BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Application of Wisconsin Public Service Corporation for Authority to Adjust Electric and Natural Gas Rates	Docket No. 6690-UR-117

REPLY BRIEF OF THE CITIZENS UTILITY BOARD

The Citizens Utility Board ("CUB") hereby submits its Reply Brief in the above-captioned matter. CUB addresses the issues of: (1) the return of the Non-Qualified Decommissioning Trust Funds ("NQF"); (2) recovery of WPSC's costs, including increased fuel costs, associated with the Spring 2005 outage and the sale of the Kewaunee Nuclear Power Plant ("KNPP"); (3) cost of service and class revenue allocation; and (4) capital structure and return on equity.

I. THE COMMISSION SHOULD REJECT WPSC'S PROPOSED TREATMENT OF THE NON-QUALIFIED DECOMMISSIONING TRUST FUND.

In its Initial Brief, Wisconsin Public Service Corporation ("WPSC") continues to assert as part of its KNPP Wind-Up Plan that the refund to ratepayers of the NQF should be amortized over five years and should be netted against the loss on the sale of KNPP and the costs of the Spring 2005 outage at KNPP. (*See* WPSC Initial Brief at 29-30.) CUB opposes WPSC's proposal and submits that the NQF should be returned to ratepayers over two years, and that WPSC should not recover from ratepayers any of the costs associated with the Spring 2005 outage or the loss from the sale of KNPP.

In its brief, WPSC erroneously characterizes CUB's position as, "[t]he wild claim by CUB that WPSC is 'stealing' the NQDT was irresponsible." (*Id.* at 30.) WPSC does not cite to the record in support of its quote, and it cannot because CUB did not submit testimony characterizing WPSC's Wind-Up Plan as "stealing" the NQF. CUB has simply proposed a shorter time period for the return of the NQF than WPSC has supported and argued that the NQF was a single purpose fund whose purpose no longer exists. In recognition of this fact, these monies should be returned to the various customer classes in the amount and manner in which they were collected as soon as possible and without offsetting deductions.

Indeed, WPSC argues that "the KNPP sale created the refund and the refund must be considered in the context of the sale's other economic considerations. . . In short, the NQDT refund is an economic benefit of the sale . . ." (*Id.* at 31-32.) However, WPSC appears to have forgotten why the NQF was created. Return of the NQF is not an "economic benefit" or gift to customers resulting from the sale of KNPP that must be tied to the costs associated with the sale of KNPP. Ratepayers funded the NQF in order to decommission KNPP, and now that the plant is no longer in the rate base, ratepayers should get their money back, no matter how the sale was structured.

CUB submits that a return of the funds over a two-year period best serves intergenerational equity and will minimize the current rate shock to customers resulting from skyrocketing fuel costs. (CUB Initial Brief at 4-5.) Moreover, the Commission should reject WPSC's argument that the amortization period for the return of the NQF must be exactly tied to the amortization for the costs associated with KNPP. There is no good reason to delay returning the NQF funds to customers. In addition, WPSC's argument erroneously assumes that WPSC is entitled to recover those costs. As explained in CUB's Initial Brief and below, WPSC's imprudence caused the outage that led to the loss on the sale of KNPP and the costs associated with the outage. Therefore, ratepayers should not shoulder those burdens, and there is no need to tie the return of the NQF to the time frame proposed by WPSC.

II. CONTRARY TO WPSC'S PROTESTS, MANAGEMENT IMPRUDENCE CAUSED THE SPRING 2005 OUTAGE, AND RATEPAYERS SHOULD NOT HAVE TO SUBSIDIZE THAT IMPRUDENCE.

In this section, CUB rebuts WPSC's argument that ratepayers should pay for the costs associated with the Spring 2005 outage at KNPP and the loss on the sale of KNPP. CUB submits that management's imprudence caused the outage that led to these costs and loss, and ratepayers should not have to subsidize that imprudence. In addition, CUB rejects WPSC's argument that it is entitled to recover its deferred fuel costs incurred during the outage because those costs were not caused suddenly by forces beyond the utility's control or reasonable foresight.

A. Ratepayers Should Not Have To Pay For The Costs Associated With The Spring 2005 Outage That Were Caused By WPSC's Imprudence.

In WPSC's Initial Brief, WPSC claims that it and the Nuclear Management Company ("NMC") at all times managed KNPP effectively and operated it safely; therefore, WPSC should be allowed to recover the costs associated with the Spring 2005 outage at KNPP and the loss on the sale. (WPSC Initial Brief at 20-21, 28.) However, as discussed in detail in CUB's Initial Brief, CUB submits that management imprudence caused the Spring 2005 outage, and ratepayers should not be required to subsidize that imprudence. (*See* CUB Initial Brief at 8-20.)

