DIRECT TESTIMONY OF KEVIN C. HIGGINS

Q. Please state your name and business address.

A. Kevin C. Higgins, 39 Market Street, Suite 200, Salt Lake City, Utah, 84101.

Q. By whom are you employed and in what capacity?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. On whose behalf are you testifying in this proceeding?

A. My testimony is being sponsored by The Kroger Co. ("Kroger") on behalf of its Fred Meyer Stores and Quality Food Centers divisions. Kroger is the largest retail grocer in the United States, and operates 130 facilities in the state of Washington, 66 of which are located in the territory served by Puget Sound Energy ("PSE"). These stores purchase more than 185 million kWh annually from PSE.

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all course work and examinations toward the Ph.D. in Economics at the University of Utah, and have served on the adjunct faculties of both the University of Utah and Westminster College, teaching both undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public-sector clients with energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters. I have testified numerous times on the subjects of electric utility cost-of-service, rate design, and industry

restructuring before state utility regulators in Utah, Arizona, Oregon, Wyoming, Georgia, and New York.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I testified regularly before the Utah Public Service Commission on utility policy matters. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, one of the larger municipal governments in the western U.S., where I was responsible for development and implementation of a broad spectrum of public policy. A more detailed description of my qualifications is contained in Exhibit KCH-1, attached to this testimony.

Q. What is the purpose of your testimony in this proceeding?

A. I have been asked to evaluate the rate design for the surcharge PSE is proposing in its Petition for Interim Rate Relief. I also have been asked to propose, if necessary, any modifications to the surcharge rate design that might be appropriate.

Q. What conclusions have you reached in your analysis?

A. I have concluded that PSE's proposal to impose a flat-kwh surcharge to recover the interim rate relief it seeks is an inappropriate rate design that will exacerbate existing rate disparities in PSE's tariff and arbitrarily shift cost recovery responsibility among customers during the interim period. I propose an alternative rate design in which any interim rate relief is recovered through a simple two-step process:

(1) For any interim recovery approved by the Commission, each rate class subject to the charge would pay the same proportion of the average percentage increase as it would pay under PSE's General Rate Case proposal. This would result in an interim percentage increase for each rate schedule that would take into account cost-of-service considerations.

(2) The interim percentage increase established for a given rate schedule would then be applied to each customer taking service under that rate schedule on an equal percentage basis. This would be effected by multiplying the rate schedule's interim percentage increase times the amount of the customer's monthly total bill.

Q. Please describe PSE's rate design proposal.

A. In its Petition for an Accounting Order and its Petition for Interim Rate Relief, PSE is seeking to impose an interim surcharge that would recover approximately $170.7 million during the eight-month period from March 2002 through October 2002.[1] PSE proposes that this surcharge, called Rate Schedule 128, be set at a flat rate of 1.4568 cents per kwh levied on all sales to retail customers of the Company (except retail wheeling customers).[2]

Q. Why do you believe that PSE's proposed rate design for the interim surcharge is inappropriate?

A. The interim surcharge is being proposed as a means of providing financial stability for PSE while its General Rate Case is under consideration. At the same time, there is considerable cost-of-service evidence in the General Rate Case

[1] See Direct Testimony of William A. Gaines, Exhibit WAG-3, Spreadsheet A, p. 1, lines 40-41.
[2] Petition of Puget Sound Energy, Inc. for an Accounting Order, par. 5.

filing indicating that the Company currently is earning very unequal returns across its various rate schedules. A flat per-kwh surcharge will exacerbate this problem during the interim period. Moreover, a flat per-kwh surcharge would assign a disproportionately greater responsibility for ensuring PSE's financial integrity during the interim period on higher-load-factor customers. To the extent that the Commission grants PSE's request for interim relief, the burden borne by the various customer classes should not be established in a vacuum; that is, the rate design should not ignore significant indications that some rate schedules are already paying more than their fair share of PSE's costs. Nor should the rate design result in arbitrarily disproportionate cost responsibilities across customer load patterns by penalizing higher-load-factor customers.

