



1 **II. Response to Mr. Donovan**

2 **Q: Please summarize Mr. Donovan’s response to your direct testimony**  
3 **regarding recovery of cleanup costs for the Ashland Site.**

4 A: Mr. Donovan asserts that I do not “fully understand the unique nature of the Site  
5 nor the enormity of the undertaking and cost compared to the size of NSPW’s  
6 gas utility.”<sup>1</sup> Mr. Donovan also disputes my finding that the Company’s  
7 proposal for cost recovery would increase the cost burden on ratepayers as  
8 compared to recovery pursuant to the Commission’s current policy. Finally, Mr.  
9 Donovan claims that the Company “could not have reasonably anticipated the  
10 nature and extent of the MGP cleanup costs at the time of NSPW’s merger with  
11 LSDP.”<sup>2</sup>

12 **Q: Do you disagree with Mr. Donovan’s characterization of the Ashland Site**  
13 **cleanup as “unique”?**

14 A: No. In fact, as I discussed in my rebuttal testimony, the one issue that all parties  
15 appear to agree on is that the Ashland Site cleanup is exceptional because of the  
16 potentially enormous cost burden on the Company’s natural-gas customers.  
17 Where NSPW and I part ways is with regard to the appropriate response to this  
18 exceptional circumstance.

19 The Company’s proposal for responding to this unique situation is  
20 unreasonable and inequitable. Faced with an exceptionally costly undertaking,  
21 NSPW proposes a cost recovery mechanism that would reduce financial harm to  
22 shareholders by shifting more of the cost burden onto natural-gas (and perhaps  
23 electric) ratepayers. In fact, under the guise of moderating rate impacts for

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<sup>1</sup> Rebuttal-NSPW-Donovan-2, ll. 11-13 (PSC REF #:175690).

<sup>2</sup> Rebuttal-NSPW-Donovan-2, ll. 18-19.

1 natural-gas customers, the Company’s proposal would increase the percentage  
 2 share of cleanup costs borne by ratepayers above Ms. Swailes’s estimate of the  
 3 highest level ever allowed by the Commission in previous, unexceptional MGP  
 4 cases.

5 In contrast, the just and reasonable response to the exceptional  
 6 circumstances in this case would be to recover cleanup costs in a manner that  
 7 holds ratepayers harmless in relation to the Commission’s current policy (or  
 8 even reduces their cost burden) while mitigating rate impacts and adverse effects  
 9 on the Company’s earnings.

10 As I indicated in my rebuttal testimony, there are alternatives to the  
 11 Commission’s current policy that would mitigate adverse rate and financial  
 12 impacts, but would not increase costs to ratepayers as with the Company’s  
 13 proposal. For example, cleanup costs could be amortized over twelve years  
 14 starting in 2013, without any carrying costs on unamortized balances. In this  
 15 case, as shown in Table 1 below, ratepayers’ share of total cleanup costs under  
 16 this alternative cost-recovery option would be the same as under the  
 17 Commission’s current policy. Moreover, the average reduction to the Company’s  
 18 return on equity from 2014 to 2017 would decline from █ basis points under  
 19 the Commission’s current policy to █ basis points under this alternative.

20 **Table 1**

21 **Ratepayer Costs and Earnings Impacts from Recovery of**  
 22 **Ashland Site Cleanup Costs**

<b>Recovery Mechanism</b>	<b>Present-Value Ratepayer Cost (\$M)</b>	<b>Ratepayer Share of Cleanup Cost</b>	<b>Average Earnings Impact 2014-2017</b>
Current Policy	█	█%	█%
12-Year Amortization; No Carrying Costs	█	█%	█%
NSPW Proposal	█	█%	█%



1 A: Mr. Donovan alleges that my finding is “refuted by the analysis performed by  
2 Ms. Swailes.”<sup>3</sup> However, Mr. Donovan does not explain why he believes that  
3 the results of Ms. Swailes’s analysis contradicts my finding.

4           Regardless, Mr. Donovan’s belief is unfounded. As I indicated in my  
5 rebuttal testimony, the results of Ms. Swailes’s analysis are almost identical to  
6 those from my analysis of the ratepayer impact of the Company’s proposal. Both  
7 Ms. Swailes and I find that the present value of cleanup costs recovered from  
8 ratepayers would be █ % greater under the Company’s proposal than under the  
9 Commission’s current policy.

10 **Q: How does Mr. Donovan respond to your direct testimony regarding**  
11 **whether the Company was aware at the time of the merger with LSDP of**  
12 **the potential for environmental contamination at the Ashland Site?**

13 A: In my direct testimony, I stated that I was unable to determine what NSPW  
14 knew at the time of the merger, because the Company had refused to provide  
15 responses to CUB discovery regarding this issue. However, I noted that the  
16 Company may have been aware of the potential for contamination, because its  
17 parent company was evaluating at that time potential remedial measures for one  
18 of its MGP sites in Minnesota.

