

EXECUTIVE SUMMARY
SURREBUTTAL TESTIMONY OF DAVID L. STOWE
DOCKET NO. EO-2002-384

In his surrebuttal testimony, Aquila witness David L. Stowe addresses the rebuttal testimony of the Missouri Public Service Commission Staff (“Staff”) and Office of the Public Counsel (“OPC”). Stowe explains the foundations of the capacity utilization method of allocating costs, and describes how Staff’s time-of-use (“TOU”) allocator departs from those foundations. Stowe also describes inconsistencies in the Staff’s and OPC’s logic, and shows how that flawed logic has led them to faulty conclusions.

SECTION I: Update of Cost of Service Studies.

This section states the fact that certain parties made changes to the inputs to their COS studies and introduces Surrebuttal Schedule DLS-1 which is a tabular comparison of the parties’ results.

SECTION II: Introduction and Recommendations

In this section, Aquila witness David L. Stowe is reintroduced and explains the purpose of his surrebuttal testimony. Stowe concludes the section with the recommendation that the Commission endorse Aquila’s COS methods and approve the COS results for use in Aquila’s rate design.

SECTION III: Allocation of Fixed Production Costs

In this section, Aquila witness Stowe discusses Staff’s TOU allocation of production costs. Stowe emphasizes these facts: 1. Capacity utilization-like allocations (like Staff’s TOU method) are not commonly used by anyone in the industry; 2. Staff rejects the use of “peak responsibility” methods, which are commonly used, as unrealistic; 3. Staff combines methods based on cost causation and capacity utilization, creating a hybrid method composed of both concepts; 4. Staff’s COS relies on “peak responsibility” allocators to distribute certain costs; and 5. Staff’s TOU method is significantly different from the typical capacity utilization method.

SECTION IV: A Properly Completed Capacity Utilization Study

In this section, Stowe outlines the steps needed to complete a proper capacity utilization study. The data requirements necessary to complete each step are also described. Stowe shows that Staff calculated its “capacity utilization-like” allocators without the aid of the critical supporting studies, and demonstrates that Staff has, in the past and when sufficient data was not available for the TOU study, used peak responsibility methods.

SECTION V: Allocation of Fixed Transmission Costs

In this section, Stowe explains the illogic of defining baseload, intermediate, and peaking functions for the transmission system. Stowe shows that these functions are defined by Staff simply to justify its use of the TOU allocators to distribute fixed transmission costs.

SECTION VI: Classification of Distribution System Costs

In this section Stowe describes a variety of concerns with respect to the OPC’s inconsistent classification of primary and secondary fixed costs.

Exhibit No.:

Issues: Fixed Production Costs Allocation,
Fixed Transmission Costs Allocation,
Distribution Cost Classification

Witness: David L. Stowe

Sponsoring Party: Aquila Networks – L&P
Aquila Networks – MPS

Case No.: EO-2002-384

Before the Public Service Commission
Of the State of Missouri

Surrebuttal Testimony

Of

David L. Stowe

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF DAVID STOWE
ON BEHALF OF AQUILA INC.
DOCKET NO. EO-2002-384**

SECTION I: Introduction and Recommendations

- 1 Q. Please state your name and business address.
- 2 A. My name is David Stowe and my business address is 10700 East 350 Highway,
3 Kansas City, Missouri 64138.
- 4 Q. Are you the same David Stowe that filed direct and rebuttal testimony in this case
5 on behalf of Aquila, Inc. (“Aquila”, or “Company”)?
- 6 A. Yes, I am.
- 7 Q. What is the purpose of your surrebuttal testimony in this case before the Missouri
8 Public Service Commission (“Commission”)?
- 9 A. My surrebuttal testimony will respond to the rebuttal testimony of Commission
10 Staff (“Staff”) regarding Staff’s time-of-use (“TOU”) allocation method. I will
11 also respond to the rebuttal testimony of the Office of the Public Counsel
12 (“OPC”) regarding the classification of distribution costs.
- 13 Q. What are your recommendations?
- 14 A. I recommend that the Commission:
- 15 • Reject the Staff’s cost of service (“COS”) study due to Staff’s misuse of
16 the hybrid TOU allocation of fixed production and transmission costs.
- 17 • Reject the OPC’s COS due to the numerous errors and inconsistencies
18 found in the methods and supporting data.

