

**BEFORE THE  
PUBLIC SERVICE COMMISSION OF WISCONSIN**

Application of Northern States Power                    )  
Company, a Wisconsin Corporation, for                )  
Authority to Adjust Electric and                        )  
Natural Gas Rates    )           Docket No. 4220-UR-119

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**REBUTTAL TESTIMONY OF JONATHAN WALLACH  
ON BEHALF OF THE CITIZENS UTILITY BOARD OF WISCONSIN**

October 18, 2013

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1    **I.    Introduction**

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

3    A:    My name is Jonathan F. Wallach. I am Vice President of Resource Insight, Inc.,  
4           5 Water Street, Arlington, Massachusetts.

5    **Q:    Are you the same Jonathan F. Wallach that filed direct testimony in this**  
6           **proceeding?**

7    A:    Yes.

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

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

10   **Q:    What is the purpose of your rebuttal testimony?**

11   A:    This rebuttal testimony describes my proposal for allocating to residential and  
12           small C&I rate classes the Commission staff audit forecast of the 2014 test year  
13           electric revenue deficiency. This proposal is based on my recommendation for  
14           allocating the audit revenue deficiency to customer classes, as described in my

1 direct testimony. This proposal also relies on the audit forecast of billing  
2 determinants, as provided in the direct testimony of Commission staff witness  
3 Jerry Albrecht.

4 In addition, I propose specific rate designs for the residential and small  
5 C&I electric rate classes to recover my recommended allocations of the audit  
6 revenue deficiency.

7 Finally, this rebuttal testimony responds to proposals by Richard A.  
8 Baudino, on behalf of the Wisconsin Industrial Energy Group (WIEG),  
9 regarding: (1) classification and allocation of production capacity costs; and (2)  
10 allocation of energy-related production costs.<sup>1</sup>

## 11 **II. Revenue Allocation and Rate Design**

12 **Q: Please describe your proposal for allocating the audit revenue deficiency to**  
13 **customer classes.**

14 **A:** As I discussed in my direct testimony, my proposal is based on the results of the  
15 CUB AUDIT CCOSS, which showed a revenue excess of about \$3.5 million, or  
16 about 1.2% of 2014 test year revenues under current rates, for residential and  
17 small C&I customers. In light of these results, but also to allow for moderate  
18 rate increases for all customer classes and to ensure that all classes' rate  
19 increases fall within a narrow band around the system-average rate increase, I

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<sup>1</sup> In my direct testimony, I stated that I would also be addressing on rebuttal Commission staff's proposal for adjusting the Company's forecast of 2014 test year cleanup costs for the Ashland Manufactured Gas Plant. I have reviewed Commission staff's proposal, as described in the direct testimony of Commission staff witness Jodee J. Bartels, to remove 2014 test year revenue requirements for cleanup of the Sediment Area and I find that adjustment to be reasonable.

1 recommend that the audit revenue deficiency be allocated to customer classes as  
2 shown in Table 1.

3 **Table 1. Recommended Revenue Allocation**

	Current Revenues	Revenue Increase	Percent Increase
Residential and Small C&I	\$285,218,173	\$7,130,454	2.5%
Medium C&I	\$93,249,070	\$4,527,014	4.9%
Large C&I	\$249,601,105	\$12,117,523	4.9%
Total System	\$628,068,348	\$23,774,991	3.8%

4  
5 As I also indicated in my direct testimony, I intended to propose allocations  
6 to individual residential and small C&I rate classes once I had the opportunity to  
7 review the results of Commission staff’s cost of service studies of audit revenue  
8 requirements and had been provided the audit forecast of rate class billing  
9 determinants.

10 **Q: What is your response to Commission staff’s cost of service studies of the**  
11 **audit forecast of 2014 test year revenue requirements?**

12 A: The results of Commission staff’s cost of service studies confirm the  
13 reasonableness of my recommendation for the allocation of the audit forecast of  
14 the 2014 test year revenue deficiency.

15 **Q: Please describe your proposal for allocating the audit revenue deficiency to**  
16 **residential and small C&I rate classes.**

17 A: I provide my proposed allocation in Ex.-CUB-Wallach-2. As indicated in Ex.-  
18 CUB-Wallach-2, I propose allocations for each of the residential and non-  
19 demand general service rate classes, but not for the individual lighting, medium  
20 C&I, large C&I, or miscellaneous rate classes.

21 **Q: What do you recommend with regard to the design of residential and non-**  
22 **demand general service rates?**

1 A: I provide my recommended rate designs for the residential and small C&I rate  
2 classes in Ex.-CUB-Wallach-3. These proposed rates maintain customer charges  
3 at current levels, as recommended by NSPW. I increase current energy charges  
4 for all rate classes by a uniform percentage in order to achieve the revenue  
5 allocations shown in Ex.-CUB-Wallach-2.

### 6 **III. Response to Mr. Baudino**

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

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

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

14 A: Mr. Baudino offers three arguments in support of his proposal to classify all  
15 production capacity costs as demand-related. First, Mr. Baudino argues that only  
16 peak loads, and not system energy requirements, drive investments in  
17 production plant. Second, Mr. Baudino asserts that classifying fixed production  
18 costs as energy-related would result in off-peak prices that exceed marginal off-  
19 peak energy costs and therefore provide economically inefficient price signals.<sup>2</sup>  
20 Finally, Mr. Baudino argues that all production capacity costs should be

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<sup>2</sup> 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 classified as demand-related, because such costs, once incurred, do not vary  
2 with energy usage.