1. Although The Parties Agree On The Legal Standard For Prudence, They Disagree As To Whether WPSC's Imprudence Caused The Spring 2005 Outage.

As WPSC noted in its brief, prudence has been defined as "[c]arefulness, precaution, attentiveness, and good judgment." (WPSC Initial Brief at 11.) CUB agrees with this definition. However, CUB disagrees with WPSC regarding whether WPSC and NMC met these standards.

The evidence demonstrates that WPSC and NMC did not exercise carefulness, precaution, attentiveness, and good judgment with respect to KNPP's Auxiliary Feedwater

("AFW") system and the other issues at KNPP identified in the NMC's March 18, 2005 commitment letter to the Nuclear Regulatory Commission ("NRC"). The NRC warned WPSC following the Three Mile Island accident that additional requirements for KNPP's AFW system were needed. (Tr. 1307.) WPSC did not act on NRC's warning for over ten years, from 1983 to 1993, and when it did its solution was to install discharge pressure trips to the pumps that failed to protect the pumps from a variety of possible events. (CUB Initial Brief at 9-10.) In its brief, WPSC claims that the NRC "concluded that this redesign ensured the safe operation of the plant." (WPSC Initial Brief at 13.) NRC did no such thing. As discussed in CUB's Initial Brief, NRC merely sent a letter to WPSC granting WPSC's request to change the trips from the suction to the discharge side of the AFW pumps. (CUB Initial Brief at 10.) The letter did not approve the overall design of the AFW system, nor did it certify the safety of the system. (Tr. 1341-42.)

Four years later, in 1997, NRC posed more questions about KNPP's discharge pressure switches, and WPSC modified a calculation, but failed to analyze the issue further. (Exh. 91, at 11.) Eight years later, early in 2005, NRC again asked WPSC's agent, NMC, probing questions regarding the AFW system design. NMC finally fully analyzed the issues, and determined that the AFW pumps were, in fact, inoperable, and shut down the plant. (Tr. 1165; 1309.) Once NMC began addressing the problems with the AFW system, NMC also determined that there were numerous other problems at the plant that it needed to fix before it could restart the plant. (Tr. 1311-12.) WPSC's and NMC's failure to correct deficiencies with the AFW system design for more than 25 years does not demonstrate prudent management of a nuclear power plant.

2. The Root Cause Evaluation Is A Useful Tool To Evaluate Whether WPSC Was Imprudent.

As CUB noted in its Initial Brief, NMC's root cause evaluation for the AFW system supports CUB's view that WPSC's imprudence caused the Spring 2005 outage. The root cause evaluation states in part, there was "a lack of knowledge and understanding of what constituted a proper rigor of analysis, review, or documentation when resolving issues related to the design basis for the AFW pumps." (Tr. 1324.) Moreover, the contributing causes to the root cause evaluation note how the NRC repeatedly prompted WPSC and NMC regarding the AFW system, but WPSC and NMC did not address the problems. (Tr. 1325-26.)

WPSC argues that CUB is claiming that the conclusions of the root cause evaluation "constitute conclusive findings of imprudence." (WPSC Initial Brief at 17.) WPSC also asserts that the Commission should not rely on the root cause evaluation to determine whether it was imprudent because root cause evaluations "are likely prepared with the benefit of hindsight" and they are not "prepared looking towards prudence." (WPSC Initial Brief at 18.) WPSC misstates CUB's position, and the Commission should reject WPSC's attempt to trivialize the importance of root cause evaluations.

As Dr. Jacobs noted in his testimony, a root cause evaluation probes the history and events leading up to an outage and identifies deficiencies that were or should have been known and corrected prior to the outage. (Tr. 1364-65.) A root cause evaluation is not conclusive evidence of imprudence but it is a tool that can be used, and has been used by this Commission, in conjunction with other evidence to determine whether nuclear plant managers have acted prudently. *See e.g. Amended Findings of Fact, Amended Conclusions of Law, and Conditional Order*, p. 24, Docket No. 6630-UR-109 (December 23, 1997). Moreover, although root cause evaluations are necessarily prepared after an outage has occurred, that does not mean that they are clouded by hindsight. (Tr. 1365.) The root cause evaluation in this case is not an example of "arm-chair quarterbacking" by intervenors or other groups unfamiliar with the plant. NMC – the quarterback of the outage - itself wrote the root cause evaluation. This Commission should therefore carefully consider the root cause evaluation in this case when determining whether NMC's imprudence led to the Spring 2005 outage.