- Adopt Aquila’s COS study and use the resulting revenues as a basis for designing new rates in this case.

SECTION II: Update of Cost of Service Studies

Q. Have the parties made changes to their COS studies since the original filing of direct testimony?

A. Yes, the Staff, the OPC, and the Sedalia Industrial Energy Users Association (“SIEUA”) made minor changes to their COS study inputs. The reasons for those changes are described in each parties’ rebuttal testimony.

Q. How did these changes affect the results of the Staff’s, the OPC’s, and the SIEUA’s COS studies?

A. Surrebuttal Schedule DLS-1 briefly lists the COS latest results. Staff distributed updated work papers too late to fully analyze, but I believe the results shown in Surrebuttal Schedule DLS-1 for the Staff to be reasonably accurate.

Q. Has Aquila made changes to its COS study since the original filing of direct testimony?

A. No, but the COS results of certain classes were combined in Surrebuttal Schedule DLS-1 for uniformity and comparison purposes.

SECTION III: Allocation of Fixed Production Costs

Q. Have you read the rebuttal testimony of Staff witness James Watkins?

A. Yes.

Q. What allocation method does the Staff support for distributing fixed production costs?

A. Staff supports the time-of-use (“TOU”) allocation of fixed production costs.

1 Q. Is the Staff's TOU allocation method commonly used to distribute fixed costs?

2 A. No. In response to data request 12 from the Sedalia Industrial Energy Users
3 Association (SIEUA), Staff responded, "Staff is unaware of any other
4 Commission that utilized the generation allocation method, except for the
5 MoPSC¹".

6 Q. Does Staff explain its reasons for supporting the TOU allocation method for
7 distributing fixed production costs?

8 A. Somewhat. In his rebuttal testimony, Staff witness Watkins attempts to explain
9 the shortcoming of what he terms the "peak responsibility" methods. The
10 implication is that the TOU allocation method does not have this shortcoming.

11 Q. What is the shortcoming of the "peak responsibility" methods according to
12 witness Watkins?

13 A. He claims that "peak responsibility" methods do not consider how capacity is
14 utilized throughout the year, and because of this, these methods "have no basis in
15 reality."²

16 Q. Does Staff explain how capacity costs are utilized throughout the year?

17 A. In his rebuttal testimony, Staff witness Watkins writes,

18 "An electric utility's resource planning process considers the
19 tradeoff between the higher capacity cost and *lower running*
20 *costs of coal* fired generation and the lower capacity cost, but
21 *higher running costs of natural gas*-fired generation in

¹ Copies of the data requests cited in this surrebuttal are attached as Surrebuttal Schedule DLS-1.

² Rebuttal testimony of James C. Watkins, pg. 4.

1 determining what type of capacity it should add next.
2 Furthermore, in dispatching generation to serve load, the
3 *lowest running cost units* are dispatched first, and the *highest*
4 *running cost units* are dispatched last. This results in the
5 *lowest running cost units* being utilized in every hour
6 throughout the year that they are available, and *the highest*
7 *running cost units* being reserved to meet reserve margins (*i.e.*,
8 available, but not running) except in the few hour of the year
9 when no cheaper alternatives are available.³ [emphasis
10 added]

11 While the excerpt from Staff witness Watkins' testimony mentions capacity (*i.e.*,
12 fixed) costs, his explanation focuses primarily on the running costs. By doing so,
13 the quote reveals something remarkable about the basis of Staff's allocation of
14 fixed costs.

15 Q. What does the quote reveal?

16 A. It reveals a reversal of logic.

17 Q. Please explain.

18 A. When Staff shifts the focus from the cause of fixed capacity costs to emphasize
19 the "running" or variable costs instead, it implies that the issue is no longer about
20 fixed costs and their cause. Staff suggests that the issue is now about the variable

³ Id. pg. 4.

1 costs involved in running, dispatching, and utilizing the power plants, and the
2 utilization of their capacity.

