EXHIBIT NO. ____(KCH-1T)
DOCKET NO. UE-060266/UG-060267
2006 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-060266** **Docket No. UG-060267**

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

July 19, 2006

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RESPONSE TESTIMONY OF KEVIN C. HIGGINS

Introduction

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

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 phase of the 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 one of the largest retail grocers in the United States, and operates approximately 145 facilities in the state of Washington, 68 of which are located in the territory served by Puget Sound Energy ("PSE"). These facilities purchase more than 185 million kWh annually from PSE, and are served on Electric Rate Schedules 24, 25, 26, and 40. Kroger is also a sizeable natural gas customer of PSE, purchasing most of its gas on Rate 31G-C.

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward the Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the

University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

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 helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before this Commission?

A. Yes. I testified in the PSE 2004 general rate case and participated in the settlement discussions that resulted in a partial settlement pertaining to rate spread and rate design issues in that proceeding. I also testified in the interim phase of the PSE 2001 general rate case and participated in the collaborative process that led to the settlement agreement submitted by the parties to that general rate proceeding, which was subsequently approved by the Commission.

Q. Have you testified before utility regulatory commissions in other states?

A. Yes. I have testified in over sixty proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Michigan, Minnesota, Nevada, New York, Ohio, Oregon, Pennsylvania, South Carolina, Utah, West Virginia, and Wyoming.

A more detailed description of my qualifications is contained in Exhibit No.__ (KCH-1), attached to my response testimony.

<u>Overview and Recommendations</u>

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

A. My testimony addresses the depreciation tracker proposed by PSE. My testimony also confirms Kroger's support for the Partial Settlement Agreement regarding electric rate spread, rate design and low income energy assistance that has been filed as part of this proceeding.

Absence of comment on my part on the other aspects of PSE's filing does not imply support or opposition to those items.

Q. Does Kroger support the Partial Settlement Agreement regarding electric rate spread, rate design and low income energy assistance that has been filed as part of this proceeding?

A. Yes. Kroger is a party to that agreement and recommends its approval by the Commission.

Q. What conclusions have you reached regarding PSE's proposed depreciation tracker?

A. I recommend against adoption of the depreciation tracker proposed by PSE.

PSE Depreciation Tracker Proposal

Q. What has PSE proposed with respect to a depreciation tracker?

A. As described in the direct testimony of John H. Story, PSE is proposing that any increased expense associated with growth in depreciation for electric and natural gas transmission and distribution plant investments be recovered using a tracker mechanism that would be collected through a surcharge. The surcharge would be based on the incremental depreciation expense of natural gas and electric transmission and distribution investment over and above the depreciation expense reflected in existing rates. The surcharge design would take into account growth in revenues associated with increased load.

Q. What is you assessment of this proposal?

A. The depreciation tracker proposed by PSE is a flawed ratemaking concept that would result in an unreasonable cost burden for customers. I recommend that it be rejected by the Commission.

I offer the following reasons for my recommendation:

1. Allowing a "stand-alone" rate adjustment for incremental depreciation expense is an example of "single-issue ratemaking," in which a single item is permitted to impact rates in isolation from all other rate considerations. Unless it can be shown to involve a compelling public interest, single-issue ratemaking is generally not sound regulatory policy, as it 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. There is no compelling reason to permit single-issue ratemaking in this instance.

2. PSE already has in place other Commission-approved mechanisms that provide the Company with the opportunity for significant revenue adjustments between general rate cases. On the gas side, PSE has the PGA Mechanism, which allows for 100 percent pass-through of prudent natural gas purchases costs. On the electric side, PSE has the Power Cost Adjustment ("PCA") mechanism and the ability to file a Power Cost Only Rate Case ("PCORC"). These existing mechanisms already address PSE's most critical cost recovery risks between general rate cases. An additional layer of rate adjustments is not warranted and would unduly burden customers.

3. The Company's proposal does not recognize that incremental depreciation expense may be associated with cost-savings that reduce expenses in other areas. Replacement of older equipment should reduce the operations and maintenance costs in some instances. These cost savings would not be reflected in the tracker calculation. Thus, even if concerns about single-issue ratemaking were waived to allow a depreciation tracker, the rate adjustment would likely be overstated.

