167 basis points (with an average of 84 basis points absolute value) for the gas delivery system. The 25 basis point ROE adjustment lies well within this range of earnings volatility and

²⁶ D.P.U. 10-70, *Petition of Western Massachusetts Electric Company, pursuant to G.L. c. 164, §94 and 220 C.M.R. §§ 5.00 et seq. for Approval of a General Increase in Electric Distribution Rates and a Revenue Decoupling Mechanism*. Order at 283.

²⁷ Order No. 09-020, Docket No. UE 197, *In the Matter of Portland General Electric Company, Request for a General Rate Revision*. January 22, 2009. Order at 29.

is a reasonable adjustment for removing this source of earnings volatility for the Company. If this 25 basis point reduction in ROE is applied as part of the ERF proceeding, as Kroger recommends,²⁸ it will result in a reduction in the ERF electric revenue requirement of approximately \$5.1 million and in the ERF gas revenue requirement of approximately \$3.1 million.²⁹

- b. The decoupling mechanism proposed by the Joint Parties should be modified to incorporate any found margin associated with growth in customer count as a credit against the proposed RDA balancing account.**

The concept of found revenue is discussed at some length in the Commission's Report. The Commission's statement emphasizes that a properly constructed full decoupling mechanism would balance out both lost and found margin from *any* source. [Report at Par. 27. Emphasis added.] Unfortunately, the full revenue decoupling proposal advanced by the Joint Parties recognizes found margin only to the extent that it may affect allowed revenue per customer. The proposal provides no recognition of found revenue that would be associated with growth in the number of customers. Under the terms of the proposal, the full benefit of incremental fixed cost recovery associated with new customers accrues solely to PSE.³⁰

This is demonstrated in Exhibit No. __ (KCH-4) in which Mr. Higgins modified the inputs in PSE Exhibit Nos. __ (JAP-18) and (JAP-22) to assume a faster rate of growth in customer count than PSE is projecting, while holding usage-per-customer (i.e., allowed revenue per customer) constant for both residential and non-residential customers. Mr. Higgins also removed the effect of prior deferrals because deferral recovery impacts the decoupling unit charge, but does not change the apportionment of forward-looking revenue requirements

²⁸ Direct Testimony of Kevin Higgins pp. 21-23.

²⁹ Prefiled Response Testimony of Kevin C. Higgins, pp. 20-21.

³⁰ Prefiled Response Testimony of Kevin C. Higgins, p. 23.

between PSE and customers. As shown in Exhibit No. __ (KCH-4), lines 13-14, 100 percent of the incremental revenue recovered from the incremental customers accrues to PSE, with no recognition as an offset to lost revenues. Kroger believes that this analysis shows that the proposal is deficient in providing for full recognition of found margins and should be rejected. However, if full revenue decoupling is approved by the Commission, the mechanism proposed by the Joint Parties should be modified to incorporate any found margin associated with growth in customer count as a credit against the RDA balancing account.³¹

c. Customers with billings demands of greater than 350 kW should be excluded from the decoupling mechanism.

The Joint Parties have already proposed to exclude lighting and retail wheeling customers from the decoupling mechanism. While these exclusions are appropriate they do not go far enough.

First, maintaining a “fixed-cost recovery per customer” target, as incorporated into the Joint Parties’ proposal, is not an appropriate rate design objective for classes of customers that have heterogeneous populations, and/or whose class composition shows a wide range of usage levels, such as occurs with larger non-residential customers. The fixed-cost recovery per customer of these classes will be very sensitive to the *composition* of these customers. In short, given the tremendous diversity among non-residential customers, targeting “average fixed-cost recovery per customer” as a ratemaking metric for these customers is without merit. Certainly, attempting to attribute to utility-sponsored energy conservation projects changes in “average fixed-cost recovery per customer” of non-residential customers is an unreasonable stretch.³²

³¹ Prefiled Response Testimony of Kevin C. Higgins, p. 23-24.

³² Prefiled Response Testimony of Kevin C. Higgins, pp. 24-25.

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 completely unrelated to energy conservation.³³

The recent experience of Detroit Edison is instructive in this regard. In early 2010, Detroit Edison implemented a full revenue decoupling mechanism tied to average energy usage per customer; the decoupling mechanism included larger non-residential customers, just as proposed by the Joint Parties in this case. This revenue decoupling mechanism (“RDM”) had been approved the prior year by the Michigan Public Service Commission (“MPSC”) against Kroger’s recommendation and the recommendations of several other parties.³⁴ By late 2010, Detroit Edison concluded that that the usage-per-customer revenue RDM was subject to the very shortcomings Kroger warns about here and was failing to accomplish its intended purpose, particularly for larger customers. In the words of Detroit Edison witness Don M. 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

³³ Prefiled Response Testimony of Kevin C. Higgins, p. 25.