19           In response, Mr. Donovan confirms that NSPW was aware at the time of  
20 the merger of the potential for environmental contamination on the Ashland  
21 MGP property, not because of its parent’s experience, but because the Company  
22 had engaged in an initial “Phase I” evaluation of contamination at all of the  
23 Wisconsin MGP properties owned by NSPW or LSDP, including the Ashland  
24 MGP property.

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<sup>3</sup> Rebuttal-NSPW-Donovan-8, ll. 15-16.

1 **Q: What did NSPW conclude from this Phase I assessment?**

2 A: In a 1985 report on the Phase I review, the Company concluded that:

3 Due to the site location and the lack of documentation of waste  
4 management activities, a Phase II study may be in order. However, because  
5 the site is controlled by LSDP and there is no evidence or visible signs of  
6 environmental impairment caused by plant wastes, the Phase II study  
7 ranking of the Ashland site should be of lesser priority in relation to other  
8 gas plant Phase II determinations.<sup>4</sup>

9 In other words, the Phase I report concluded that additional in-depth  
10 review and monitoring of the Ashland MGP property was warranted, but of  
11 lower priority than at other MGP properties.

12 **Q: Should the Company have given greater Phase II priority to the Ashland**  
13 **MGP property in light of the proposed merger with LSDP?**

14 A: Yes. It would have been reasonable for NSPW to more-definitively determine  
15 the extent of the environmental contamination at the Ashland MGP property  
16 before responsibility for that environmental liability was transferred to the  
17 Company's ratepayers. Even if it were not feasible to carry out a Phase II study  
18 prior to the merger, the Company should have at least informed the Commission  
19 that there was a risk that ratepayers would be assuming an environmental  
20 liability as a result of the merger with LSDP.

21 **Q: What do you conclude with regard to the Company's proposal for**  
22 **recovering Ashland Site cleanup costs?**

23 A: The Commission should reject the Company's proposal to recover cleanup costs  
24 in a manner that shifts more of the cost burden from shareholders to gas or  
25 electric ratepayers. Given the unprecedented magnitude of expected cleanup  
26 costs, the fact that NSPW assumed the obligation for such costs without

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<sup>4</sup> NSPW response to 5-CUB/RFP-1, attached hereto as Ex.-CUB-Wallach-6, p. 11 of 58.

1 complete knowledge of the risk of environmental contamination, and that the  
2 Company's customers received little in the way of offsetting benefits from the  
3 acquisition of this liability, ratepayers should not have to bear more of the cost  
4 burden than would be the case under the Commission's current policy.

### 5 **III. Response to Mr. Marx's Rebuttal**

6 **Q: What is Mr. Marx's response to your direct testimony regarding the**  
7 **classification and allocation of production capacity costs?**

8 A: Mr. Marx asserts that "the allocators supported by both WIEG and CUB favor  
9 their individual customer groups," and that, in contrast to my proposed  
10 classification, the Company's proposal reflects "moderate blends of demand and  
11 energy weighting."<sup>5</sup> Mr. Marx further alleges that my recommendation for  
12 classifying production capacity costs is based on "an Equivalent Peaker method  
13 introduced in a previous docket."<sup>6</sup> Finally, Mr. Marx characterizes my  
14 recommended classification as "more of a bookend point when considering the  
15 generally accepted allocators supported by PSCW staff, the Company and other  
16 Wisconsin major IOUs."<sup>7</sup>

17 **Q: Did you base your recommendation for classifying and allocating**  
18 **production capacity costs on the fact that it would "favor" the residential**  
19 **class?**

20 A: No. Contrary to what Mr. Marx implies, I did not make my recommendation  
21 because it opportunistically favors the residential class. If that had been my

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<sup>5</sup> Rebuttal-NSPW-Marx-3, ll. 2-3 and 9 (PSC REF #:175685).

<sup>6</sup> Rebuttal-NSPW-Marx-3, ll. 22-23.

<sup>7</sup> Rebuttal-NSPW-Marx-5, ll. 22-24.

1 intent, I would have recommended that demand-related production capacity  
2 costs be allocated using the 4CP allocator, since this would have produced more  
3 favorable results for the residential class than my recommendation.<sup>8</sup> Instead, I  
4 recommended a classification that reasonably and appropriately allocates  
5 production capacity costs on the basis of cost causation.

6 In contrast, the Company appears to have selected its preferred  
7 classification not on the basis of cost causation, but because it yields a  
8 “moderate blend” of demand-related and energy-related production capacity  
9 costs. However, the Company’s preferred classification appears “moderate” only  
10 in relation to Mr. Marx’s unrealistic “bookends,” which classify production  
11 capacity costs as either 100% demand-related or 100% energy-related. In fact,  
12 when viewed through the lens of cost causation, the Company’s preferred  
13 classification falls at the extreme end of a reasonable range, while my  
14 recommended classification yields a “moderate blend” of demand-related and  
15 energy-related production capacity costs.

