

**BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN**

Application of Wisconsin Power and Light Company for Authority to Adjust Rates in Accordance with its 2012 Fuel Cost Plan)) Docket No. 6680-FR-104)

**SURREBUTTAL TESTIMONY OF JONATHAN WALLACH
ON BEHALF OF THE CITIZENS UTILITY BOARD OF WISCONSIN**
November 18, 2011

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

2 A: My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc.,
3 5 Water Street, Arlington, Massachusetts.

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

6 A: Yes.

7 **Q: On whose behalf are you testifying?**

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

9 **Q: What is the purpose of your surrebuttal testimony?**

10 A: This surrebuttal testimony responds to the rebuttal testimony filed in this
11 proceeding by Martin W. Seitz, Eric J. Guelker, and Scott A. Blankman on
12 behalf of Wisconsin Power and Light Company (WPL or “the Company”).

13 **Q: What is your general response to the Company’s rebuttal testimony?**

14 A: The Company, as well Commission staff member Michael A. Ritsema, appears
15 to agree with CUB that there is considerable uncertainty at this time concerning

1 compliance requirements and costs for 2012 under the Cross State Air Pollution
2 Rule (CSAPR). According to Mr. Seitz:

3 WPL agrees that there is uncertainty in the cost estimates of monitored fuel
4 expense for 2012. This uncertainty has been exacerbated by the recently
5 issued CSAPR, challenges to CSAPR, requests to change or stay CSAPR,
6 and what costs to assign to CSAPR, including what unit price to assume for
7 allowances.¹

8 In addition, the Company, CUB, and Commission Staff appear to be in
9 general agreement that uncertainty with regard to CSAPR requirements and
10 compliance costs introduces uncertainty into the compliance planning process,
11 requires flexibility in the Company's compliance strategies, and provides
12 reasonable grounds for tightening or suspending the bandwidth on monitored
13 fuel costs for 2012.

14 However, CUB parts with the Company and Mr. Ritsema regarding how
15 best to reflect CSAPR-related costs in 2012 monitored fuel costs in light of this
16 uncertainty. As I discussed in my direct and rebuttal testimony, neither the
17 Company's nor Mr. Ritsema's proposals for 2012 monitored fuel costs reflect
18 realistic forecasts of CSAPR-related costs, since these forecasts are based on
19 outdated allowance market prices and do not reflect least-cost strategies for
20 complying with 2012 CSAPR requirements. Consequently, neither of these
21 forecasts should be relied on for the purposes of establishing monitored fuel
22 costs for 2012.

23 Instead, as I discussed in my direct and rebuttal testimony, there are two
24 reasonable approaches for reflecting CSAPR-related costs in 2012 monitored
25 fuel costs given uncertainty regarding CSAPR implementation. One approach

¹ *Rebuttal Testimony of Martin W. Seitz*, PSCW Docket No. 6680-FR-104, November 9, 2011, p. WPL-Rebuttal-Seitz-6.

1 would be to not reflect any CSAPR-related costs in 2012 monitored fuel costs
2 and instead defer recovery of CSAPR compliance costs until 2013. The other
3 approach would be to forecast monitored fuel costs for 2012 using current
4 market prices for SO₂ and NO_x allowances and for energy purchases from the
5 Midwest Independent Transmission System Operator (MISO).

6 **Q: Does WPL support the option of deferring CSAPR-related costs?**

7 A: No. According to Mr. Seitz, the Company opposes deferral, because:

8 ... the proposed deferral process would remove costs from 2012 billings
9 and moves them to customers that receive bills in 2014, or later as noted in
10 Commission Staff testimony. WPL does not favor this shift in billings
11 between generations of customers.²

12 Mr. Seitz also states that WPL opposes deferral, because:

13 The proposed deferral, if approved, would most likely attempt to capture all
14 the incremental costs to comply with CSAPR. WPL believes that there
15 currently is not a good process to determine what those incremental costs
16 would be or how to capture them and remove them from the total fuel
17 expense.³

18 **Q: Would deferral of CSAPR-related costs shift billings from one generation of**
19 **customers to another?**

20 A: Yes. However, so would non-deferred recovery of forecasted CSAPR-related
21 costs. In the latter case, any over- or under-recovery of CSAPR-related costs in
22 2012 would be credited to or recovered from customers starting in 2013.⁴ Thus,
23 issues of inter-generational equity would arise whether CSAPR-related costs
24 were deferred or not.

² *Id.*, p. WPL-Rebuttal-Seitz-5.

³ *Id.*

⁴ Although Mr. Seitz and Mr. Ritsema assert that deferred 2012 CSAPR-related costs would be recovered starting in 2014, the fuel rules allow for recovery of deferred balances starting in 2013.