3. The Commission Should Reject WPSC's Attack On Dr. Jacobs' Credentials.

In addition to claiming that the Commission should ignore the root cause evaluation, WPSC argues that Dr. Jacobs' entire opinion should be discounted because his opinion "is not based on any direct knowledge of KNPP operations, processes and procedures, but rather on his interpretation of documents generated by WPSC, the [NMC] and the NRC." (WPSC Initial Brief at 4, 19.) WPSC's argument is ironic. WPSC asserts that Dr. Jacobs' opinion should be discounted because he had no direct knowledge of the day-to-day operations at KNPP, yet WPSC also claims that the Commission should pay no heed to the statements of the entity that *did* have direct knowledge of the day-to-day operations at KNPP, namely NMC in its root cause evaluation. WPSC cannot have it both ways.

WPSC's attack on Dr. Jacobs also locks the Commission into an unreasonable standard. If no one but the nuclear plant owner and operator with direct knowledge of a plant's operations, processes, and procedures can offer an opinion as to whether a plant is being operated prudently, then no plant owner will ever be found imprudent because no plant owner is going to voluntarily admit to having operated a plant imprudently. Dr. Jacobs has more than 30 years experience in the nuclear power industry, including more than a dozen years of experience in the construction and start-up of nuclear plants. (Tr. 1297.) Dr. Jacobs conducted interviews with employees of NMC and WPSC, and reviewed WPSC, NMC, and NRC documents in preparing his assessment.

(Tr. 1299.) Dr. Jacobs' analyses of nuclear plant operation have been accepted and relied upon by regulatory bodies across the country including the South Carolina Public Service Commission, the Florida Public Service Commission, the Indiana Utility Regulatory Commission, the Louisiana Public Service Commission, and this Commission in Docket No. 6630-UR-109. (Tr. 1300.) Dr. Jacobs is exceptionally qualified to offer an opinion regarding the prudence of the operations at KNPP.

4. Evidence Of WPSC's Imprudence Extends Beyond The Root Cause Evaluation, The Factual Chronology, And Dr. Jacobs' Opinion.

CUB also directs the Commission to more evidence of WPSC's imprudence in addition to the root cause evaluation, the factual chronology of events, and the analysis of Dr. Jacobs. In September 2005, the NRC issued a Notice of Violation ("NOV") regarding the AFW system at KNPP. (Exh. 93.) In its Initial Brief, WPSC erroneously claims that the NRC "has not taken any enforcement action with respect to the 2005 forced outage." (WPSC Initial Brief at 21.) However, PSC staff witness Jeffrey Kitsembel included evidence of the enforcement action (the NOV) issued by the NRC as an exhibit to his testimony. The NOV states in relevant part:

> Title 10 CFR Part 50, Appendix B, Criterion III, "Design Control," requires, in part, that measures be established to assure that the design basis for safety-related functions of structures, systems, and components are correctly translated into specifications, drawings, procedures, and instructions. Further, Criterion III requires that the design control measures shall provide for verifying or checking the adequacy of designs.
>
> Contrary to the above, prior to February 11, 2005, the licensee failed to implement design control measures to verify and check the adequacy of the auxiliary feedwater (AFW) system design to mitigate all postulated accidents. Specifically, the AFW system design relied upon pump discharge pressure trip switches that would not have protected the pumps from air ingestion during natural events such as tornado and seismic events. In addition, the AFW system design would not have protected the pumps from "runout" conditions that may be encountered during other design and license basis scenarios, including steam line breaks and station blackouts.

(Exh. 93.) The NOV identifies two problems with the AFW system at KNPP: (1) the discharge pressure trips would not have protected the pumps from air ingestion during a tornado or seismic event; and (2) the AFW system design did not protect the pumps from "runout" conditions that may be encountered during other events such as a steam line break or station blackout. The NOV then asks the owner of KNPP (now Dominion Energy Kewaunee, Inc. ("DEK")) to submit a written statement to the NRC noting, *inter alia*, the reason for the violation, or, if the violation was contested, the basis for disputing the violation. (*Id*.)

DEK responded to the NOV on October 17, 2005. In its response, DEK chose not to dispute the NOV, but to submit a written statement noting the reason for the violation. DEK determined the reason for the violation was as follows:

> 1) <u>The Reason for the violation, or, if contested the basis for disputing the violation or severity</u>.
>
> The violation is correct as stated. The root cause of this failure to implement adequate design control measures was concluded to be due to a lack of engineering knowledge and understanding of what constituted proper rigor of analysis, review, and documentation in the resolution of issues related to the design basis of the AFW system. Significant contributing causes include:
>
> - Weak program and process guidance.
> - Poor planning and issue management of the modification.
>
> ***The violation regarding the AFW pump is due to specific application of these underlying causes.***

(Exh. 100, *emphasis added.*) DEK's response is notable both for what it says, and what it does not say. First, DEK quotes from the root cause evaluation and states conclusively that the violation regarding the AFW pump was due to the "specific application" of those underlying causes. Second, DEK does not say, as WPSC does, that the Spring 2005 outage resulted from a "new and more conservative failure mode" postulated by the NRC regarding air ingestion into the AFW system. (Tr. 1172.) Nor does it say that the possibility for air ingestion was the only problem that led to the outage. Instead, DEK agrees with NRC's assessment that the lack of protection from runout conditions also initiated the outage, and neither the air ingestion problem nor the runout problem was new. (Exh. 93.)