3 Q. What about the actual cause of the costs?

4 A. The true cause of the costs, (i.e., the capacity of the equipment), is obscured by
5 the notion that capacity utilization trumps cost causation. Staff “supports” this
6 reversal of logic by insisting in direct and rebuttal testimony that loads throughout
7 the year determines fixed costs, an idea that is demonstratively incorrect. The
8 inconsistency of using two fundamentally different allocation methods in the
9 same COS, as I explain in more detail later in this testimony, is never explained
10 by Staff witnesses. Yet, Staff relies on its questionable assumptions to justify the
11 move from a COS based on cost causation, to a hybrid COS based loosely on
12 capacity utilization.

13 Q. What assumptions does the Staff accept that allows it to move from cost causation
14 to capacity utilization?

15 A. Staff attempts to tie fixed and variable costs together by making one critical
16 assumption: Units that cost less to operate will run throughout more of the year.
17 Thus the costs of those units, which tend to be the most expensive to build, should
18 be allocated to the customers according to the “utilization” of the capacity. This
19 is one of the fundamental concepts behind the capacity utilization method. Staff
20 assumes its TOU allocation is equivalent to this method.

21 Q. Do you agree that the Staff’s TOU allocation is equivalent to the capacity
22 utilization method?

1 A. No. Staff's TOU allocators distribute all fixed costs as baseload capacity costs
2 whereas the capacity utilization method assigns the costs of baseload,
3 intermediate, and peaking units separately to the classes that caused them to
4 operate.

5 SECTION IV: A Properly Completed Capacity Utilization Study

6 Q. Earlier you discussed the Staff's inconsistency of using two fundamentally
7 different allocation methods in the same COS. Please explain what you meant.

8 A. Every party in this case has testified that costs should be distributed to the classes
9 using a method which considers the cause of those costs. Consistent with this,
10 costs classified as "demand" related were distributed using demand allocators.
11 Fuel and purchased power expenses, which were classified as "energy", were
12 distributed using energy allocators, and meter and services costs were classified
13 as "customer" and distributed using customer weighted allocators. This is the
14 basic premise of any embedded COS study.

15 Inexplicably, after following this process for much of its COS study, Staff
16 attempts to allocate millions of dollars in fixed, demand related, costs based on
17 capacity utilization; a method that is inconsistent with the Staff's own
18 classification of these costs, and is clearly unrelated to the cause of the costs. To
19 complicate the matter, Staff's TOU allocators are applied in a manner which is
20 inconsistent with typical capacity utilization techniques. Time-differentiated
21 methods, such as the capacity utilization method Staff's TOU method, require
22 radically different datasets than were used in this case.

23 Q. Please explain what you mean.

1 A. A simple example can be used to illustrate the techniques and data requirements
2 of a proper capacity utilization study. Consider a utility with three types of
3 generation facilities. We will name them baseload, intermediate, and peaking
4 units. Suppose that the baseload units operate during every hour of the year, and
5 that they are the most expensive units to build. Analysis finds the fixed costs of
6 these units equal 50% of the total fixed production costs. A proper capacity
7 utilization study requires that the fixed costs of the baseload units be distributed
8 to the classes using a proper allocator over the proper time period. Since the
9 baseload units operate in every hour of the year, and since the fixed costs are
10 caused by the capacity of the baseload unit, it is proper to use an allocator based
11 on hourly demands for every hour of the year.

12 Q. Did the Staff identify the costs associated with the baseload units?

13 A. No. Staff used total fixed costs which included the costs of all of Aquila's
14 generation units when distributing fixed production costs to the classes.

15 Q. Please continue.

16 A. The second step in a proper capacity utilization study is to allocate the fixed costs
17 of intermediate units. Just as in the preceding step, these fixed costs need to be
18 separately identified and allocated. An additional study is required to determine
19 how many hours of the year the intermediate units operate. Suppose that the
20 correct analyses are completed, and the fixed costs of the intermediate units are
21 found to be 25% of total fixed production costs. In addition, the intermediate
22 units are found to run for 12 hours each day, beginning at 6:00 a.m. The units'

1 fixed costs must now be distributed to the customers who caused those units to
2 operate, based on their hours of operation.

