

- 1 • Amortization and recovery through rates of cleanup costs for the
2 Ashland Site, as proposed by Commission staff member Christine A.
3 Swailes.
- 4 • Allocation to the residential class of the revenue deficiency for the 2013
5 test year, as proposed by Commission staff member Jerry Albrecht.
- 6 • Allocation of all production capacity costs on the basis of each customer
7 class's contribution to the average of the four summer monthly peaks
8 (4CP), as proposed by Richard A. Baudino on behalf of the Wisconsin
9 Industrial Energy Group (WIEG).

10 **II. Recovery of Ashland Site Cleanup Costs**

11 **Q: How does Commission staff member Ms. Swailes respond to the Company's**
12 **proposal for recovering the cost to clean up the Ashland Site?**

13 A: Ms. Swailes asserts that it "may be appropriate" to implement the Company's
14 proposal to amortize cleanup costs over a ten-year period starting in the 2013
15 test year.¹ However, Ms. Swailes proposes that amortization start in 2013 only
16 for those costs estimated to be incurred in 2012 and 2013 for the cleanup of the
17 Upland Area, but not those estimated for cleaning up the bay.

18 In addition, Ms. Swailes states that "it appears appropriate" to allow the
19 Company to recover carrying costs on unamortized balances at the cost of debt.²

20 **Q: Did Ms. Swailes estimate the cost impact of implementing the Company's**
21 **proposal?**

¹ Direct-PSC-Swailes-3, line 7 (PSC Ref #:175093).

² Direct-PSC-Swailes-5, line 7.

1 A: Yes. Ms. Swailes's analysis confirms the finding in my direct testimony that,
2 compared to the Commission's current policy, the Company's proposal would
3 dramatically further shift the cleanup cost burden from shareholders to
4 ratepayers. Specifically, Ms. Swailes finds that the Company's proposed
5 modifications to the Commission's current policy would increase ratepayers'
6 share of cleanup costs from █ % to █ %.³

7 **Q: What is the basis for Ms. Swailes's observations regarding the**
8 **appropriateness of the Company's proposal?**

9 A: Ms. Swailes believes that it may be appropriate to make an exception to
10 Commission policy in this case, and only this case, because the Ashland Site
11 cleanup presents a unique situation:

12 The Ashland site is like no other in the state. It is an Environmental
13 Protection Agency (EPA) Superfund site, the cost of clean-up will be
14 significant in comparison to the size of NSPW, and several regulatory
15 agencies are involved in negotiating and planning for the clean-up.
16 Whatever is decided in this proceeding regarding Ashland MGP clean-up is
17 unique to that site.⁴

18 Furthermore, Ms. Swailes finds that the Company's proposal may be
19 appropriate because the resulting cost sharing between ratepayers and
20 shareholders falls within the range of results from application of the
21 Commission's current policy in prior cases.

22 **Q: Do you agree that the Ashland Site cleanup is exceptional?**

23 A: Yes. What is exceptional in this case is the magnitude of the potential cost
24 burden on the Company's natural-gas customers, and the fact that this burden is

³ Ex.-PSC-Swailes-1c, Schedule 1 (PSC REF #:175098).

⁴ Direct-PSC-Swailes-2, ll. 3-7.

1 the consequence of a merger which offered little in the way of compensating
2 benefits to those customers.

3 Given these exceptional circumstances, it would not be appropriate to shift
4 even more of the cleanup costs from shareholders to ratepayers, as would be the
5 case under the Company's proposal. To the contrary, the appropriate and
6 equitable response to the unique circumstances in this case would be to
7 implement a cost-recovery mechanism that mitigates the potential cost burden
8 on ratepayers.

9 **Q: Are there alternatives to the Commission's current policy that might offer
10 benefits to both ratepayers and shareholders?**

11 A: Yes. One option would be to amortize cleanup costs to rates starting in the 2013
12 test year, as with the Company's proposal, but to amortize those costs over more
13 than the ten years proposed by the Company and without the carrying costs
14 proposed by the Company. For example, cleanup costs could be amortized over
15 fifteen years starting in 2013, without any carrying costs on unamortized
16 balances. In this case, I estimate that ratepayers' share of total cleanup costs
17 would decline from █ % under the Commission's current policy to █ % under
18 this alternative cost-recovery option.⁵ Moreover, the maximum reduction to the
19 Company's return on equity (in 2015 and 2016) would decline from █ basis
20 points under the Commission's current policy to █ basis points under this
21 alternative.