The NOV also rebuts another contention made by WPSC. Mr. Molzahn of WPSC asserts that the practices and procedures in place in 1993 were acceptable at that time even if they do not meet current standards in 2005. (Tr. 1191.) The NOV refutes this argument. As noted above, the NOV states, "prior to February 11, 2005, the licensee failed to implement design control measures to verify and check the adequacy of the [AFW] system design to mitigate all postulated accidents." (Exh. 93.) It clearly indicates that at no time prior to February 11, 2005 (including in 1993) did WPSC implement adequate design control measures for the AFW system.

WPSC also argues that even if it should have addressed the AFW system issues earlier, the results would have been the same, and "CUB would probably have argued even then that the operator was imprudent for not 'fixing' the 'problem' sooner." (WPSC Initial Brief at 20.) Once again WPSC cites to nothing in the record for either of its conclusions, and once again that is because there is nothing for WPSC to cite to. WPSC's arguments are sheer speculation. In fact, had WPSC addressed the system issues earlier, common sense suggests it could have resolved the problems much faster in a planned rather than forced outage. NMC or WPSC would have had adequate staff and contractors in place to more readily complete the modifications, and the outage need not have been extended to remedy the host of other problems that required resolution prior to start-up in the Spring 2005 outage.

5. The Commission Should Reject WPSC's Attempts To Shift Blame For The Outage.

Despite the cumulative evidence that demonstrates that WPSC's and NMC's imprudence caused the outage, WPSC continues to claim that it was not at fault. In fact, a persistent theme throughout WPSC's discussion of the KNPP outage is that the outage was everyone's fault but its own. For instance, WPSC implies that the outage was:

- NRC's fault for postulating "a new and more conservative failure mode";
- Pioneer Service and Engineering's fault for drafting the original plant design; and
- Fluor Engineering's fault for not discovering the problem when it evaluated KNPP

(WPSC Initial Brief at 14, 19-20.) WPSC also argues that ratepayers would not be asked to pay for the outage if the Commission had simply approved the sale to DEK within the time frame WPSC originally requested. (*See* WPSC Initial Brief at 10.) However, WPSC omits the reasons why the Commission did not immediately approve the sale of KNPP, including the fact that the Commission originally *denied* the application after finding that the proposed sale was not in the public interest. *See Final Decision*, Docket No. 05-EI-136 (December 16, 2004). Moreover, WPSC ignores the fact that, after it filed for rehearing of the Commission's denial, WPSC repeatedly introduced new conditions on the sale further delaying the proceedings. *See Final Decision*, Docket No. 05-EI-136, p. 3 (April 21, 2005). The Commission should reject WPSC's blame-shifting arguments, and find that WPSC's imprudence caused the outage at KNPP and ratepayers should not subsidize that imprudence.

6. CUB's Submission That WPSC Was Imprudent Is Not A Personal Attack On The Managers Of KNPP.

In its brief, WPSC appears deeply offended by any criticism as it relates to the operation of KNPP:

> To characterize the plant operators' management and operation of KNPP as imprudent, as CUB does, is an unwarranted insult to WPSC and NMC that, unfortunately, has been funded by WPSC's and WPL's customers.

(WPSC Initial Brief at 21.) WPSC's outrage is misplaced. WPSC mischaracterizes CUB's argument as one designed to insult the plant operators and managers of KNPP. CUB has no interest in personal attacks and is only concerned with the fairness of forcing ratepayers to pay for the mistakes made by management. In this case, WPSC and NMC failed to exercise proper care and precaution to fix a problem NRC had urged them to examine for years. Prudent management of a nuclear power plant requires the owners and operators to constantly and rigorously analyze problems and potential problems, and WPSC failed to conduct those analyses in this case. (Tr. 1336.)

B. WPSC Did Not Meet Its Burden Of Proving That The Increased Fuel Costs Associated With The Spring 2005 Outage Were Caused By Forces Beyond Its Control Or Reasonable Foresight.

