Gary A. Dodge, #0897
HATCH, JAMES & DODGE
10 West Broadway, Suite 400
Salt Lake City, UT 84101
Telephone: 801-363-6363
Facsimile: 801-363-6666
Email: gdodge@hjdlaw.com
Attorneys for UAE

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

Joint Application of Questar Gas Company, the Division of Public Utilities, and Utah Clean Energy, for the Approval of the Conservation Enabling Tariff Adjustment Option and Accounting Orders	Docket No. 05-057-T01

PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

The Utah Association of Energy Users ("UAE") hereby submits the Prefiled Direct Testimony of Kevin C. Higgins in this docket on issues relating to the proposed "Conservation Enabling Tariff."

DATED this 15th day of May, 2006.

_____
Gary A. Dodge,
Attorney for UAE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was sent this 15th day of May, 2006, to the mail or email addresses listed below:

C. Scott Brown
Coleen Larkin Bell
Questar Gas Company
180 East 100 South
P.O. Box 45360
Salt Lake City, UT 84145
scott.brown@questar.com
colleen.bell@questar.com

Gregory B Monson
David L Elmont
Stoel Rives
201 S Main Street, Suite 1100
Salt Lake City, Utah 84111
gbmonson@stoel.com
dlelmont@stoel.com

Sarah Wright
Utah Clean Energy
917 2nd Ave.
Salt Lake City, UT 84103
sarah@utahcleanenergy.org

Michael Ginsberg
Patricia Schmid
Assistant Attorney General
500 Heber M. Wells Building
160 East 300 South
Salt Lake City, UT 84111
mginsberg@utah.gov
pschmid@utah.gov

Reed Warnick
Paul Proctor
Assistant Attorney General
160 East 300 South, 5th Floor
Salt Lake City, UT 84111
rwarnick@utah.gov
pproctor@utah.gov

F. Robert Reeder
William J. Evans
Parsons Behle & Latimer
One Utah Center
201 South Main Street, Suite 1800
P.O. Box 45898
Salt Lake City, UT 84145-0898
BobReeder@pblutah.com
Vbaldwin@pblutah.com

Dale F. Gardiner
Parry Anderson &Y Gardiner
60 East South Temple, #1200
Salt Lake City, Utah 84111
dfgardiner@parrylaw.com

Thomas W Forsgren
2868 Jennie Lane
Holladay, Utah 84117
twforsgren@msn.com

Claire Geddes
3542 Honeycomb Road
Salt Lake City, Utah 84121
geddes@xmission.com

Betsy Wolf
Salt Lake Community Action Program
764 S 200 West
Salt Lake City, Utah 84101
bwolf@slcap.org

Roger Swenson
238 North 2200 West
Salt Lake City, Utah 84116
roger.swenson@prodigy.net

_____

BEFORE
THE PUBLIC SERVICE COMMISSION OF UTAH

Direct Testimony of Kevin C. Higgins

on behalf of

UAE

Joint Application of Questar Gas Company, the Division of Public Utilities, and Utah Clean Energy, for the Approval of the Conservation Enabling Tariff Adjustment Option and Accounting Orders

Docket No. 05-057-T01

May 15, 2006

DIRECT TESTIMONY OF KEVIN C. HIGGINS

Introduction

Q 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 proceeding?

A. My testimony is being sponsored by the Utah Association of Energy Users (UAE).

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 a 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 gas and electric 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. Since 1984, I have testified at least fifteen times before the Utah Public Service Commission on natural gas and electric power issues.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes. I have testified in over forty other 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, South Carolina, Washington, West Virginia, and Wyoming.

A more detailed description of my qualifications is contained in UAE Exhibit 1.1 (KCH-1), attached to my direct testimony.

Overview and conclusions

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

A. My testimony addresses the joint proposal of Questar Gas Company ("QGC"), the Division of Public Utilities ("Division"), and Utah Clean Energy (collectively, the "Proposing Parties") to adopt, on a pilot basis, a rate decoupling mechanism that the Proposing Parties term the Conservation Enabling Tariff ("CET").

Q. What is UAE's interest in this proceeding?

A. Although UAE members primarily utilize transportation service, which is not directly affected by the decoupling mechanism being proposed in this proceeding, many UAE members also take some service under GS-1, which would be directly impacted by the proposed CET. In addition, and perhaps more importantly, UAE members are very concerned about the ratemaking precedent at issue in this proceeding.