1 **Q: Do you agree with Mr. Seitz’s assertion that there is “not a good process”**
2 **for determining the amount of CSAPR-related costs if such costs were to be**
3 **deferred?**

4 A: No. To the contrary, in my rebuttal testimony I describe two methods for
5 determining 2012 monitored fuel costs, depending on whether the Commission
6 decides to defer all incremental CSAPR-related costs or only those costs
7 associated with allowance purchases.⁵

8 **Q: In lieu of deferral, does the Company support your proposal to use current**
9 **market prices for allowances and power purchases to derive 2012**
10 **monitored fuel costs?**

11 A: The Company appears to support the use of current market prices for power
12 purchases, but not for SO₂ and NO_x allowances. According to Mr. Guelker, the
13 Company continues to support an SO₂ allowance price of \$3,000/ton as a proxy
14 for the cost of complying with CSAPR in 2012, even though allowances are
15 currently trading at around \$550/ton.

16 **Q: Why does the Company oppose the use of current allowance market prices**
17 **as a proxy for CSAPR compliance costs?**

18 A: According to Mr. Guelker, “the CSAPR allowance market is not sufficiently
19 robust and mature to be used as a reasonable proxy for the cost of compliance

⁵ Incremental CSAPR-related costs would include: (1) incremental fuel, variable O&M, and other dispatch costs for the Nelson Dewey generating units associated with fuel-switching from petroleum coke to low-sulfur coal at those units; (2) incremental system costs associated with the Nelson Dewey fuel-switch; (3) incremental system costs associated with any emissions-related restrictions on coal plant dispatch or other measures for complying with CSAPR emissions limits; (4) incremental system costs associated with inclusion of SO₂ and NO_x allowance prices in coal plant dispatch costs; and (5) the cost to purchase allowances to cover emissions in excess of CSAPR limits.

1 with CSAPR.”⁶ The Company apparently believes that inefficiencies in the
2 current market have led to allowance trades at prices that are below those likely
3 during 2012:

4 Given the considerable uncertainty surrounding CSAPR’s ultimate
5 compliance requirements and whether or not it will remain effective in the
6 wake of judicial challenges, the current market prices for SO₂ and NO_x
7 allowances may not be a meaningful predictor of availability and price of
8 allowances during 2012.⁷

9 **Q: Is this a reasonable basis for continuing to assume an SO₂ allowance price**
10 **of \$3,000/ton?**

11 A: No. If anything, the allowance market is more robust and mature today than it
12 was when WPL adopted the allowance price of \$3,000/ton as a proxy for
13 CSAPR compliance costs. In fact, the Company established the \$3,000/ton price
14 before allowance markets were established or before any actual allowance
15 trading in those markets.

16 According to the Company’s response to MAR-12.1, WPL assumed a
17 \$3,000/ton SO₂ allowance price for its original filing on May 18, 2011:

18 ... based upon phone conversations with possible brokers of the CATR
19 allowances. As the CATR had not been finalized, brokers were hesitant to
20 provide specific price quotes, but when asked about the price ranges we
21 were anticipating, none indicated that our price ranges were unreasonable.

22 The Company continued to assume a \$3,000/ton allowance price for its
23 supplemental filing on August 17, 2011, apparently based on additional
24 discussions with brokers sometime prior to August 8, 2011(i.e., the date of the
25 Company’s response to MAR-12.1):

⁶ *Rebuttal Testimony of Eric J. Guelker*, PSCW Docket No. 6680-FR-104, November 9, 2011, p. WPL-Rebuttal-Guelker-6.

⁷ *Id.*, p. WPL-Rebuttal-Guelker-4.

1 With the issuance of the final CSAPR, WPL continues to believe that the
2 prices assumed under CATR remain reasonable under CSAPR. The
3 attached confidential file supports WPL's belief that its projected price of
4 CSAPR SO₂ allowances is within the current range of available prices
5 based upon additional discussions with potential brokers.⁸

6 According to Mr. Guelker, as far as the Company is aware, CSAPR
7 allowances were first traded on the Intercontinental Exchange on August 30,
8 2011, well after these "additional discussions with potential brokers."

9 Thus, the Company first adopted a price of \$3,000/ton for SO₂ allowances
10 based on general discussions with brokers before CSAPR was even finalized
11 and allowance markets were established. The Company then continued to
12 assume a \$3,000/ton price for its supplemental filing based on indicative price
13 quotes provided by brokers prior to actual trading of such allowances.

14 **Q: Given the lack of market trading, or even a market, did the Company**
15 **conclude at that time that the assumed \$3,000/ton SO₂ allowance was not a**
16 **reasonable proxy for the cost to comply with 2012 CSAPR requirements?**

17 A: To the contrary, Mr. Guelker stated in his supplemental direct testimony that
18 "WPL believes the cost of purchasing an SO₂ emission allowance is a
19 reasonable proxy for the cost of specific actions yet to be identified and those
20 that might be taken."⁹

21 **Q: Is it possible that allowance market prices in 2012 would be higher than**
22 **current prices, as Mr. Guelker apparently contends?**

23 A: Allowance market prices in 2012 could be higher or lower than current prices,
24 depending on the outcome of the various judicial challenges and on the actual

⁸ Company response to MAR-12.1 (PSC REF #: 152183).