3 The lighting class should be excluded from sharing these costs because
4 intermediate units are not generally operated to service nighttime loads. There
5 may be other classes which could be excluded from sharing the intermediate unit
6 fixed costs as well, but an adequate study is required to identify them. Once the
7 remaining classes are identified, the intermediate units' fixed costs are distributed
8 using a method that fairly allocates the costs.

9 Q. In calculating its TOU allocators, did Staff attempt to identify the fixed costs of
10 the intermediate units, their hours of operation, or the classes which utilize their
11 capacity?

12 A. No.

13 Q. Please continue.

14 A. In the final step, the fixed costs of the peaking units are allocated. These fixed
15 costs are simply the remainder of the total fixed production costs. Again, certain
16 analyses are needed to identify the classes that share these units' costs and the
17 hours in which they operate. The lighting class did not share in the intermediate
18 costs, so it is also exempt from sharing these costs, and due to its high load factor,
19 the industrial class would probably be excluded as well. If analyses found the
20 peaking units to be in operation for 2 hours a day, the final 25% of the fixed
21 production costs would be distributed to the remaining classes using a method
22 that fairly allocates the costs over that period of time. In this case, an allocator
23 that considers the few hours of operation and allocates on the demand ratios

1 during those few hours. Such an allocator is, by definition, a “peak
2 responsibility” allocator.

3 Q. In calculating its TOU allocators, did Staff identify the fixed costs of the peaking
4 units, their hours of operation, or the customer classes which utilized their
5 capacity?

6 A. No.

7 Q. Did Staff attempt to allocate any portion of the fixed production costs using a
8 “peak responsibility” allocator?

9 A. No.

10 Q. Are “peak responsibility” allocation methods commonly used by cost analysts to
11 distribute fixed production costs?

12 A. Yes. A “peak responsibility” method should be used to distribute some or all of
13 the fixed production costs as part of *any* COS study, including those using the
14 capacity utilization method.

15 Q. Did the Staff use a “peak responsibility” allocation method to distribute any fixed
16 costs, other than those associated with production, in this case?

17 A. Yes. Staff distributed millions of dollars in distribution fixed costs using methods
18 that considered the class peak and customer peak demand.

19 Q. In the past, has the Staff ever used a “peak responsibility” allocation method to
20 distribute fixed production costs?

21 A. Yes. Staff witness James Watkins responded to data request number 3 from
22 SIEUA by stating, “I believe that *hourly data was not available in those cases,*
23 and the Staff’s “*Average and Peak*” method using 12 Class Peaks was

1 *adopted...*” Clearly, the precedent has been established that when the proper data
2 is not available for a complete TOU analysis, the Staff proposed and the
3 Commission adopted a “peak responsibility” method.

4 Just as adequate data was not available for a complete TOU analysis in *that* case,
5 adequate data is also not available in *this* case. Neither has Staff completed the
6 supporting studies to obtain that data. Even so, Staff continues to support its
7 TOU allocators in this case, based on assumptions and approximations, as the
8 proper and reasonable way to distribute fixed production costs.

9 The Commission should reject Staff’s COS as unreliable because it is a hybrid of
10 two fundamentally different allocation methods which do not support each other,
11 and contains significant errors and inconsistencies.

12 SECTION V: Allocation of Fixed Transmission Costs

13 Q. Does the Staff use its TOU allocation method to distribute fixed transmission
14 costs?

15 A. Yes.

16 Q. Does Staff witness Watkins explain his reasons for supporting the TOU allocation
17 method for fixed transmission costs?

18 A. Yes. In his rebuttal testimony, he states:

19 “Even though the cost per kW of each kW of transmission capacity
20 is the same, a portion of the transmission capacity serves a
21 baseload function, *i.e.*, it is required to carry load in every hour of
22 the year that it is available, a portion serves an intermediate
23 function, and a portion serves a peaking function, *i.e.*, that portion

of the transmission capacity is required only to carry the peak
loads.⁴”

Q. Is it common practice to identify baseload, intermediate, and peaking functions of
the transmission system?

A. No. In fact, to my knowledge, it is unprecedented. In recent discussions with
Aquila’s transmission planning group I found nobody in that group was familiar
with the concept of subdividing the transmission system into functions. The
notion that a portion of the transmission serves a base or intermediate load is
nonsensical and defies the physics of the system.

