BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Northern States Power Company - Wisconsin for Authority to Adjust Electric and Natural Gas Rates	)))	Docket No. 4220-UR-117

SURREBUTTAL TESTIMONY OF JONATHAN WALLACH ON BEHALF OF THE CITIZENS UTILITY BOARD OF WISCONSIN

November 1, 2011

I. Introduction and Summary

Q: Please state your name, occupation, and business address.

A: My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc., 5 Water Street, Arlington, Massachusetts.

Q: Are you the same Jonathan Wallach that filed direct and rebuttal testimony in this proceeding?

A: Yes.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of the Citizens Utility Board (CUB).

Q: What is the purpose of your surrebuttal testimony?

A: This surrebuttal testimony responds to the rebuttal testimony filed in this proceeding by Gerald W. Marx on behalf of Northern States Power of Wisconsin (NSP or "the Company") and by Richard A. Baudino on behalf of the Wisconsin Industrial Energy Group (WIEG).

Q: What is your general response to Mr. Marx's and Mr. Baudino's rebuttal testimony?

A: In their rebuttal to my direct testimony, Mr. Marx and Mr. Baudino offer narrow arguments against particular production capacity cost allocations or distribution cost classifications, as if I recommended sole reliance on those specific schemes. However, I made no such recommendations.

To the contrary, I based my recommendations on the revenue allocations resulting from a reasonable range of production and distribution cost allocations. As the Commission has recognized, it is appropriate and reasonable to look across a range of cost-allocation results, and to take into account broader considerations of equity and fairness, when distributing revenue increases (or decreases) among customer classes. My recommendation is that the Commission look across two dimensions of revenue-allocation results, the one defined by a range of production cost allocations and the other by a range of distribution cost classifications, in its determination of the appropriate allocation of revenues to customer classes.

Moreover, as I discussed in my direct testimony, if the Commission, having looked across these two dimensions, wishes to moderate rate impacts for all customer classes, it could do so by allocating any revenue increase according to the following guidelines:

- Increase revenues for the medium and large rate classes by the system average percentage plus one percentage point.
- Increase revenues for lighting customers by the system average percentage.
- Increase revenues for the residential and small general service classes by the remainder of the allowed total revenue increase after allocations to the medium, large, and lighting classes.

II. Response to Mr. Marx's Rebuttal

Q: What is Mr. Marx's response to your direct testimony regarding the allocator for production capacity costs?

A: Mr. Marx claims that I recommend that production capacity costs be allocated using a 30% demand / 70% energy blended allocator, and notes that "the allocators supported by both WIEG and CUB favor their individual customer groups."[1] Mr. Marx further claims that I supported my recommendation for the 30% demand / 70% energy allocator with an Equivalent Peaker analysis that was incomplete, because it did not account for the Minnesota plants in the NSP system.

Q: Are these claims valid?

A: Mr. Marx is mistaken on both counts. Nowhere in my direct testimony do I recommend that production capacity costs be allocated using a 30% demand / 70% energy blended allocator. Instead, I recommended that production capacity costs be allocated using the range of results from the Company's two blended allocators, neither of which would allocate 70% of production capacity costs on energy. To repeat the conclusion from my direct testimony on this issue:

> I agree with Mr. Marx when he states that the CCOSS results associated with the 57.3% demand / 42.7% energy and the 38.4% demand / 61.6% energy allocators represent a "continuum of reasonable alternatives." **The Company should therefore allocate any revenue increases based on the range of CCOSS results associated with these two blended allocators.** [Emphasis added.]

In other words, I recommended a range of allocations that on average would allocate 48% of production capacity costs on demand and 52% on energy.

[1] *Rebuttal Testimony of Gerald W. Marx*, PSCW Docket No. 4220-UR-117, October 25, 2011, p. R1.97.

Contrary to Mr. Marx's characterization, I clearly did not recommend this range because it opportunistically favors the residential class. If that had been my intent, I would have recommended the 4CP allocator, which identifies a lower cost increase than my recommendation.[2] Instead, I recommended a range of allocations that reasonably and appropriately allocate production capacity costs on the basis of cost causation.

Nor did I rely on my Equivalent Peaker analysis to support a 30% demand / 70% energy blended allocator. Instead, I undertook an analysis to evaluate the merits of the Company's undocumented and unsupported claim that its 38.4% demand / 61.6% energy blended allocator "assigns too much cost responsibility to energy-using customers." Contrary to the Company's assertion, I found with the Equivalent Peaker analysis that the cost allocations using a 38.4% demand / 61.6% energy allocator fall within a reasonable range.

Finally, Mr. Marx is incorrect in his claim that I did not include the Company's Minnesota plants in my Equivalent Peaker analysis. In fact, I included plant data for all plants in the NSP system, as reported in the 2010 FERC Form 1 reports for both NSP Wisconsin and NSP Minnesota.

Q: What is Mr. Marx's response to your direct testimony with regard to the classification of distribution plant costs?

A: In my direct testimony, I showed the impact on class revenue allocations from an alternative classification of distribution costs that classified all costs (other than costs for lighting) in FERC Accounts 364 through 368 as demand-related

[2] In fact, I urged the Commission in my rebuttal testimony to reject Mr. Baudino's proposal to rely on the 4CP allocator.

and all costs in FERC Account 369 as customer-related.[3] In his rebuttal testimony, Mr. Marx characterizes this alternative classification as "extreme."

Q: Is that a reasonable characterization of your alternative classification?