³⁴ Michigan Public Service Commission, Case No. U-15768.

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."³⁵

Detroit Edison proposed to abandon its revenue decoupling mechanism in favor of a lost-revenues approach. Although the MPSC did not allow Detroit Edison to make this change, the MPSC's decision was ultimately rendered moot when the Michigan Court of Appeals found that the MPSC lacked authority to approve or direct the use of a revenue decoupling mechanism for an electric utility. The upshot here is that Detroit Edison's experience provides a cautionary tale about the hazards of broadly applying revenue decoupling to all classes of customers and all sources of changes in average customer usage.³⁶

There are only two major electric utilities in the western U.S. outside of California that have implemented full revenue decoupling: Idaho Power and Portland General Electric. Appropriately, neither of these utilities applies revenue decoupling to large non-residential customers. Idaho Power's decoupling mechanism only applies to residential customers and small commercial customers consuming 2,000 kWh per month or less. As discussed above, PGE's revenue decoupling mechanism applies only to residential customers and small commercial customers with billing demands of 30 kW or less. Customers with demands

³⁵ Michigan Public Service Commission, Case No. U-16472. Pre-filed direct testimony of Don M. Stanczak, pp. 14-16, October 29, 2010.

³⁶ Prefiled Response Testimony of Kevin C. Higgins, p. 26.

between 30 kW and 1000 kW are subject to a lost fixed cost recovery mechanism, but not revenue decoupling. Customers with billing demands greater than 1000 kW are not subject to any lost fixed cost recovery mechanism.³⁷

Additionally, in 2011 Arizona Public Service Company (“APS”) initially proposed full revenue decoupling for all customers but ultimately decided to exclude larger customers. Like this Commission, the Arizona Corporation Commission (“ACC”) had adopted a policy statement encouraging revenue decoupling. However, consequent to settlement discussions, APS withdrew its full revenue decoupling proposal and, along with a broad spectrum of stakeholders, agreed to a lost fixed cost recovery mechanism (“LFCR”) that applies only to residential customers and non-residential customers with demands below 400 kW. The LFCR mechanism includes a rate design option that allows residential customers to “opt out” of the LFCR program.³⁸

APS correctly recognized that much of its concern about recovery of lost margins associated with energy conservation could be addressed through rate design for its larger customers. In particular, a concerted effort was made to ensure that as much of the utility’s fixed costs as practicable were recovered from customer and demand charges for demand-billed customers.³⁹

This approach mitigated APS’s concerns because both APS and the ACC Staff concluded that revenue from demand charges would not be as sensitive to changes in average customer usage as revenue from kilowatt-hour charges would be. Indeed, in determining the revenue adjustment for the LFCR, the mechanism not only excludes the portion of distribution and

³⁷ Prefiled Response Testimony of Kevin C. Higgins, pp. 26-27.

³⁸ Prefiled Response Testimony of Kevin C. Higgins, p. 27.

³⁹ Prefiled Response Testimony of Kevin C. Higgins, p. 28.

transmission costs that is recovered through the customer charge, it also excludes 50 percent of such costs recovered through non-generation/non-transmission demand charges.⁴⁰

The second reason why larger non-residential customers should be excluded from the decoupling rider is that the methodology PSE proposed to use to calculate the amount of the rider for non-residential customers overstates PSE's actual revenue loss on a per customer basis. The metric that PSE proposes to use to measure "actual" revenues-per-customer for non-residential customers is *imputed* based solely on changes in kilowatt-hour sales⁴¹ – even though a substantial portion of the revenues collected for delivery service from demand-billed customers is in the form of demand charges. To the extent that revenue sensitivity of PSE's demand revenues is less than that of kilowatt-hour revenues, this imputation will overstate the changes in revenue-per-customer attributable to changes in -per-customer (for demand-billed customers). The likelihood of this overstatement is even greater when one considers that PSE's tariff contains demand ratchets for Schedules 26-P, 31, and 49, which further dampen the volatility of revenues collected from the demand charge.

In calculating the decoupling rider for non-residential customers in any given month, PSE subtracts its "Actual Monthly Delivery Revenue Per Customer"⁴² from its "Allowed Total Revenue"⁴³ per month. The difference between these two amounts is recovered from customers through the decoupling rider.

The problem with this method is that the "*Actual* Monthly Delivery Revenue Per Customer" is a misnomer. It is not actually "Actual." It is an amount that is imputed using a

⁴⁰ Prefiled Response Testimony of Kevin C. Higgins, p. 28.

⁴¹ See for example, PSE Exhibit No. __ (JAP-22), p. 2, lines 5-7.