Q. How does it defy the physics of the system?

A. Transmission systems are designed and operated to carry power at specific high
voltages (e.g., 245 KV). As the loads change throughout the year, these high
voltages remain the same. Only the electrical current on the lines will change.
Due of the high voltages, larger distances are needed, between the conductors and
other conductors, towers, buildings or the ground, to prevent arcing. Thus, much
of the transmission fixed costs are used to build these distances into the
transmission system and are directly related to the specified *voltage*. The
remainder of the fixed cost is used to purchase and install transmission equipment
(e.g., transformers) which must be capable of handling the *maximum load*. In
other words, the transmission system is designed to transmit the maximum power
at sustained operating voltages. There is no parameter or characteristic that

⁴ Id. pg. 5

1 suggests a baseload, intermediate, or peaking function of the transmission system.

2 Staff witness Watkins has imagined “functions” of the transmission system that
3 truly do not exist in the physical world.

4 Q. Is there any real benefit for dividing the fixed transmission costs into baseload,
5 intermediate, and peaking functions?

6 A. None whatsoever. Staff recognizes this fact when witness Watkins writes,
7 “While, unlike generating capacity, there is only one type of transmission
8 capacity...” However, after this admission, he concludes, “... its utilization
9 throughout the year should be accounted for in allocating transmission capacity
10 costs.”⁵ Here again, Staff makes a critical assumption which is never explained or
11 justified. However, when that assumption is accepted, the way is opened for the
12 TOU allocators, with all their inconsistencies, to distribute fixed transmission
13 costs.

14 SECTION VI: Classification of Distribution System Costs

15 Q. Have you read OPC witness Barb Meisenheimer’s rebuttal testimony wherein she
16 describes the classification of primary and secondary distribution costs?

17 A. Yes, I have.

18 Q. How does the OPC classify primary and secondary distribution costs?

19 A. The OPC classifies all primary distribution costs as demand related, and all
20 secondary distribution costs as demand and customer related.

21 Q. What reason does the OPC give for classifying primary costs as demand related
22 rather than demand and customer related?

1 A. A couple of reasons are given. OPC witness Meisenheimer states:

2 “First, from a network perspective, most residential and
3 business customers receive electricity from secondary
4 distribution lines. Therefore, these facilities are most closely
5 linked to customers and are less likely to have flexibility in
6 alternative service arrangements.”⁶

7 Q. Do you agree with this statement?

8 A. Yes and no. It is correct to say that most of Aquila’s customers take service at
9 secondary voltages. However, one could just as correctly say that *every* customer
10 receives electricity from the primary system. This is because the primary system
11 serves the secondary system. Every customer served by the secondary is also
12 served by the primary. The OPC’s contrivance of a “closer link” between the
13 secondary and the customer ignores the fact that some portion of the entire
14 distribution system is necessary to serve the customer.
15 The phrase, “flexibility in alternative service arrangements” is also very unusual
16 and out of place in this discussion. The OPC never explains what “alternative
17 service arrangements” are, or how they gain and lose flexibility. One is left to
18 guess at the witness’ meaning. Aquila does offer *alternative rates*, but these are
19 typically offered based on the customer’s load and usage characteristics, not on
20 an arbitrary “link” to the customer.

⁵ Id. pg. 5

⁶ Rebuttal testimony of Barbara Meisenheimer, pg. 8

1 Q. What other reasons does the OPC give for classifying primary distribution
2 differently than secondary?

3 A. OPC witness Meisenheimer states:

4 “Next, secondary, defined as service provided at lower voltage
5 is, therefore, less able to accommodate a large number of
6 users.”⁷”

7 Q. Do you agree with this statement?

8 A. No.

9 Q. Why not?

10 A. The quote states that the secondary system is less able to accommodate as many
11 customers as the primary system. Yet the OPC’s previous point was that the
12 *majority* of customers are served from the secondary system. The two statements
13 are incompatible. Either the secondary serves the majority and is therefore able to
14 accommodate large numbers of users, or the secondary serves the *minority* and is
15 *unable* to accommodate large numbers of users. The secondary cannot both serve
16 the majority, and be **unable** to accommodate large numbers of users at the same
17 time.