Both parties agree that WPSC must demonstrate that the fuel costs it incurred qualify as an "emergency" under the fuel rules. (*See* WPSC Initial Brief at 26; CUB Initial Brief at 21.) WPSC argues that the Commission should use the same analysis it uses to determine the prudence of the utility's management with respect to the outage to determine whether the fuel costs were "caused suddenly by forces beyond the utility's control or reasonable foresight." (WPSC Initial Brief at 11.) But there is an important difference between a prudence determination and a determination under the fuel rules; i.e. under the fuel rules, WPSC (not intervenors) has the burden of demonstrating that the increased fuel costs were caused suddenly by forces beyond its control or reasonable foresight. *See Amended Findings of Fact, Amended Conclusions of Law, and Conditional Order*, p. 12, Docket No. 6630-UR-109 (December 23, 1997).

However, nowhere does WPSC explain how the outage was caused "suddenly by forces beyond the utility's control or reasonable foresight." WPSC has failed to demonstrate that it could not have discovered the AFW system design problems prior to the NRC's inspection earlier this year. Moreover, the start-up date for KNPP kept falling back from late March, to early April, to mid-April, to early May, to late May, to early June, to late June, and finally to July 2 in light of the many tasks that NMC needed to accomplish prior to start-up under its March 18th commitment letter to the NRC. (Exh. 76.) WPSC has failed to show how forces beyond NMC's control or reasonable foresight prevented NMC from previously completing such tasks as:

- Implementing NMC fleet operations mentoring program to improve conduct of operations;
- Improving the quality of operability determinations;
- Validating the quality of existing open operability determinations;
- Confirming prior NRC commitments have been implemented as required;
- Improving the quality of engineering products;
- Addressing the turbine building flooding concerns;[1]
- Validating the timeliness for resolution of current open significant issues.

(Tr. 1358-62.)

The increase in fuel costs due to the outage at KNPP was caused by forces within WPSC's control and should have been addressed with reasonable foresight. Therefore, WPSC

---

[1] The NRC recently released an inspection report regarding the turbine flooding issue. (NRC Inspection Report 05000305/2005011, October 6, 2005, ADAMS # ML052800430, available at http://www.nrc.gov/reading-rm/adams/web-based.html.) The NRC report found that the turbine building flooding issue should have been identified by WPSC at the latest in 2003 when KNPP experienced minor flooding in the building. The NRC characterized the flooding issue as having "substantial to high safety significance," and specifically found that the cause of WPSC's failure to meet design control requirements to protect against flooding, "***was within the licensee's ability to foresee and correct***." (*Id*. at NRC Report, p. 7, *emphasis added*.) The resolution of the flooding issue required "completion of extensive system and structural modifications" to KNPP during the Spring 2005 outage. (*Id*. at Cover Letter, p. 2.) The turbine building flooding concern required resolution prior to KNPP exiting the forced outage. (*Id*. at NRC Report, p. 6.) If any party objects to the Commission's consideration of this publicly available report, CUB requests that the Administrative Law Judge take administrative notice of it or reopen the record for its admission as an exhibit as may be appropriate.

did not meet the test for recovery under the fuel rules, and its request for rate recovery of its replacement power costs attributable to the Spring 2005 outage should be denied.

III. THE COMMISSION SHOULD FOLLOW COST CAUSATION PRINCIPLES IN ITS REVIEW OF COSS.

WPSC asserts that the Commission should prefer the company's COSS because it is the one true cost of service study that is consistent with the company's efforts to "reduce and eliminate subsidization of residential classes by commercial and industrial classes." (WPSC Initial Brief at 5.) Of course, WPSC never defines an appropriate test or standard for "subsidization" nor does it explain why or how there is only one correct approach to allocating costs that cannot be directly allocated or costs that are essentially unallocable. Untroubled by these omissions, it goes on to drape laurels around itself for taking these steps even though they are "difficult popularly and politically" as if industry lacked a political voice and a political presence. (*Id.*)

All persons in this state are properly concerned about the state of industry in Wisconsin. But that does not mean that this Commission should abandon COSS principles that best allocate costs on determinations of causation. Nor does it mean that unduly shifting costs to the residential class is the best method to support the business sector because residential customers, faced with even higher utility costs, would see their disposable income shrink still further, reducing their ability to purchase goods and services from the very same commercial and industrial classes WPSC is purportedly attempting to save. (Tr. 875.) The objective of COSS should be to assess the best means of allocating costs on the basis of direct cost causation, when possible such as for production capacity and energy costs, and to recognize the increasing lack of a basis in direct cost causation as costs become more remote from direct attribution. Indeed, the Commission's use of a range of cost studies has been in recognition of the inherent limitations of any single study to allocate all costs on the basis of direct cost causation and the prevalence of such costs that cannot be allocated on the basis of direct cost causation in the utility industry.