⁵ According to the analysis by Ms. Swailes, this lower percentage is still well within the range of cost sharing resulting from application of the Commission's current policy in prior cases (i.e., where ratepayers have paid, on average, 50% to 85% of total MGP cleanup costs). Direct-PSC-Swailes-4.

1 **Q: Would this alternative approach for recovering Ashland Site cleanup costs**
2 **mitigate the rate impacts that might result from cost recovery pursuant to**
3 **the Commission's current policy?**

4 A: Yes. As indicated in the following chart, this alternative approach would
5 substantially reduce the rate impacts that might result from recovering Ashland
6 Site cleanup costs pursuant to either the Commission's current policy or the
7 Company's proposal.

8 Figure 1 - Confidential
9



10

11 **Q: Why does Ms. Swailes propose that NSPW be allowed to recover in 2013**
12 **rates only those costs incurred for cleaning up the Upland Site?**

1 A: Ms. Swailes proposes to exclude projected costs for cleaning up the bay because
2 she believes that there is too much uncertainty at this time with regard to those
3 cost projections for 2013. Instead, Ms. Swailes suggests that recovery of bay
4 cleanup costs be deferred for another year to allow the regulatory process to
5 unfold and to gain greater certainty as to the magnitude of the costs required to
6 clean up the bay.

7 Ms. Swailes's proposal appears to be an appropriate and practical way to
8 address uncertainty at this time regarding the bay cleanup costs.

9 **III. Revenue Allocation**

10 **Q: Please summarize Commission staff member Mr. Albrecht's study of**
11 **revenue allocations to customer classes.**

12 A: Mr. Albrecht presents three variations on the Company's class cost of service
13 study (CCOSS) using Commission staff's proposed revenue requirements for
14 the 2013 test year. Two of these studies vary the classification and allocation of
15 production capacity costs. One variant classifies 60% of production capacity
16 costs as demand-related and the remaining 40% as energy-related ("Time of Use
17 study"), while the other classifies all production capacity costs as demand-
18 related ("Capacity study"). The third study modifies the allocator used for
19 distribution plant costs so that all such costs are allocated on demand ("Location
20 study").

21 **Q: What do you conclude from your review of Mr. Albrecht's analysis?**

22 A: It would not be appropriate to rely on the results of the Capacity study to
23 allocate Commission staff's proposed revenue increase. As I discussed in my
24 direct testimony, classifying all production capacity costs as demand-related is
25 inconsistent with the investment decision-making that gave rise to such costs,

1 since such investments were driven by changes in both customer demand and
2 energy requirements. In fact, I found in my direct testimony that it would be
3 more appropriate and consistent with cost causation to classify 40% of
4 production capacity costs as demand-related and 60% of such costs as energy-
5 related.

6 It would also not be appropriate to rely solely on the results of Mr.
7 Albrecht's Time of Use study to allocate the 2013 test year revenue deficiency,
8 since this study misclassifies demand-related distribution plant costs as
9 customer-related based on an unreliable minimum-system analysis. As is
10 indicated by the results of Mr. Albrecht's Location study, correcting for this
11 misclassification of distribution plant costs reduces the allocation of the 2013
12 test year revenue deficiency to the residential class by more than 50%.

13 On the other hand, Mr. Albrecht's Location study may overstate the portion
14 of distribution plant costs reasonably classified as demand-related, since it
15 appears that this study classifies all services costs as demand-related. As I
16 discussed in my direct testimony, it may be more appropriate to classify all
17 services costs as customer-related for cost-allocation purposes. Taking into
18 consideration this potential classification issue, as well as the likely
19 overstatement of the appropriate demand-related portion of production capacity
20 costs, the results from Mr. Albrecht's Location study using Commission's staff's
21 adjusted revenue requirement indicate that residential rates should be increased
22 by no more than 3%.

23 **IV. Classification and Allocation of Production Capacity Costs**

24 **Q: What does WIEG witness Mr. Baudino propose with regard to the**
25 **classification and allocation of production capacity costs?**

1 A: Mr. Baudino proposes that all production capacity costs be classified as demand-
2 related, and that all such demand-related costs be allocated using the 4CP
3 allocator.