Q. Please describe the cost-of-service evidence that indicates there is currently a disparity in rates-of-return across rate schedules.

A. Exhibit JAH-2 to the Direct Testimony of James A. Heidell filed by PSE in the General Rate Case indicates that PSE's realized rate of return ranges from 1.05 percent for the High Voltage class to 11.8 percent for Schedule 25.[3] In fact, according to PSE's cost-of-service report, the Schedule 25 class is already paying rates that *exceed* PSE's *requested* rates of return in the General Rate Case.[4] Realized rates of return by customer class as calculated by PSE are reproduced in Exhibit KCH-2, line 24.

[3] See 2001 PSE Rate Case, Exhibit JAH-2, p. 1, line 24. The highest returns are actually being earned from the Retail Wheeling class (13.37 %), but this class is not included in PSE's proposed interim surcharge.

[4] See 2001 PSE Rate Case, Exhibit JAH-2, p. 2, line 12, which shows the revenue-to-revenue-requirement ratio for Secondary Service Schedule 25 equal to 104%.

Q. Are you vouching for the veracity of PSE Exhibit JAH-2?

A. No, obviously I did not prepare that PSE exhibit nor was it prepared under my direction. I view the information in that exhibit as equivalent to information that would be provided in response to a data request on this topic, i.e., it is the Company's portrayal of its own cost recovery – by rate class – under current rates.

Q. How should this information be used in the Interim Case?

A. The information should be used to help guide the rate design of any interim surcharge, with the understanding that: (1) the final validity of any interim surcharge will depend on the findings in the General Rate Case, (2) consistent with the Commission's practice, any interim surcharge is subject to refund, and (3) any cost-of-service analysis provided as part of the General Rate Case, but which is used to help guide the rate design of the interim surcharge, is itself subject to challenge and modification in the General Rate Case. Within this framework, I believe it is reasonable and in the public interest to use the cost-of-service information provided by PSE in the General Rate Case as a reference point for designing any interim surcharge.

Q. How do you propose to use this "reference point"?

A. In its General Rate Case filing, PSE uses its cost-of-service analysis as a guide in proposing new, higher rates for all customers.[5] These proposed increases are reproduced in Exhibit KCH-3, column A. I propose using the ratio of each rate class's proposed General Rate increase to the proposed average General Rate

[5] 2001 PSE Rate Case, Direct Testimony of James A. Heidell, Exhibit JAH-1T, pp. 15-18.

increase as the basis for setting any interim rate increase. These ratios are shown in column B of Exhibit KCH-3. If an interim increase is granted, these ratios would then be applied to the overall average percentage interim rate increase (across all rate classes subject to the interim charge) to determine each rate class's specific percentage increase.

Q. Can you provide a simple example of how your rate design proposal would work?

A. Yes. In Exhibit KCH-4 I provide an example using a hypothetical interim rate increase averaging 10 percent across all applicable rate schedules (i.e., excluding Schedule 449 and Firm Sales for Resale). Applying the ratios developed in Exhibit KCH-3, column B, to the hypothetical overall interim increase of 10 percent, yields the following percentage increases for each rate class (which are also shown in Exhibit KCH-4, column B):

Residential	11.8%
Schedule 24	9.6%
Schedules 25/29	5.0%
Schedule 26	6.6%
Schedule 31	10.7%
Schedules 35/43	15.0%
Schedules 46/49	10.7%
Lighting	15.0%
TOTAL	10.0%

Q. Once each rate class's percentage increase is established, how should the increase be applied to individual customers?