⁴² PSE Exhibit No. __ (JAP-22), p. 2, line 7.

⁴³ PSE Exhibit No. __ (JAP-22), p. 2, line 3.

method that will always understate the amount of revenue collected by PSE, thereby overstating PSE's revenue loss.

In order to calculate the “*Actual Monthly Delivery Revenue per Customer*” for non-residential customers, PSE takes the total kWh billed in a given month⁴⁴ and multiplies it by 0.021006; a number PSE calls “*Delivery Revenue per Unit.*”⁴⁵ The problem with this method is that the “*Delivery Revenue per Unit (0.021006)*” was calculated by dividing test year energy (kWh) and demand (kW) by kWh sales.⁴⁶ However, when “*Actual Monthly Delivery Revenue per Customer*” is calculated only the actual (kWh) energy sales are multiplied by the “*Delivery Revenue per Unit.*” In other words PSE's methodology assumes that the actual loss in kWh sales is proportional to an imputed loss of kW sales. We know that this is not the case. Demand and energy charges track completely different types of costs. Energy charges bill a customer for its total kWh usage in a month and demand charges bill a customer for its peak (kW) usage in a month, or in the case of PSE's demand ratchet rates, for a customers' peak usage over a 12-month period. There is no reason to assume, as PSE does, that a reduction in kWh sales will be proportionate to a reduction in kW billed. It is well understood that demand revenue is more stable than energy revenue because it is generally easier and more common for a customer to reduce the total kWh it uses in a month than it is for a customer to reduce its peak demand, especially when a demand ratchet provision is in place. PSE did not rebut Kroger witness, Mr. Higgins' assertion (on pages 28-29 of his Response Testimony) that PSE's method of the decoupling rider is very likely to overstate the amount of lost revenues.

⁴⁴ PSE Exhibit No. __ (JAP-22), p. 2, line 5.

⁴⁵ PSE Exhibit No. __ (JAP-22), p. 2, line 6.

⁴⁶ Note that a very small amount of the 0.021006 (0.000338) is attributable to the K-factor.

The imputation proposed by the Joint Parties is problematic and underscores the inherent inapplicability of full revenue decoupling for larger non-residential customers. If full revenue decoupling is adopted by the Commission, customers with billings demands of greater than 350 kW (e.g., Rate Schedules 26, 31, and 40) should be excluded from the mechanism. At a minimum, before subjecting these customers to revenue decoupling, 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 for delivery service to better align with recovery of fixed costs.⁴⁷

PSE evidently did not even explore the possibility of addressing lost revenue due to conservation efforts through rate design. In its response to Kroger Data Request No. 3-003 (Exhibit JAP-27x) PSE states that it:

“is unable to determine what portion of its deliver-related revenues from customers under Schedules 26 and 31 are recovered in the kWh charges because the rates charged under these schedules are not functionally unbundled...”

If PSE does not know what proportion of its delivery-related revenues come from demand and energy charges then it must not have investigated whether revenue losses from conservation can be addressed through rate design. It is odd that PSE did not consider addressing revenue loss from conservation through rate design, as Arizona Public Service Company did in the case cited above, before subjecting its demand-billed customers to an expensive decoupling rider. The goal of PSE and the Commission should be to implement rate tools that will allow PSE to promote energy efficiency without suffering a loss in revenue as a result. This can be achieved fairly through rate design for demand billed customers, perhaps

⁴⁷ Prefiled Response Testimony of Kevin C. Higgins, p. 29.

though a combination of raising demand charges (which are likely set too low in current rates based on cost-causation)⁴⁸ and implementing stricter demand ratchets.

For the reason explained above, Kroger recommends that the Commission reject PSE's proposed decoupling mechanism. Failing that, customers with billings demands of greater than 350 kW should be excluded from the decoupling mechanism. At the very least if these customers are not excluded from the mechanism, then the mechanism should be modified such that a reasonable portion (e.g. 50%) of the demand-billed delivery revenues are excluded from the revenue decoupling adjustment (i.e., are treated as unvarying with kWh variations), similar to the treatment employed in Arizona.

DATED this 30th day of May, 2013.

Respectfully submitted,



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⁴⁸ The costs of distribution service, the major component of delivery service, are properly classified as either customer-related or demand-related; they are not generally considered to be energy-related. There is little or no reason for the cost of distribution service to be recovered using an energy charge from demand-billed customers. See Prefiled Response Testimony of Kevin C. Higgins, p. 30.

MASTER SERVICE LIST

As of: 5/30/2013

Docket: 121697

Original MSL Date: 10/26/2012

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As of: 5/30/2013

Docket: 130137

Original MSL Date: 2/4/2013

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