In this section, CUB replies to WPSC's arguments in support of the company's COSS method as well as Wausau Paper's improper assertions of Commission staff bias, and WIEG's concerns regarding the Commission's use of the 12-CP method to allocate capacity costs. CUB also reaffirms the importance of establishing reporting requirements for the WPSC-CUB load management collaborative.

A. Despite Its Assertions To The Contrary, The WPSC COSS Is Flawed.

WPSC's unqualified support for its own COSS despite strong record evidence of its flaws is reminiscent of the Wizard of Oz scene in which Toto pulls back the curtain to reveal that the "Great and Powerful" Oz is not as great or powerful as appearances first seemed. Numerous weaknesses of WPSC's COSS include its allocation methods associated with the KNPP Purchase Power Agreement ("PPA"), production plant and interruptible customers as well as its faith-based adherence to the minimum distribution system ("MDS").

WPSC advocates against allocating the KNPP PPA as if the KNPP were still a baseload plant owned jointly by WPSC and Wisconsin Power and Light Company. (WPSC Initial Brief at 44.) Instead, WPSC asserts that its allocation method best follows cost causation because it reflects how WPSC is billed under the PPA. Under this approach, it has allocated fixed and variable payments on a demand and energy basis respectively. But this does not reflect the reality of the deal between WPSC and Dominion Energy Kewaunee. WPSC has said that the PPA was structured to make KNPP just like a baseload plant. (Tr. 676-77.) WPSC entered into the KNPP PPA to acquire lower cost baseload energy to replace the energy that WPSC would have generated from KNPP had it continued to own the facility. It is therefore appropriate to recognize and allocate the "capitalized energy" costs WPSC incurs under the PPA just as with any other baseload plant. The Commission should not elevate form over substance. The terms of the PPA should yield to the reality of the deal between WPSC and DEK as to cost causation for why capacity and energy were acquired, and the costs of the KNPP PPA should be allocated accordingly.

WPSC also argues against the allocation of production plant on both demand and energy. (WPSC Initial Brief at 45.) First, it claims that such an approach does not take into account production demand costs of WPSC on a system basis. (*Id*.) But the equivalent peaker method supported by CUB and used by Commission Staff, is in fact based on a utility's system planning criteria to select and build plants that best reduce total system costs. (Tr. 879.) Baseload plants are built not just to meet system demand needs but also to supply lower system energy costs, so that overall system costs are "least cost" for customers. (Tr. 837.) This is how WPSC justified adding its Weston 4 baseload unit. (*Id*.) These "capitalized energy" costs are therefore appropriately allocated on energy. (Tr. 839.) Second, WPSC's claim that its COSS is the one true (i.e. "actual") COSS study seems to imply that utilities like Xcel and We Energies who have used the equivalent peaker method in pending rate cases must be political wimps "subsidizing" small customers at the expense of their larger customers and the state's economy. (Tr. 718.) The use of the equivalent peaker method is appropriate because it allocates the costs of production demand costs on the basis of direct cost causation. WPSC's method does not, which is why the Staff appropriately discounted WPSC's study in weighting the appropriate range to establish class revenue requirements.

Likewise, WPSC acknowledges that interruptible customers do benefit in the form of lower cost responsibility and a lower rate because WPSC's COSS excludes their interruptible demand from firm coincident demand allocators. (WPSC Initial Brief at 46.) No one in this case has asserted that interruptible customers do not provide value to the system and in return for that value should not have lower rates than firm customers. That is not the issue. By excluding interruptible demand from the demand allocator, interruptible customers are not only not assigned the peaking capacity costs that they avoid but also any capacity and other costs allocated in whole or in part based on the demand allocator that they do in fact utilize and benefit from. (*Id*.) This is not a matter of double counting, but a matter of failing to adequately and appropriately allocate costs to interruptible customers that they help cause rather than avoid (which must then be paid by other customers). That is why CUB supports Staff's inclusion of interruptible demand in the demand allocator with an appropriate rate credit to reflect that the utility has avoided some, but not all, capacity and other costs in serving this customer class (at least until a further analysis of interruptible class benefits and costs has been presented). (Tr. 685.)

Finally, WPSC supports continued use of MDS. In doing so, it distorts the record by saying that CUB's experts "conceded" that certain distribution costs can be directly assigned to customer classes on a customer-weighted basis. (WPSC Initial Brief at 47.) Here's what CUB experts George Edgar and Wayne De Forest actually said:

> While we agree that there are certain customer-side distribution costs (meters and a truly minimum size service drop) that can be directly assigned to various customer classes on a customer-weighted basis, the costs of a utility-side "minimum distribution system" (beyond the service drop) are incurred to provide a common system to provide energy to all customer classes.