16 **Q: Did you base your recommendation for classifying production capacity**  
17 **costs in this proceeding on the results of your Equivalent Peaker analysis in**  
18 **Docket No. 4220-UR-117, as Mr. Marx alleges?**

19 A: No. My recommendation in this proceeding is to classify production capacity  
20 costs in accordance with the classification supported by NSPW in prior rate  
21 cases. Specifically, in Docket No. 4220-UR-116, the Company supported the  
22 classification of production capacity costs as 38.4% demand-related and 61.6%  
23 energy-related. In Docket No. 4220-UR-117, I conducted an Equivalent Peaker  
24 analysis, the results of which indicated that production capacity costs should be

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<sup>8</sup> In fact, I urged the Commission in my rebuttal testimony to reject Mr. Baudino’s proposal to rely on the 4CP allocator.



1 classified as 30% demand-related and 70% energy-related. However, just as in  
2 the instant proceeding, I did not recommend in Docket No. 4220-UR-117 that  
3 production capacity costs be classified as indicated by the results of my  
4 Equivalent Peaker analysis. Instead, on the basis of those results, I determined  
5 that the Company's 38.4%/61.6% demand/energy classification fell within a  
6 reasonable range. And it is on the basis of that determination, that I recommend  
7 in this proceeding that production capacity costs be classified as 40% demand-  
8 related and 60% energy-related.

9 **Q: What is the basis for Mr. Marx's characterization of your recommended**  
10 **classification as "more of a bookend point"?**

11 A: Mr. Marx appears to base this characterization on the results of two  
12 comparisons. First, Mr. Marx compares my recommended classification against  
13 those proposed by other Wisconsin utilities in recent rate cases, as reported in  
14 Table 2 of his rebuttal testimony. Second, in Table 3 of his rebuttal testimony,  
15 Mr. Marx compares the allocation of the 2013 test year revenue deficiency to  
16 customer classes resulting from my recommended classification of production  
17 capacity costs against the allocations resulting from the classifications  
18 recommended by the Company, Commission staff, and WIEG.

19 **Q: Is Mr. Marx's comparison of your recommended classification against other**  
20 **Wisconsin utilities' classifications valid?**

21 A: No. Mr. Marx's comparison is flawed in two respects. First, in his Table 2, Mr.  
22 Marx misstates Madison Gas and Electric Company's (MGE) proposed  
23 classification as 100% demand-related and 0% energy-related. In fact, in Docket  
24 No. 3270-UR-118, MGE based its proposed revenue allocation on the results of

1 three cost of service studies, two of which relied on Commission staff's  
2 60%/40% demand/energy classification of production capacity costs.<sup>9</sup>

3 Second, Mr. Marx fails to account for the fact that Wisconsin Electric  
4 Power Company's (WEPCO) 60%/40% demand/energy classification is derived  
5 from an Equivalent Peaker analysis of WEPCO production plant.<sup>10</sup> As I  
6 discussed above, an Equivalent Peaker analysis of NSPW's production plant  
7 would have supported classifying an even greater portion of the NSPW's  
8 production capacity costs as energy-related than I recommend.

9 **Q: Is Mr. Marx's comparison of revenue allocations in Table 3 of his rebuttal**  
10 **testimony a reasonable basis for his characterization of your recommended**  
11 **classification as "more of a bookend point"?**

12 A: No, because Mr. Marx is comparing apples to oranges. Although Mr. Marx  
13 purports to be comparing the effects on revenue allocations of the different  
14 parties' classifications of production capacity costs, the results shown for the  
15 CUB analysis reflects differences from other parties in the classification of both  
16 production capacity and distribution plant costs.

17 The following table corrects Mr. Marx's error by removing the impact of  
18 my recommended classification of distribution plant costs from the results  
19 shown in Mr. Marx's Table 3 for the CUB analysis. As indicated in this table,  
20 the revenue allocations resulting from my recommended classification of  
21 production capacity costs do not materially differ from those resulting from  
22 Commission staff's 60%/40% or the Company's 57.3%/42.7% demand/energy  
23 classifications.

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<sup>9</sup> Docket No. 3270-UR-118, Direct-MGE-James-4-8 (PSC REF #: 166580).

<sup>10</sup> Docket No. 5-UR-106, Direct-WEPCO/WG-Rogers-13 (PSC REF #: 164646).