A. Within each rate class the interim rate increase should be applied on an equal percentage basis against each customer's monthly bill. In this manner, the burden of the interim increase is split between the customer's demand and energy usage in the same proportion as exists in current rates. To do otherwise (e.g., levy only a kwh charge), would be to bias any interim relief responsibility *within* the rate class to the unfair disadvantage of customers with particular load shapes (e.g., higher-load-factor customers). Within a given rate class, each customer should bear an equal percentage burden in maintaining PSE's financial integrity during the pendency of the General Rate Case.

Q. In recommending that the Commission use PSE's proposed rate spread in the General Rate Case to apportion any interim increase, are you endorsing that same rate spread for application in the General Rate Case?

A. Not necessarily. There are a number of aspects of PSE's rate spread proposal in the General Rate Case with which I may take issue, not the least of which is PSE's proposed continuation of a considerable subsidy from mid-sized secondary service customers to other rate classes. But those arguments will wait for the General Case. In the meantime, it is preferable to design any interim rates by showing *some* deference to cost-of-service considerations rather than to ignore such considerations entirely, as would occur in imposing a flat-kwh surcharge.

Q. You stated that a flat-kwh surcharge would exacerbate existing rate disparities in PSE's tariff. Please explain.

A. PSE's cost-of-service analysis indicates that there is currently a considerable disparity in cost recovery across rate schedules. In particular, Schedules 25, 26, and 29 are recovering a greater proportion of their costs than other full-service rate schedules.

In Exhibit KCH-5, I demonstrate that this disparity would be made worse by the imposition of a flat-kwh surcharge. The upper box of Exhibit KCH-5 (lines 4-13) is reproduced from PSE's cost-of-service report and shows the calculation of revenue parity ratios for each rate class under current rates, with the results shown in bold on line 13.[6] Rate classes that have revenue parity ratios in excess of 100% are providing recovery of a greater proportion of their revenue requirements than the system average; conversely, rate classes that have revenue parity ratios below 100% are providing recovery of a smaller proportion of their revenue requirements than the system average.

The middle box of Exhibit KCH-5 shows the calculation of revenue parity ratios if a flat-kwh charge of 1.4568 cents were to be adopted, shown in bold on line 20.[7] We can see that PSE's proposal for a flat-kwh charge raises the revenue parity ratio for the Schedule 25/29 rate class slightly to 121.6%, while the Schedule 26 class experiences an appreciable increase from 110.6% to 113% – thereby worsening the rate disparities in PSE's tariff.

For comparison purposes, I also calculate the revenue parity ratios that would obtain under the interim rate design I have proposed, shown in the lower

[6] As I use the term here, "revenue parity ratio" is equivalent to PSE's "Adjusted Revenue to Revenue Requirement ," which is reported in 2001 PSE Rate Case, Direct Testimony of James A. Heidell, Exhibit JAH-2, p. 2, line 13.

box, with the results shown in bold on line 26.[8] The results show that under the interim rate design I am proposing, the Schedule 25/29 and Schedule 26 rate classes continue to experience revenue parity ratios that are above the average (e.g., in excess of 100%), but which are significantly less extreme, and consequently, more reasonable.

Q. Does anything in your proposal affect the credits to residential customers from the Residential Exchange Program?

A. No. My understanding is that residential customers are scheduled to receive an increase in the Residential Exchange Program credit of .265 cents-per-kwh effective January 2002. The effect of this credit will be to reduce the net increase experienced by residential customers from any interim rate surcharge. The proposed rate spreads provided in my testimony are all calculated *prior* to taking account of the scheduled increase in Residential Exchange Program credits. Consequently, the effect of taking account of the increase in the Residential Exchange Program credits will be to reduce the net increase experienced by residential customers – by the amount of the credit – below the rate spreads I have proposed.

Q. Does this conclude your direct testimony?

A. Yes, it does.

[7] In order to make the revenue parity ratios for the interim cases comparable to current rates, I make a pro-forma adjustment to the interim charges by assuming them to be in place for a full year.

[8] To make this calculation comparable to the two other scenarios, I applied my rate design proposal to PSE's requested interim revenue requirement normalized for a full year.