(Tr. 845.) In other words, CUB witnesses testified that the only parts of the distribution system that it makes sense to allocate on a customer basis are those that directly serve specific customers. In rejecting the MDS method, CUB submits that distribution systems are designed and constructed to meet demand and energy services, and allocations should reflect this central principle. The MDS is premised on a hypothetical system posited by the cost analyst. (Tr. 847.) Its existence and use is an example of misplaced logic rather than of reality. Despite CUB's objections to MDS, CUB's COSS did in fact include some MDS costs (although moderated to avoid the extreme and unjustifiable impacts of a pure MDS as explained in our Initial Brief) to provide a reasonable result that would be between the TOD and Location studies.

For the reasons stated in its Initial Brief, CUB believes that the Commission Staff's TOD and Location COSS provide an appropriate range for determining class revenue allocations. (*See* CUB Initial Brief at 29-31.) They provide better cost-based goalposts than the single flawed COSS favored by WPSC. In addition, CUB recognizes that the Commission may determine to moderate the results of an appropriate range of COSS in making class revenue requirement allocations (i.e. move away from the COSS results to accommodate other concerns). CUB submits that the Commission should consider providing the residential class an increase based on the average per kWh increase, rather than solely on the basis of a lower percentage increase, if it chooses to moderate appropriate COSS results in this case.

B. Wausau Paper Corp. Wrongly Accuses Staff Of Bias.

Wausau Paper Corp. asserts that Staff had a "preconceived desire to impose a disproportionate share of the company's [WPSC's] increased revenue requirements on industrial customers." (Wausau Paper Corp. Initial Brief at 3.) This is a surprising, unsupported and unwarranted attack on the integrity of the Commission Staff. Anyone who has worked with Dr. Petersen—the staff member to whom Wausau Paper's venom was directed—knows that this characterization is without merit. On this basis alone, the Commission should disregard the arguments made by Wausau Paper as they relate to COSS issues.

C. The Commission Should Order Reporting Requirements For The WPSC-CUB Load Management Collaborative.

The debate over COSS and customer class revenue allocation highlights the underlying problem of increasing rate pressures faced by all customer classes. Residential and business customers alike are confronting large rate increases due to the rise in fuel costs as well as the cost of projects needed to modernize the existing energy infrastructure. The ultimate solution to this problem is not shifting costs from one class to another until the underpinnings of a vibrant state economy and quality of life for working and other families are jointly devastated. What is needed instead is a coherent and effective joint effort to mitigate the rise in overall costs. In recognition of the need for collaboration, CUB withdrew its request for the Commission to consider a new Time of Use rate design in favor of cooperatively exploring with WPSC this design in the current Load Management Collaborative (a fact that WPSC mistakenly failed to recognize in its Initial Brief when it asserted that CUB was seeking such a decision in this case). (WPSC Initial Brief at 50.) The importance of developing and taking effective actions now to mitigate future cost increases is also the basis for CUB's continued request that the Commission require the WPSC-CUB collaborative to report on the progress made, future plans, and timelines in early 2006. Such a reporting requirement would assure that all potentially effective designs and options, including CUB's, are being appropriately and expeditiously considered and pursued. While innovative rate designs and effective load management are only elements in a broader effort needed to mitigate future rate increases, they are essential elements as there is no magic bullet that can achieve this necessary result.

D. CUB Is Willing To Continue Working With WIEG To Develop Something Better Than The 12-CP Method.

In its Initial Brief, WIEG urges the Commission to "revisit its historical use of the 12-CP method." (WIEG Initial Brief at 14.) CUB responds briefly that it is willing to continue working with WIEG to determine if there are better allocators for capacity costs incurred to ensure reliability, as indicated in the joint WIEG-CUB comments submitted in the Commission's COSS Investigation. *See* Principles Useful In Electric Cost of Service Studies and Rate Design, Docket No. 05-EI-137. This issue cannot be looked at in isolation, however. CUB submits that review of the 12-CP method is only appropriate in the context of using the equivalent peaker method that allocates the cost of production plant on both demand (for costs to ensure reliability) and energy (for "capitalized energy" costs to secure lower overall system energy costs). WIEG has argued that the use of the 12-CP methodology to allocate capacity costs incurred for reliability may not be appropriate for a utility like WPSC that has meaningful differences in monthly system demand peaks over the course of a year (which is why CUB believes that the issues of the equivalent peaker and the use of the 12-CP allocator must be linked). As Staff witness Dr. Petersen noted, if one fails to distinguish between why capacity costs are incurred and allocates all such costs on a single allocator, the 12-CP may indeed be appropriate to reflect that all classes use such capacity each month. (Tr. 687.)

