BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Joint Application of Wisconsin Electric Power Company and Wisconsin Gas LLC, both d/b/a We Energies, to Conduct a Biennial Review of Costs and Rates – Test Year 2013	))))	Docket No. 05-UR-106

REBUTTAL TESTIMONY OF JONATHAN WALLACH
ON BEHALF OF THE CITIZENS UTILITY BOARD OF WISCONSIN
September 20, 2012

I. Introduction

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 testimony in this proceeding?

A: Yes.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of CUB.

Q: What is the purpose of your rebuttal testimony?

A: This rebuttal testimony addresses the following issues raised in direct testimony filed in this proceeding:

- Allocation of all production plant costs and Power the Future (PTF) lease payments on the basis of each customer class's contribution to the average of the four summer monthly peaks (4CP), as proposed by Richard A. Baudino on behalf of the Wisconsin Industrial Energy Group (WIEG).
- Increase to the residential facilities charge, as proposed by Commission staff member Jerry Albrecht.

II. Classification and Allocation of Production and PTF Lease Costs

Q: What does Mr. Baudino propose with regard to the classification and allocation of production plant costs and PTF lease payments?

A: Mr. Baudino proposes that all production plant and PTF costs be classified as demand-related, and that all such demand-related costs be allocated using the 4CP allocator. Alternatively, in the event that WEPCO continues to rely on the Equivalent Peaker method to classify production costs, Mr. Baudino recommends that PTF lease payments be classified using the same 60%/40% demand/energy split that the Company applies to production plant costs.

Q: What is the basis for Mr. Baudino's proposal that all production plant and PTF costs be classified as demand-related?

A: Mr. Baudino offers two arguments in support of his proposal to classify all fixed production costs as demand-related. First, Mr. Baudino argues that only peak loads, and not system energy requirements, drive investments in production plant:

> Fixed production costs should all be classified as demand-related and allocated to customer classes on the basis of class contribution to system peak demand or, in this case, 4CP. This recognizes the fact that all production plant must be available and on line to meet the peak demand requirements of WEPCO's customers. Excess capacity exists during off-peak periods, indicating that off-peak loads and consumption do not contribute to the need for full production capacity throughout the year.[1]

Second, Mr. Baudino asserts that classifying fixed production costs as energy-related would result in off-peak prices that exceed marginal off-peak energy costs and therefore "discourages the improvement of customer load factors and the use of existing base load and intermediate load plant."[2]

Q: Are production plant costs incurred solely for the purposes of meeting peak demand, as Mr. Baudino contends?

A: No. As I discussed in my direct testimony, under typical generation expansion planning practice, plant investment is driven by both reliability requirements and system energy requirements, with the overall goal of meeting both peak and energy requirements at lowest total cost. System planners would likely invest solely in peaking capacity if plant investment were driven solely by reliability requirements, since peaking units would be the least-cost option for meeting an increase in peak demand and planning reserve requirements. However, the Company has also invested in baseload and intermediate capacity, even though these units have higher fixed costs than peaking capacity, in order to minimize the total cost of meeting an increase in energy requirements.

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[1] Direct-WIEG-Baudino-9, line 19 through Direct-WIEG-Baudino-10, line 3 (PSC REF #: 171725).

[2] Direct-WIEG-Baudino-10, ll. 5-6. Mr. Baudino also argues that energy classification of production plant costs would penalize customers with high load factors, because these customers would incur higher costs than would be the case with demand classification if they were to shift usage to off-peak periods. However, this argument appears to be the same as his second argument that energy classification would drive off-peak prices above marginal energy costs.

From a cost-causation perspective, the fixed costs incurred for baseload or intermediate capacity over and above those 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. According to Company witness Eric A. Rogers, this is in fact the reason why WEPCO relies on the Equivalent Peaker method to classify production plant costs:

> We used the equivalent peaker method to split production plant costs into demand-related and energy-related components. This is the method that best fits the theory that base load and intermediate load plants are built to provide less expensive energy, as well as providing capacity.[3]

Q: Do you agree that classifying fixed production costs as energy-related would dampen customer incentives to improve load factor or reduce peak demand?