Q. What is your primary conclusion and recommendation?

A. For reasons that I explain below, I conclude that the decoupling mechanism being proposed in this proceeding should be rejected.

<u>Decoupling Proposal</u>

Q. Please describe the decoupling proposal put forward by the Proposing Parties.

A. Decoupling is a rate design approach that allows a utility's revenues to be insulated from declines in per-customer usage. In this docket, the Proposing

Parties are requesting that a decoupling mechanism be implemented for QGC's GS-1 rate schedule.

According to the Application of the Proposing Parties, the decoupling mechanism would be implemented as follows. First, the target monthly distribution non-gas ("DNG") revenue requirement per customer would be determined. This target would be calculated using current DNG rates, year-end 2005 revenues, the historical pattern of usage across the months of the calendar year, and the year-end 2005 customer count. Next, each month, the target monthly DNG revenue per customer would be multiplied by the actual number of GS-1 customers and compared to actual DNG revenue. Any difference would be booked into an interest-earning balancing account. Third, at least twice a year, QGC would file for an adjustment to the GS-1 block rates to amortize the balance of the account described above over the upcoming twelve months. That is, GS-1 rates would be adjusted to keep the monthly DNG revenue per customer as close to the target amount as possible.

Q. What would this decoupling proposal accomplish?

A. By separating – or "decoupling" – DNG revenues from usage per customer, the Company's DNG revenues would be insulated from changes in customer usage patterns. In particular, if per-customer usage for GS-1 were to decline for any reason – such as customer price-responsiveness, energy conservation, or change in customer composition, to cite a few examples – QGC's

target monthly DNG revenues per customer would be restored, with interest, via a compensating rate increase.

The primary rationale advanced for the adoption of this program is that it would remove the economic disincentive that QGC is purported to have with respect to supporting energy conservation programs. According to QGC, this disincentive occurs because the current rate design does not allow the Company to collect all its fixed costs when there is a decline in customer usage. Because the decoupling mechanism would raise GS-1 DNG rates in response to per-customer usage reductions, it is advanced by its proponents as having conservation-enabling properties, by virtue of the removal of QGC's disincentive to support conservation programs.

Q. Can you provide a simple example of how this proposal would work?

A. Yes. If, for example, GS-1 customers reduced their average monthly gas consumption by 3 percent as a result of energy conservation, the proposed decoupling mechanism would subsequently raise GS-1 DNG rates by approximately 3 percent to keep QGC's DNG revenues-per-customer constant, plus pay interest on any temporary "shortfall."

Q. What is your assessment of the decoupling proposal?

A. Decoupling is as much a "revenue assurance" mechanism as it is a "conservation enabling" mechanism. The proposal put forward in this docket would result in a transfer of risk from QGC to its customers. Because this proposal is being evaluated outside the purview of a general rate case, there is no

opportunity to weigh the associated reductions in the Company's risk simultaneously with the determination of the Company's allowed return. By itself, this is sufficient reason to reject the decoupling proposal in this proceeding.

Further, adoption of the decoupling mechanism would entail a fundamental and unwarranted change in ratemaking philosophy. Currently, Utah ratemaking establishes fixed base rates in a general rate proceeding and presumes it is the responsibility of utility management to cope with normal business hazards and the operation of economic forces. The decoupling proposal introduces a fundamental change in ratemaking philosophy in which the non-fuel portion of base rates would become variable, and would be adjusted on a regular basis to absolve utility management of a significant portion of the risk associated with its normal business operations. This burden would be shifted to customers.

In my opinion, the decoupling proposal is an example of the proverbial cure that is worse than the disease. By its own admission, QGC's indifference – or possible antagonism – toward energy conservation has not kept per-customer usage in Utah from declining steadily for years. In light of this fact, shifting the assignment of shareholder/customer risk and significantly altering ratemaking philosophy is too great a change to impose just to remove a utility disincentive that, by all appearances, has not prevented customer energy reductions from being successfully carried out over the past twenty-five years. Promoting energy conservation is a worthy objective, but it is not necessary to provide the utility

with special incentives to comply with the Commission's rules in support of such a policy.

For these reasons, which I discuss in greater detail below, I recommend that the decoupling proposal be rejected by the Commission.