IV. WPSC'S ARGUMENTS CONCERNING CAPITAL STRUCTURE AND RETURN ON EQUITY IGNORE REALITY.

In its Initial Brief, CUB argued in support of lowering the amount of equity in WPSC's capital structure and reducing WPSC's return on equity ("ROE") to 10%. (CUB Initial Brief at 23.) WPSC contends that reducing the amount of equity and increasing the amount of debt in its capital structure will not reduce customer rates. (WPSC Initial Brief at 38-39.) Despite having filed its case under an assumed 11.5% ROE, the Company also argues that its ROE should be set at 12%. (Tr. 15; WPSC Initial Brief at 44.) Neither WPSC contention is persuasive.

A. The Commission Should Establish Cost-Effective Equity Ranges For WPSC.

WPSC asserts that Staff's calculation of a $4.6 million revenue requirement reduction attributable to lowering the amount of equity in WPSC's capital structure to levels supported by CUB fails to take into account that WPSC's debt costs might increase due to credit agencies' perception of increased risk with the result being higher rates. (WPSC Initial Brief at 39.)[2] These broad generalized statements do not bear up under scrutiny.

First, as stated in its Initial Brief, CUB's proposed equity levels of 45% to 52.1% will hardly lead to the financial calamity predicted by WPSC. Of 110 Integrated Electric, Gas and Combination Utilities, 108 have ratings lower than WPSC's "A+" rating, and CUB's suggested equity range is consistent with WPSC's current rating. (Tr. 458.)

Second, as Commission Staff member Lois Hubert put it, "when you're operating in a real world, you really need to look at a lot more." (Tr. 1034.) Standard & Poor's already has given the Company an "A" rating even though the Commission established higher equity ranges in WPSC's last rate case. (Tr. 458, 1037.) Moody's has announced that it may change WPSC's "AA" rating because of WPSR's announced intention to purchase utilities, and adopting WPSC's proposed equity levels won't change this result. (Tr. 1036-37.) Finally, borrowing more money, as WPSC may do for its construction program, may also cause WPSC's credit rating to downgrade even if the Commission supported a higher equity range as the Company has

[2] The range of savings actually varies from between $5.1 million if the Company replaces equity with short-term debt to $4.6 million if the Company replaces equity with long-term debt. (Exh. 38.)

requested. (Tr. 1043-44.) The Commission should take these "real world" factors into account to establish cost-effective equity levels for the Company.

B. WPSC'S Arguments On ROE Miss The Point.

WPSC captions its argument in support of a higher ROE as "Is the Commission Going to Continue to Support Financially Healthy Utilities?" (WPSC Initial Brief at 41.) The question it asks is incomplete and misleading. The question of financial health is not limited to only utilities. Residential and business ratepayers need this Commission to protect their financial health too. To adopt WPSC's request to raise its return on equity to 12% would needlessly increase retail rates by $9 million above staff's suggested ROE levels of 11%.[3] Given the large rate increase WPSC is requesting, such ROE levels should be rejected. WPSC has also not demonstrated that lower ROE levels will lead to financial difficulties for the Company. In fact, as recognized by WIEG in its Initial Brief, substantial evidence exists in this record to conclude that WPSC's ROE could be lower than even Staff's recommended 11% ROE while still maintaining the financial health of WPSC. (WIEG Initial Brief at 9-11.)

For these reasons, and those stated in its Initial Brief, CUB urges the Commission to adopt for WPSC a 10% return on equity or in the alternative, consistent with WIEG's position, an ROE no higher than 10.5%.

V. CONCLUSION.

For the reasons stated above and in CUB's Initial Brief, the Commission should: (1) reject WPSC's proposal for treatment of the NQF; (2) disallow recovery of WPSC's costs, including increased fuel costs, associated with the Spring 2005 outage and the sale of KNPP; (3) support customer class revenue allocations in a range between Commission Staff's TOD and

---

[3] This is an estimate based on roughly a $3 million and $1.5 million revenue requirement impact for each .5% change in ROE levels for electric and gas operations respectively. (*See* Exh. 45, Schedules 9 and 10.)

Location COSS; (4) establish a lower range for the amount of equity in WPSC's capital structure than proposed by the Company; and (5) reduce WPSC's return on equity to 10%.

Dated this 11th day of November, 2005.

Respectfully submitted,

CULLEN WESTON PINES & BACH LLP

By: /s/ Curt F. Pawlisch
Curt F. Pawlisch
Kira E. Loehr
Attorneys for Citizens Utility Board

122 West Washington Avenue, Suite 900
Madison, WI 53703
(608) 251-0101 Phone
(608) 251-2883 Fax
E-mail: pawlisch@cwpb.com
loehr@cwpb.com