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

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

15 From a cost-causation perspective, the fixed costs incurred for baseload or  
16 intermediate capacity over and above those incurred for peaking capacity, i.e.,  
17 capitalized energy costs, are appropriately classified as energy-related, since  
18 these additional fixed costs are incurred to meet energy requirements at lowest  
19 total cost.

20 **Q: Do you agree that classifying fixed production costs as energy-related**  
21 **would result in economically inefficient price signals?**

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

24 Mr. Baudino's concern is one of rate design, not cost allocation. The cost-  
25 allocation process is primarily concerned with the assignment of system costs to  
26 customer classes based on cost causation. Once those costs have been allocated

1 to customer classes, the rate-design process attempts to create rate structures that  
2 recover those allocated costs while promoting efficient outcomes. In other  
3 words, it is the rate-design process, not the cost-allocation process, that  
4 determines whether rates provide efficient price signals and promote economic  
5 improvements to load factor or reductions in peak demand.

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

8 A: Mr. Baudino is correct in his assertion that fixed production costs do not vary  
9 with energy usage. For that matter, neither do such costs vary with peak  
10 demand. Thus, by Mr. Baudino's reasoning, it would not be appropriate to  
11 classify production capacity costs as either demand-related or energy-related,  
12 since investments in production plant do not vary with either peak demand or  
13 energy usage.

14 From a cost-causation perspective, the relevant consideration for  
15 classifying production capacity costs is not the extent to which such costs vary  
16 with demand or energy once placed in ratebase, but the extent to which the  
17 Company's investments in production plant were driven by increases in  
18 planning-reserve or energy requirements. From this perspective, it would be  
19 unreasonable to classify all production plant costs as demand-related, since  
20 investments in baseload and cycling plant were driven by the need to meet both  
21 reliability and energy requirements.

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

24 A: Mr. Baudino argues that using the 4CP allocator is justified by the fact that the  
25 average peak demand over the four summer months is 27% higher than the  
26 average peak demand over the winter months and by the fact that there is excess

1 capacity on the Company's system during the non-summer months. Mr.  
2 Baudino's argument appears to be that the 4CP allocator is justified because  
3 reliability requirements, and thus demand-related production capacity costs, are  
4 driven solely by peak demands in the four summer months.

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

6 A: No. As I discussed in my direct testimony, because of the diversity exchanges  
7 with Manitoba Hydro, excess winter capacity provides reliability value to the  
8 NSPW system in the form of exchanged reserve capacity imports in the summer  
9 months. Thus, it is more appropriate to rely on the 12CP allocator, since it  
10 reflects the fact that peak demands in all months drive investments in demand-  
11 related production capacity.

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

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

18 **Q: What does Mr. Baudino propose with respect to the allocation of energy-**  
19 **related production costs?**

20 A: Mr. Baudino advocates using the E8760E allocator to allocate energy-related  
21 production costs, and especially so for any production capacity costs that are  
22 classified as energy-related. Mr. Baudino recommends using the E8760E  
23 allocator for energy-related production capacity costs, stating that he does "not

1 believe that there is any disagreement that the E8760E allocator more accurately  
2 reflects class responsibility for energy-related production plant.”<sup>3</sup>

3 **Q: Do you agree that the E8760E allocator reasonably reflects class**  
4 **responsibility for energy-related production capacity costs?**

5 A: No. To the contrary, the E8760E allocator overstates the responsibility of low  
6 load factor classes for those capitalized energy costs classified as energy-related.

7 For example, as noted above, the Company invested in baseload plant  
8 because the addition of that plant generated system fuel savings (relative to  
9 system fuel costs with the addition of a peaker) in excess of that plant’s  
10 capitalized energy costs. Moreover, in this instance, fuel savings exceed  
11 capitalized energy costs because the baseload plant is being dispatched to serve  
12 energy requirements over most hours of the year (i.e., it is dispatched at a high  
13 capacity factor). Thus, high load factor customers (whose load is spread fairly  
14 evenly over all hours) bear greater responsibility than low load factor customers  
15 (whose load is concentrated in the on-peak hours) for both the capitalized  
16 energy investment and the fuel savings generated by that investment.

17 The E8760E allocator allocates capitalized energy costs contrary to  
18 customers’ responsibilities for those costs, since it will allocate more capitalized  
19 energy costs to a low load factor customer than to a high load factor customer of  
20 equal size. As a result, the E8760E allocator will allocate more capitalized  
21 energy cost to low load factor customers than is appropriate from a cost-  
22 causation perspective.

23 Consequently, the Commission should reject Mr. Baudino’s proposal to use  
24 the E8760E allocator to allocate energy-related production costs. Instead, for the

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<sup>3</sup> Direct-WIEG-Baudino- 15, ll. 5-7.



1 reasons I discussed in my direct testimony, energy-related production costs  
2 should be allocated using the E10T allocator.

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

4 A: Yes.