Transfer of Risk

Q. How does the decoupling proposal transfer risk to customers?

A. Under current ratemaking practice in Utah, the risk associated with declining usage per customer – for any reason except mild winter weather – is borne by the utility. Under the decoupling proposal, this risk will be shifted to customers. For example, if customers respond to high natural gas prices by lowering their thermostats, their DNG rates will be increased to compensate QGC for any resultant reduction in per-customer usage. The transfer of this risk is a clear benefit to the utility.

Q. Is any compensation being proposed to ratepayers for this transfer of risk?

A. The Application as filed proposes to reduce rates to all Utah rate classes by $10.2 million, driven in large part by recognition of a change in depreciation methodology and a reduction in long-term debt costs. Subsequent to the filing of the Application, the Proposing Parties and other parties, including UAE, entered a stipulation recommending a permanent rate reduction of $9.7 million based on the change in depreciation methodology and the reduction in long-term debt costs, netted against the amortization of deferred pipeline integrity costs.

Based on my review of the Application as it now stands, it is unclear to what extent QGC intends to offer additional rate reductions in exchange for decoupling. Regardless of any such offer, however, the decoupling proposal is being considered outside a general rate proceeding; therefore, there is no opportunity in this docket for the Commission to make appropriate adjustments to the Company's allowed return-on-equity to reflect the proposed transfer of risk to customers.

Q. You indicated that reductions in per-customer usage due to mild winter weather is an exception to the current Utah ratemaking practice that the revenue risk associated with reductions in usage is borne by the utility. Please elaborate.

A. QGC already adjusts the DNG billing volumes for individual GS-1 customers up or down to account for deviations in winter temperatures from normal, although residential customers may request to be excluded from this adjustment. This provision, the Weather Normalization Adjustment ("WNA"), is discussed in section 2.08 of the QGC tariff. The WNA was adopted by the Commission in 1995 as part of a general rate case settlement in which UAE members participated. As is the case with the much broader decoupling proposal at issue in this docket, the WNA reduces Company risk; however, unlike the adoption of the WNA, the decoupling proposal, as noted above, is being evaluated outside the purview of a general rate case. The adoption of the WNA in 1995 occurred in a setting that allowed the parties and the Commission to weigh the

associated reductions in the Company's risk simultaneously with the determination of the Company's allowed return. The opportunity to make this trade-off does not exist in this docket. By itself, this is sufficient reason to reject the decoupling proposal in this proceeding.

Q. You stated that the proposed decoupling mechanism would restore QGC's target monthly DNG revenues per customer even if there was a change in customer composition. What do you mean by this?

A. The proposed decoupling mechanism would effectively hold constant the Company's per-customer monthly DNG revenue for GS-1, based on average GS-1 usage at year-end 2005. The calculation of average GS-1 usage for this purpose covers a diversity of customers – both residential and non-residential. If the composition of new GS-1 customers were to differ from the existing baseline – for example, if the composition of new customers turns out to be more heavily weighted toward residential – then the decoupling mechanism would adjust GS-1 rates to attribute average baseline revenues to these new customers. I see no merit in making such an adjustment, and consider it to be an example of the type of unintended consequence that can result from adoption of the decoupling proposal.

Change in Ratemaking Philosophy

Q. On what basis do you assert that decoupling constitutes a fundamental change in ratemaking philosophy?

A. The basic approach to natural gas and electric ratemaking in Utah is one in which the non-fuel portion of base rates is fixed pursuant to a general rate proceeding.[1] This approach provides rate stability and allows for a multitude of factors to be considered in determining rates that are just and reasonable. Although periodically-variable rates have been allowed for the pass-through of fuel costs, such variable treatment is not applied to the non-fuel portion of base rates that provides the utility's opportunity to earn a return. Significantly, in approving rates that establish the opportunity to earn a return, this Commission has taken the position that it is "entitled to presume that the utility is soundly managed as it faces what the Supreme Court has referred to as 'normal business hazards' and the 'operation of economic forces.'"[2]

The underlying ratemaking philosophy expressed here is that it is the job of the utility's management to cope with normal business hazards and the operation of economic forces. The decoupling proposal transfers a significant portion of this responsibility to the rate design mechanism, with the associated risk shifted squarely onto the shoulders of customers. In my opinion, this constitutes a significant – and unwarranted – change in ratemaking philosophy that also sets an unwelcome precedent. These are additional reasons for the proposal's rejection.