<u>Single-Issue Ratemaking</u>

Q. What is single-issue ratemaking?

A. Single-issue ratemaking occurs when utility rates are adjusted in response to a change in a single cost item considered in isolation. In contrast, when regulatory commissions determine the appropriateness of a rate or charge that a utility seeks to impose on its customers, the standard practice is to review and consider all relevant factors, rather than just a single factor. Indeed, in some states, this is required by law. To consider some costs in isolation might cause a commission to allow a utility to increase rates to recover higher costs in one area without recognizing counterbalancing savings in another area. For this reason, single-issue ratemaking is generally not sound regulatory policy.

Q. Are there circumstances that warrant exceptions to preclusions against single-issue ratemaking?

A. There are certain types of cost increases that regulatory commissions have come to allow without the benefit of conducting a general rate case. Because such exceptions constitute a form of single-issue ratemaking, it is not unusual for regulatory commissions to identify criteria that must be met for such treatment to be allowed, such as whether the costs in question exhibit volatility and/or whether the costs are largely outside the utility's control. In light of such criteria, the single-issue adjustments most commonly adopted are commodity and power cost adjustment mechanisms. The PGA Mechanism and PCA are examples of such adjustment mechanisms that this Commission has approved for PSE.

Q. Do transmission and distribution depreciation expenses fit the description of "costs that are outside the utility's control" or "costs that exhibit volatility?"

A. No, quite the opposite is true. Incremental depreciation expense is directly within the utility's control. Further, if these costs were to show a pattern of volatility, it would invariably be the result of utility management decisions. Depreciation expense does not meet the criteria typically used to justify exceptions to prohibitions against single-issue ratemaking.

Q. Is it reasonable to adjust rates based on the changes in depreciation expense without regard to other components of cost that might provide a counterbalancing savings?

A. No. In that regard, it is useful to examine the information in PSE Exhibit No.__ (JHS-12) which presents the trended attrition analysis referenced by Mr. Story in his testimony. As shown in that exhibit, expense due to amortization of property loss declined $1.4 million between the rate year ending September 2003 and the rate year ending September 2005. If the Commission were to approve an adjustment mechanism that simply isolated increases in transmission and distribution depreciation expense, it would fail to acknowledge this kind of offsetting reduction in expense. This example illustrates the hazard of adopting a policy that would allow rates to be increased based on a cost change in a single item.

Q. Do you have any other observations regarding the "trended attrition analysis" provided by the Company?

A. Yes. The electric trended attrition analysis shows that the biggest non-production cost drivers between the 2003 general rate case and the current rate case were customer service expenses and A&G expense. A&G expense was also a major cost driver in the gas trended attrition analysis presented in PSE Exhibit No.__ (KRK-6). Taken together, these results do not support the case for a depreciation tracker.

Q. Are you opposed to PSE being able to recover prudently-incurred transmission and distribution investment costs?

A. No, I am not. I am opposed to adoption of single-issue tracker mechanisms absent a compelling public interest. The appropriate forum for establishing rates to recover prudently-incurred utility investment is a general rate proceeding in which all cost and revenue information can be considered.

<u>Depreciation Tracker Proposal in the Context of Existing Adjustment Mechanisms</u>

Q. In assessing PSE's depreciation tracker proposal, why is relevant to consider the existence of other PSE adjustment mechanisms?

A. Because in evaluating the Company's request, the context is important. The Company has presented its proposal as a means to compensate against earnings attrition. Yet, the Commission has already put in place mechanisms that mitigate the Company's earnings risks in its most vulnerable areas: commodity costs on the gas side and power costs on the electric side. In seeking a depreciation tracker, PSE is not proposing to roll back any portion of the benefits conveyed to it by these existing adjustment mechanisms; instead, PSE request a depreciation tracker *in addition to* the current mechanisms.

The existing adjustment mechanisms already place customers at risk for rate increases between general rate cases; the depreciation tracker would add to that customer burden without a corresponding benefit.

Q. Would you support the adoption of an "attrition adjustment" in lieu of a depreciation adjustment?

A. No. The reasons for rejecting a depreciation tracker apply equally to an attrition adjustment: it is an example of single-issue ratemaking that must be viewed in the context of the existing mechanisms that mitigate the Company's earnings risks.

New Investment and Decreased Expenses

Q. You indicated that the Company's proposal does not recognize that incremental depreciation expense may be associated with decreased expenses. Please explain.

A. PSE indicates that some of its non-generation investment will be directed towards replacing aging infrastructure. Often, replacement of older facilities results in associated reductions in operations and maintenance expenses. Under the Company's proposal, these cost savings would not be reflected in the tracker calculation. Thus, even if concerns about single-issue ratemaking were waived to allow a depreciation tracker, the rate adjustment would likely be overstated.

Q. Does this conclude your response testimony?

A. Yes, it does.