⁹ *Pre-Filed Supplemental Direct Testimony of Eric J. Guelker*, PSCW Docket No. 6680-FR-104, August 17, 2011, p. D1.68.

1 cost to utilities of complying with the 2012 requirements.¹⁰ Like any other
2 market participant, WPL cannot predict with reasonable certainty how market
3 prices will trend over time.¹¹

4 **Q: Given this inherent uncertainty in market pricing, how should the**
5 **Company forecast allowance prices for the purposes of setting 2012**
6 **monitored fuel costs?**

7 A: As it does for its forecast of MISO market prices, the Company should forecast
8 allowance market prices based on current market expectations regarding those
9 prices for 2012. In other words, the Company should rely on current market
10 prices for allowances to set 2012 monitored fuel costs.

11 As I discussed in my direct testimony, the Company should use current
12 allowance market prices to set the cost of allowance purchases (as a proxy for
13 compliance alternatives) and to set plant dispatch costs.

14 **Q: Has the Company considered alternatives to its proxy cost of compliance**
15 **approach for reflecting CSAPR-related costs in 2012 monitored fuel costs?**

16 A: Yes. According to Mr. Blankman, the Company has assessed the alternative
17 approach recommended by Mr. Ritsema in his direct testimony.

¹⁰ After all, 2012 prices could collapse to zero if implementation of CSAPR is deferred beyond 2012. Less dramatically, 2012 prices could decline due to continued softening of the economy, an increase in coal prices, a decline in gas prices, an increase in domestic renewable generation or imports of renewable power from Canada, or other unanticipated changes in cost factors that would reduce generation and emissions from coal-fired generating plants.

¹¹ If the Company could be certain that 2012 allowance prices would rise, the prudent course of action would be to purchase as many allowances as possible at current prices. The Company could use such allowances to cover emissions in excess of 2012 limits (if the cost to comply with 2012 limits was more expensive than covering excess emissions) or re-sell such allowances at a profit when prices rose in 2012 (if it was less expensive to comply with 2012 limits).

1 As I discussed in my rebuttal testimony, whereas the Company assumed
2 CSAPR compliance solely through allowance purchases in its proxy approach,
3 Mr. Ritsema assumed CSAPR compliance through a combination of direct
4 measures to reduce emissions and allowance purchases to cover excess
5 emissions. Specifically, Mr. Ritsema forecast CSAPR-related costs based on a
6 fuel run that: (1) assumes an SO₂ allowance price of \$3,000/ton for both
7 allowance purchases and plant dispatch costs; (2) incorporates NO_x allowance
8 prices in plant dispatch costs; and (3) constrains dispatch of the Company's coal
9 plants in order to limit SO₂ emissions to 118% of the Company's CSAPR-
10 related emissions limit.

11 Based on his comparison of the Company's and Mr. Ritsema's approaches,
12 Mr. Blankman concludes that:

13 ... it appears that Mr. Ritsema's model run, which utilizes more current
14 market prices, can also be considered a reasonable proxy of possible fuel
15 costs associated with the Company's compliance with CSAPR because it
16 has incorporated various compliance alternatives under consideration by
17 the Company.¹²

18 According to Mr. Seitz, the Company has adopted Mr. Ritsema's model run
19 as the basis for setting monitored fuel costs for 2012.

20 **Q: Should 2012 monitored fuel costs be based on Mr. Ritsema's model run?**

21 A: No. As I discussed in my rebuttal testimony, Mr. Ritsema's forecast of 2012
22 monitored fuel costs is based on the same outdated allowance market prices as
23 the Company's forecast. As a result, none of the direct compliance measures
24 assumed for Mr. Ritsema's model run may be cost-effective compared to
25 allowance purchases at current market prices.

¹² *Rebuttal Testimony of Scott A. Blankman*, PSCW Docket No. 6680-FR-104, November 9, 2011, p. WPL-Rebuttal-Blankman-10p.

1 Moreover, even if these compliance measures were to prove cost-effective
2 compared to allowance purchases, there may be alternative strategies for
3 complying with CSAPR requirements that are less expensive than that assumed
4 by Mr. Ritsema. For example, as an alternative to his 118% compliance forecast,
5 Mr. Ritsema also forecast 2012 monitored fuel costs based on a model run that
6 constrains dispatch of the Company's coal plants in order to limit SO₂ emissions
7 to 100% of the Company's CSAPR-related emissions limit. This alternative
8 100% compliance run reduces 2012 monitored fuel costs by \$4.7 million
9 relative to the 118% compliance run. Mr. Ritsema's model runs therefore
10 indicate that a compliance strategy that restricts SO₂ emissions to the CSAPR
11 limit would be less expensive than a strategy that restricts emissions to 118% of
12 the limit and purchases allowances to cover the 18% excess.

13 **Q: Does this complete your surrebuttal testimony?**

14 A: Yes.