[1] For electric utilities, the fuel-related portion is also fixed.

Energy conservation and utility disincentives

Q. Please describe the disincentive toward energy conservation that is alleged by QGC.

A. QGC witness Barrie L. McKay states that the current rate design does not allow the Company to collect its fixed costs when there is a decline in customer usage, making the current rate design a barrier to promoting energy conservation. Instead, Mr. McKay states, it is in the Company's interest to encourage customers to use more natural gas.

Q. Do you disagree with this characterization?

A. I don't disagree with the basic thrust of this assertion, but I believe it requires some qualification. Certainly, a very large portion of DNG revenues for the GS-1 rate schedule is collected on a volumetric basis. Consequently, QGC earns greater profits when customers buy more gas, *all other things being equal*. Conversely, when there is a decline in per-customer usage, *all other things being equal*, it impedes the Company's ability to reach its profit objectives. It follows, then, that it is generally true that QGC's rate design does not provide the Company with an incentive to encourage conservation.

Q. Why do you emphasize the phrase "all other things being equal"?

A. I emphasize it because the propositions we are discussing with respect to per-customer usage are logically correct to the extent that this one variable changes and nothing else does. In reality, of course, variables that affect

[2] Report and Order, In the Matter of the Investigation Into the Reasonableness of Rates and Charges of PacifiCorp, dba Utah Power & Light Company. Docket No. 97-035-01, March 4, 1999.

profitability change all the time. Consequently, isolating per-customer usage, and designing automatic rate changes to offset changes in this single variable, while ignoring all other variables, is a hazardous undertaking that is akin to single-issue ratemaking. If a decoupling mechanism is adopted, the Commission could wind up in the position of sanctioning a DNG rate increase at a time when rates might actually deserve to be reduced, if all relevant variables were considered.

Q. What about the Company's disincentive to promote conservation?

A. I think this issue warrants closer examination. Let's start with the premise. The Commission is being asked to change the GS-1 rate design in order to remove the Company's disincentive to promote energy conservation, while at the same time the Company maintains that average usage per customer has declined about 36 percent from 1980 through 2005. Clearly, customers have been reducing their gas usage over a sustained period of time, despite the utility's apparent disinclination to encourage such conservation. To me, this says that the decoupling proposal has less to do with encouraging energy conservation – energy conservation has clearly been occurring – and more to do with guaranteeing the Company's revenues when conservation does takes place. Viewed in this light, changing the GS-1 rate design in a manner that shifts risk to customers, as well as alters the Commission's underlying ratemaking philosophy, is simply not warranted.

I note, ironically, that the Company's disincentive to promote energy conservation stems, in part, from prior regulatory actions to insulate the Company

from previous business risks. In 1979, the fuel cost portion of customer bills became a pass-through charge to customers, removing all fuel cost risk for the utility. If, instead of the protections offered by Account 191, QGC was at risk today for high incremental gas costs – either through fixed rates for gas in its tariff or via a risk-sharing mechanism in the balancing account – the Company would have a clear incentive to promote conservation. Thus, an alternative means of aligning the Company's interests with energy conservation would be to modify Account 191 to put the Company partially at risk for rising energy prices. I hasten to add that I am not here making such a proposal. I suspect the Company might characterize such a change in the name of promoting conservation to be "overkill," much as I view the proposed decoupling mechanism to be overkill. The salient point here is that just because an action may reduce the Company's disincentive to promote conservation, it does not necessarily make that action desirable in a broader context. In my opinion, this point applies to decoupling.

Finally, we should not lose sight of the fact that in determining just and reasonable rules and regulations, the Commission is expressly permitted to consider means of encouraging conservation of resources and energy, and that as a public utility under the jurisdiction of the Commission, QGC is obligated to comply with those rules. Simply put, with the privilege of a monopoly comes the obligation to comply with Commission determinations as to the public interest. If encouraging energy conservation is determined to be an integral aspect of providing least-cost utility service, it is not necessary to provide the utility with

special incentives to comply with the Commission's rules in support of such a policy. This is especially true if the proposed incentives result in negative consequences for customers.

Q. Does this conclude your direct testimony?

A. Yes, it does.