A: I do not. The process of classifying and allocating costs has little bearing on whether demand or energy rates provide efficient price signals.

Mr. Baudino's concern is one of rate design, not cost allocation. The cost-allocation process is primarily concerned with the assignment of system costs to customer classes based on cost causation. Once those costs have been allocated to customer classes, the rate-design process attempts to create rate structures that recover those allocated costs while promoting efficient outcomes. In other words, it is the rate-design process, not the cost-allocation process, that determines whether rates provide efficient price signals and promote economic improvements to load factor or reductions in peak demand.

Q: Why does Mr. Baudino recommend allocating demand-related production plant costs using the 4CP allocator?

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[3] Direct-WEPCO/WG-Rogers-16, ll. 10-13 (PSC REF #: 164646).

A: Mr. Baudino's argument appears to be that the 4CP allocator is justified because reliability requirements, and thus demand-related production plant costs, are driven solely by peak demands in the four summer months:

> WEPCO is a strongly summer peaking system. WEPCO's planners must acquire and maintain capacity to meet these summer peaks.[4]

Q: Is this a valid argument?

A: No. As Mr. Rogers acknowledges in his direct testimony, WEPCO "must plan for capacity in all twelve months of the year."[5] In other words, the Company must maintain an adequate margin of available capacity over demand throughout the year in order to ensure that that the annual loss of load probability (LOLP) does not exceed acceptable levels. For example, the scheduling of plant maintenance during low-demand shoulder months may reduce capacity margins during peak periods in those shoulder months and thus increase annual LOLP and reserve requirements. If so, peak demands in these shoulder months would also contribute to the need for investments in reserve capacity.

Q: What do you conclude from your review of Mr. Baudino's proposal for classifying and allocating production plant costs?

A: Mr. Baudino has failed to offer a reasonable basis for his proposal. The Commission should therefore reject Mr. Baudino's recommendations to classify all production plant costs as demand-related and to allocate such costs using the 4CP allocator.

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[4] Direct-WIEG-Baudino-12, ll. 23-24.

[5] Direct-WEPCO/WG-Rogers-13,line 7.

Q: What is Mr. Baudino's alternative proposal in the event that the Commission rejects his proposal to classify all production plant costs as demand-related?

A: In the event that WEPCO continues to rely on the Equivalent Peaker method to classify production costs, Mr. Baudino recommends that PTF lease payments be classified using the same 60%/40% demand/energy split that the Company applies to production plant costs.

Q: What is the basis for Mr. Baudino's alternative proposal?

A: It is not clear why Mr. Baudino believes that PTF lease payments should be classified using the 60%/40% demand/energy split, rather than the 33%/67% demand/energy split derived by the Company by applying the Equivalent Peaker method to these lease payments. Mr. Baudino notes that the PTF coal plants are more expensive, after adjusting for inflation, than the Company's older coal units. Then, without explanation or any supporting evidence, Mr. Baudino somehow concludes from this finding that "there is no basis whatsoever to conclude that the excess cost of the PTF capacity is all due to fuel savings."[6]

Q: Contrary to Mr. Baudino's belief, is there a basis for concluding that the additional investment in the PTF coal units was justified by reductions in energy costs?

A: Yes, since that is precisely what the Commission concluded when it approved the Company's investments in these coal plants. For example, in its final decision approving construction of the Elm Road Generating Station, the Commission determined that a baseload coal plant was the optimal cost-effective option for meeting forecasted reliability and energy requirements:

[6] Direct-WIEG-Baudino-11, ll. 21-23.