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**Table 2**

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**Relative Share of Increase by Major Customer Class for Production**

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**Capacity Cost Allocators Supported by Parties**

<b>Customer Class</b>	<b>WIEG</b>	<b>NSPW-1</b>	<b>NSPW-2</b>	<b>PSCW</b>	<b>CUB</b>
Residential	44%	46%	40%	39%	38%
Small General	14%	11%	9%	9%	8%
Lighting	(1)%	1%	1%	1%	1%
<b>Sub-Total Small</b>	<b>57%</b>	<b>58%</b>	<b>50%</b>	<b>49%</b>	<b>47%</b>
Total Medium	18%	14%	12%	13%	12%
Total Large	25%	28%	38%	38%	41%
Overall	100%	100%	100%	100%	100%

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

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A: In my direct testimony, I showed the impact on class revenue allocations from the classification of distribution plant costs in FERC Accounts 364 through 368 as demand-related and all costs in FERC Account 369 as customer-related. In his rebuttal testimony, Mr. Marx characterizes this alternative classification as “extreme.”

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

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A: No. Mr. Marx’s opinion of my alternative classification is not shared by MGE (since one of its three cost of service studies adopts this alternative classification) or 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 classification is the general approach used in more than thirty states.<sup>11</sup>

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<sup>11</sup> Frederick Weston, *Charging for Utility Distribution Services: Issues in Rate Design*, The Regulatory Assistance Project, December 2000, p. 29.

1 **IV. Response to Mr. Baudino’s Rebuttal**

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

4 A: Although, as discussed above, I did not conduct or rely on an Equivalent Peaker  
5 analysis as the basis for my recommendation for classifying production capacity  
6 costs, Mr. Baudino discusses what he believes are problems with my alleged  
7 Equivalent Peaker analysis. Specifically, Mr. Baudino faults my alleged analysis  
8 because it is not based on the actual analysis of economic trade-offs that led to  
9 the decisions to add capacity to the NSP system. According to Mr. Baudino,  
10 without these historical analyses, “it is impossible to identify the ‘cost causation’  
11 underlying each and, in particular, the expected fuel savings that a base load  
12 coal or nuclear unit was likely to achieve.”<sup>12</sup> Mr. Baudino goes on to claim that:

13           The additional cost of a base load unit may not have been justified by fuel  
14           savings expectations alone. Rather the decision may have also considered  
15           other factors (such as the longer life of a base load unit) that, when  
16           combined with fuel savings, justified the higher cost base load unit.<sup>13</sup>

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

19 A: No. What is relevant is that the decision to invest in baseload or cycling  
20 capacity, rather than less-expensive peaking units, was based on the fundamental  
21 economic logic underlying least-cost capacity expansion planning. In other  
22 words, what is relevant is not the amount of “the expected fuel savings that a  
23 base load coal or nuclear unit was likely to achieve,” but that under typical  
24 capacity expansion planning practice the Company’s additional capital

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<sup>12</sup> Rebuttal-WIEG-Baudino-10, ll. 8-10 (PSC REF #:175687).

<sup>13</sup> Rebuttal-WIEG-Baudino-10, ll. 14-17.

1 investment for baseload or cycling units would have been justified on the basis  
2 of fuel savings. As described in the NARUC manual on cost allocation:

3 The utility can choose to construct one of a variety of plant-types:  
4 combustion turbines (CT), which are the least costly per KW of installed  
5 capacity, combined cycle (CC) units costing two to three times as much per  
6 KW as the CT, and baseloaded units with a cost of four or more times as  
7 much as the CT per KW of installed capacity. The choice of unit depends  
8 on the energy load to be served.<sup>14</sup>

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

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

15 A: Expected life, along with a number of other assumptions regarding plant and  
16 transmission-system characteristics, are typically factors that are accounted for  
17 in economic evaluations of capacity-expansion plans, and these factors, either  
18 individually or collectively, may affect the economic trade-offs between  
19 different types of plant investments. However, it is unlikely that such factors  
20 would prove to be material in the determination of the least-cost capacity  
21 additions.

22 **Q: Do you have any comment regarding Mr. Baudino's rebuttal of your**  
23 **recommended classification of distribution plant costs?**

24 A: Mr. Baudino's argument against my recommended classification appears to rest  
25 solely on his judgment that the principles underlying the Company's reliance on

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<sup>14</sup> *Electric Utility Cost Allocation Manual*, National Association of Regulatory Utility Commissioners, January 1992, p. 53.

1 the minimum-system approach are “well-reasoned, supported, and accepted.”<sup>15</sup>  
2 However, Mr. Baudino does not provide any apparent basis for his support of  
3 the minimum-system approach. Instead, he simply cites to the discussion of  
4 minimum-system methods in the NARUC cost allocation manual and then  
5 deems the Company’s approach to be reasonable.

6 Given Mr. Baudino’s cursory treatment of the issue, the Commission  
7 should give little weight to his finding that the Company’s reliance on the  
8 minimum-system method is reasonable.

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

10 A: Yes.

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<sup>15</sup> Rebuttal-WIEG-Baudino-11, line 6.