A: Mr. Marx's opinion of my alternative classification apparently is not shared by regulatory commissions in other jurisdictions, including the commission in the Company's Michigan jurisdiction. In fact, according to a study published in 2000 by the Regulatory Assistance Project, my alternative classification is the general approach used in more than thirty states.[4]

Q: Did you recommend in your direct testimony that the revenue increase for the residential class be based on an allocation of distribution costs using your alternative classification?

A: No. Residential revenues would increase by about one-fifth of the system average percentage increase if distribution costs were classified in accordance with my alternative approach. Instead, I suggested in my direct testimony that it would be appropriate to increase residential revenues by about half of the system average percentage increase.[5]

This proposal was based on an assessment of the range of revenue allocations resulting from: (1) my recommendation regarding the appropriate range of blended production capacity cost allocators; and (2) the range of

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[3] Mr. Marx slightly misstates the classification percentages for my alternative classification in Table 4 of his rebuttal testimony. I assumed the same small percentage of costs for lighting customers as shown for the Company's approach in Table 4 of Mr. Marx's rebuttal testimony.

[4] Frederick Weston, *Charging for Utility Distribution Services: Issues in Rate Design*, The Regulatory Assistance Project, December 2000, p. 29.

[5] As noted above, I also proposed an alternative scheme for allocating any revenue increase approved by the Commission, in the event that the Commission sought to moderate rate impacts for all customer classes.

distribution-cost allocations between the Company's and my alternative classification approaches. I presented the range of residential revenue increases in Table 3 of my direct testimony. The following table provides the relevant results from my direct testimony.

Table 1: Residential Revenue Increase Under Varying Production Cost Allocators and Distribution Cost Classifications

Production Capacity Allocator	Residential Increase	
	Minimum System Classification	Alternative Classification
57.3% / 42.7%	5.2%	1.3%
38.4% / 61.6%	4.8%	0.9%

III. Response to Mr. Baudino's Rebuttal

Q: What is Mr. Baudino's response to your direct testimony regarding the allocator for production capacity costs?

A: Other than to restate his objections to blended production cost allocators, which I addressed in my rebuttal testimony, Mr. Baudino discusses what he believes are problems with my Equivalent Peaker analysis. Specifically, Mr. Baudino faults my analysis because it is not based on the actual analysis of economic trade-offs that led to the decisions to add capacity to the NSP system. According to Mr. Baudino, without these historical analyses, "it is impossible to identify the 'cost causation' underlying each and, in particular, the expected fuel savings that a base load coal or nuclear unit was likely to achieve."[6] Mr. Baudino goes on to claim that:

[6] *Rebuttal Testimony of Richard A. Baudino,* PSCW Docket No. 4220-UR-117, October 25, 2011, p. R4.7.

> The additional cost of a base load unit may not have been justified by fuel savings expectations alone. Rather the decision may have also considered other factors (such as the longer life of a base load unit) that, when combined with fuel savings, justified the higher cost base load unit.[7]

Q: Are historical analyses of fuel savings relevant to the determination of cost causation for production capacity costs?

A: No. What is relevant is that the decision to invest in baseload or cycling capacity, rather than less-expensive peaking units, was based on the fundamental economic logic underlying least-cost capacity expansion planning. In other words, what is relevant is not the amount of "the expected fuel savings that a base load coal or nuclear unit was likely to achieve," but that under typical capacity expansion planning practice the Company's additional capital investment for baseload or cycling units would have been justified on the basis of fuel savings. As described in the NARUC manual on cost allocation:

> The utility can choose to construct one of a variety of plant-types: combustion turbines (CT), which are the least costly per KW of installed capacity, combined cycle (CC) units costing two to three times as much per KW as the CT, and baseloaded units with a cost of four or more times as much as the CT per KW of installed capacity. The choice of unit depends on the energy load to be served.[8]

Thus, from a cost-allocation perspective, the fixed costs incurred for baseload or intermediate capacity over and above that incurred for peaking capacity are appropriately classified as energy-related, since these additional fixed costs are incurred to meet energy requirements at lowest total cost.

Q: Could other factors, such as expected plant life, play a role in determining the type of investment, as Mr. Baudino contends?

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[7] *Id.*

[8] *Electric Utility Cost Allocation Manual*, National Association of Regulatory Utility Commissioners, January 1992, p. 53.

A: Expected life, along with a number of other assumptions regarding plant and transmission-system characteristics, are typically factors that are accounted for in economic evaluations of capacity-expansion plans, and these factors, either individually or collectively, may affect the economic trade-offs between different types of plant investments. Moreover, an Equivalent Peaker analysis can be adjusted to account for such factors, for example, through cost levelization to account for differing plant lives. However, it is unlikely that such adjustments would have been material for the purposes of my analysis, which was to assess the reasonableness of the Company's 38.4% demand / 61.6% energy blended allocator and to support my recommendation to allocate any revenue increases based on the range of results associated with the Company's 57.3% demand / 42.7% energy and the 38.4% demand / 61.6% energy allocators.

Q: Do you have any comment regarding Mr. Baudino's rebuttal of your alternative classification of distribution costs?

A: Mr. Baudino's argument against my alternative classification appears to rest solely on his judgment that the principles underlying the Company's approach are "well reasoned, supported, and accepted."[9] Mr. Baudino's judgment in this regard is not an adequate basis for relying on one approach or another. The Commission should therefore disregard Mr. Baudino's recommendation to reject my proposed revenue allocations.

Q: Does this complete your surrebuttal testimony?

A: Yes.

[9] Baudino Rebuttal, p. R4.8.