> As in other Commission decisions over the past decade, including Part I of PTF [for the Port Washington Generating Station], this docket relies extensively upon computer expansion plan modeling of the electric system to identify cost-effective means of meeting a utility's future electric demand. Both Commission staff and the applicants relied on the EGEAS model in this proceeding as the primary tool to consider optimal resource options on a quantitative basis for WEPCO's future electric demand….
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> After considering the quantitative evidence presented in the EGEAS runs, the key question in this docket is not whether additional coal-fired baseload generation should be approved, but when it should be installed.[7]

Furthermore, the Commission noted in this decision that the need for investment in baseload generation is driven by the demand of high load factor customers:

> A utility's "baseload" energy demand is driven by high load factor customer needs, i.e., electric uses such as commercial lighting, refrigeration, and industrial loads that run constantly. Generally, electric generating plants that are cost-effective when running at least 70 percent of the time are considered "baseload" units.[8]

Given the Commission's determination that the PTF investments were economically justified, it is reasonable to classify all lease payments in excess of peaking-capacity fixed costs as energy-related, as proposed by WEPCO.

Q: Has WEPCO relied previously on the Equivalent Peaker method to classify PTF lease payments?

A: Yes. In Docket No. 05-UR-104, the Company classified all lease payments in excess of peaking-capacity fixed costs as energy-related.[9]

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[7] Docket Nos. 05-CE-130 and 05-AE-118, Order, pp. 23-24 (Nov. 10, 2003) (PSC REF #: 86450).

[8] *Id.*, at footnote 4, p. 7.

[9] Docket No. 5-UR-104, Direct Testimony of Eric Rogers, pp. 223-224 (PSC REF #: 111315) and Rogers Exhibit 42 (PSC REF #: 111316).

Q: What do you recommend with regard to Mr. Baudino's alternative proposal?

A: The Commission should reject Mr. Baudino's alternative proposal to classify PTF lease payments using the 60%/40% demand/energy split. Instead, such lease payments should be classified based on the 33%/67% demand/energy split proposed by the Company.

III. Residential Facilities Charge

Q: What is the Company's proposal with respect to the facilities charge for residential rates?

A: The Company proposes to increase the residential facilities charge by 40%, from \$7.60 per month to \$10.65 per month for single-phase customers and from \$15.21 per month to \$21.29 per month for three-phase customers.

Q: What is Commission staff witness Mr. Albrecht's response to the Company's proposal?

A: Mr. Albrecht rejects the Company's proposal, noting that:

> For the small usage classes the facilities charges is a much bigger portion of the bill compared to larger usage customers and with WEPCO's proposed higher increases there will be significantly higher than average percentage increases for the low usage customers.[10]

Instead, Mr. Albrecht proposes a uniform percentage increase to both the residential facilities and energy charges, commensurate with the overall revenue increase proposed by Commission staff for the residential class for the 2013 and 2014 test years. In contrast to the Company's proposal, Mr. Albrecht argues that:

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[10] Direct-PSC-Albrecht-3, ll. 17-20 (PSC REF #: 171710).

> The facilities charges I propose include much smaller increases. These changes are consistent with the level of increase I have proposed for the energy charges for these classes. Having a lower facilities charge and slightly higher energy charges for the small usage classes could encourage more energy conservation since the customers would see more savings from reductions in kilowatt-hour usage.[11]

Q: How do you respond to Mr. Albrecht's proposal?

A: I agree that Mr. Albrecht's proposal would be less harmful to low-usage customers and would provide greater incentive for conservation savings than the Company's proposal. However, as I discussed in my direct testimony, it would not be appropriate to increase the residential facilities charge by any amount, since the analysis developed by WEPCO to support its proposed increase appears to indicate that the residential facilities charges should be lowered. Consequently, I continue to recommend that the residential facilities charges be maintained at current levels and that any revenue increase allocated to the residential class be recovered solely through the energy charge.

Q: Does this conclude your rebuttal testimony?

A: Yes.

[11] Direct-PSC-Albrecht-3, line 21 through Direct-PSC-Albrecht-4, line 2.