18 Q. Is there another possible interpretation?

19 A. It is possible that the OPC is only suggesting that individual secondary conductors
20 serve fewer customers than individual primary conductors. If that is the intent, I
21 would confirm that a segment of conductor can indeed carry more power at higher
22 voltages than at lower voltages. However, the issue involves more than just the

conductors. Distribution costs are incurred to purchase conductors, poles, cross-arms, guy wires, circuit reclosers, transformers, capacitors, conduit, insulators, fuses, etc. Some of these components operate at primary voltages, some at secondary voltages, and all are used to serve Aquila's large number of customers.

Q. How does the OPC describe the impact of allocating distribution costs as customer related?

A. OPC witness Meisenheimer states:

"The results of such allocations of distribution costs would be to place an unfair and unjustified burden on the smaller consumers, resulting in subsidies among classes and within classes...many cost analysts agree that classification by the minimum-size system method results in a double allocation of costs to low usage customers. This same problem is also inherent in any other technique, including the minimum-intercept method, which seeks to split the distribution investment into portions which depend separately upon demand and numbers of customers.⁸"

The first sentence in this quote is nearly identical to a statement by Davis J. Lessels' in an article published in *Public Utilities Fortnightly*⁹. Mr. Lessels' statement was applied to *every* method that classified any distribution costs other

⁷ Id. pg. 8

⁸ Id. pg. 10

⁹ "The results of these allocations of consumer costs were to place an unfair and unjustified burden on the smaller consumers, resulting in subsidies among classes and within classes." Davis J. Lessels, *Public Utilities Fortnightly*, Vol. 106 (#12), December 4, 1980 pg. 39.

1 than meters and services as customer related. While I disagree with Mr. Lessels
2 conclusions, I find it noteworthy that the OPC attempts to support its position
3 with comments that oppose the method the OPC used.

4 Q. Since Mr. Lessels' article was published, which regulatory Commissions have
5 adopted the classification of distribution costs as both customer and demand?

6 A. The state regulatory Commissions that have approved this method of
7 classification include Colorado, Connecticut, Florida, Maine, Missouri, New
8 York, North Carolina, Pennsylvania, Utah, and Wisconsin. These are only the
9 Commissions I have been able to identify in a brief search. The list could be
10 much longer.

11 Q. Do Mr. Lessels' research and comments address utilities like Aquila?

12 A. No. In the *Public Utilities Fortnightly* article, Mr. Lessels, a longtime employee
13 of the Rural Electrification Administration writes, "Our studies covered a
14 population of primarily rural electric systems. *We do not assert that similar*
15 *results would be obtained on distribution systems of all electric utilities.*¹⁰"

16 Q. Will Aquila's classification of distribution costs place an unfair or unjustified
17 burden on certain customers?

18 A. Not at all. It has been the stated goal of every party to allocate costs to the
19 customers for whom the costs were incurred to serve. If more costs are shown by
20 the COS studies to be the responsibility of a certain class of customers, then those
21 added costs will be the fair and justified burden which that class should bear.

¹⁰ Id. pg. 39 [emphasis added]

- 1 Q. Which parties have allocated distribution costs into portions which “depend
2 separately upon demand and the number of customers¹¹”?
- 3 A. Every party, including the OPC, has classified distribution costs as both demand
4 and customer.
- 5 Q. What techniques were used by the parties to determine the customer and demand
6 portions of distribution costs?
- 7 A. Every party, including the OPC, used values provided by Aquila from our zero-
8 intercept study.
- 9 Q. Does this conclude your surrebuttal testimony?
- 10 A. Yes.

¹¹ Rebuttal testimony of Barbara Meisenheimer, pg. 10


**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of an Examination of Class Cost of Service) Case No. EO-2002-384
And Rate Design in the Missouri Jurisdictional Electric)
Service Operations of Aquila, Inc., formerly known as)
UtiliCorp United Inc.)


[illegible]

AFFIDAVIT OF DAVID L. STOWE

David L. Stowe, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of David L. Stowe;" that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.


David L. Stowe

Subscribed and sworn to before me this 27th day of October, 2005.


Notary Public
Terry D. Lutes

My Commission expires:

8-20-2008



TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008