4 **Q: What is the basis for Mr. Baudino’s proposal that all production capacity**
5 **costs be classified as demand-related?**

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

10 Fixed production costs should all be classified as demand-related and
11 allocated to customer classes on the basis of class contribution to system
12 peak demand. This latter approach recognizes the fact that all production
13 plant must be available and on line to meet the peak demand requirements
14 of NSPW’s customers. Excess capacity exists during off-peak periods,
15 indicating that off-peak loads and consumption do not contribute to the
16 need for full production capacity throughout the year.⁶

17 Second, Mr. Baudino asserts that classifying fixed production costs as
18 energy-related would result in off-peak prices that exceed marginal off-peak
19 energy costs and therefore would “discourage the improvement of customer load
20 factors and the use of existing base load and intermediate load plant.”⁷

⁶ Direct-WIEG-Baudino-6, line 14 through Direct-WIEG-Baudino-7, line 3 (PSC REF #: 175068).

⁷ Direct-WIEG-Baudino-7, ll. 7-9. Mr. Baudino also argues that energy classification of production capacity 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.

1 Finally, Mr. Baudino argues that all production capacity costs should be
2 classified as demand-related, because such costs, once incurred, do not vary
3 with energy usage:

4 Further, fixed production costs do not vary with energy consumption
5 throughout the year. In other words, NSPW does not incur less fixed
6 production costs if energy usage falls. These costs by their very nature are
7 fixed and so they must be allocated based on class demands.⁸

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

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

20 From a cost-causation perspective, the fixed costs incurred for baseload or
21 intermediate capacity over and above those incurred for peaking capacity are
22 appropriately classified as energy-related, since these additional fixed costs are
23 incurred to meet energy requirements at lowest total cost.

⁸ Direct-WIEG-Baudino-9, ll. 15-18.

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

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

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

14 **Q: How do you respond to Mr. Baudino's assertion that fixed production costs**
15 **do not vary with energy usage?**

16 A: Mr. Baudino is correct in his assertion that fixed production costs do not vary
17 with energy usage. For that matter, neither do such costs vary with peak
18 demand. Thus, by Mr. Baudino's reasoning, it would not be appropriate to
19 classify production capacity costs as either demand-related or energy-related,
20 since investments in production plant do not vary with either peak demand or
21 energy usage.

22 From a cost-causation perspective, the relevant consideration for
23 classifying production capacity costs is not the extent to which such costs vary
24 with demand or energy once placed in ratebase, but the extent to which the
25 Company's investments in production plant were driven by increases in
26 planning-reserve or energy requirements. From this perspective, it would be

1 unreasonable to classify all production plant costs as demand-related, since
2 investments in baseload and cycling plant were driven by the need to meet both
3 reliability and energy requirements.

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

6 A: Mr. Baudino argues that using the 4CP allocator is justified by the fact that the
7 average peak demand over the four summer months is 25% higher than the
8 average peak demand over the winter months and by the fact that there is excess
9 capacity on the Company's system during the non-summer months. Mr.
10 Baudino's argument appears to be that the 4CP allocator is justified because
11 reliability requirements, and thus demand-related production capacity costs, are
12 driven solely by peak demands in the four summer months.

13 **Q: Is this a valid argument?**

14 A: No. Peak demands during non-summer months also contribute to annual loss of
15 load probability (LOLP) and thus system reserve requirements. For example, the
16 scheduling of plant maintenance during low-demand shoulder months can
17 reduce capacity margins during peak periods in those shoulder months and thus
18 increase annual LOLP and reserve requirements. Consequently, peak demands
19 in non-summer months also contribute to the need for investments in demand-
20 related production capacity.

21 In addition, the difference in capacity margins between the summer and
22 winter periods may not be as large as implied by Mr. Baudino's comparison of
23 summer to winter peak loads due to the impact of the Company's system
24 diversity agreements with Manitoba Hydro. These agreements require Manitoba
25 Hydro to make capacity available to the Company during the summer months
26 and the Company to do the same for Manitoba Hydro during the winter. These

1 diversity exchanges increase available capacity to serve the Company's peak
2 demand in the summer, and thus increase summer capacity margins, but reduce
3 available capacity and capacity margins in the winter.

4 The impact of these diversity exchanges on summer-winter peak
5 differentials appears to be significant. According to the forecast of 2013 monthly
6 demand on the NSP system provided in the Company's response to IDR FCP (S-
7 13) (PSC REF #: 165817), the average peak demand for the four summer
8 months for the NSP system is forecast to exceed that for non-summer months by
9 about █% before consideration of the diversity exchanges. However, the
10 Company's response to IDR FCP (S-13) also shows that the excess of summer
11 over non-summer peaks falls below █% once the impact of the diversity
12 exchanges are netted from gross monthly peaks.

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

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

19 **Q: Does this complete your rebuttal testimony?**

20 A: Yes.