

Exhibit No.:  
Issues: Rate Design  
Witness: James C. Watkins  
Sponsoring Party: MO PSC Staff  
Type of Exhibit: Surrebuttal Testimony  
Case No.: EC-2002-1  
Date Testimony Prepared: June 24, 2002

**MISSOURI PUBLIC SERVICE COMMISSION**  
**UTILITY OPERATIONS DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**JAMES C. WATKINS**

**UNION ELECTRIC COMPANY d/b/a**

**AMERENUE**

**CASE NO. EC-2002-1**

**Jefferson City, Missouri**  
**June, 2002**

Exhibit No. 40  
Date 7/10/02 Case No. EC-2002-1  
Reporter Kem

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

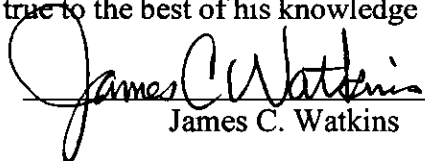
The Staff of the Missouri Public Service )  
Commission, )  
Complainant, )  
vs. )  
Union Electric Company, d/b/a )  
AmerenUE, )  
Respondent. )

Case No. EC-2002-1

**AFFIDAVIT OF JAMES C. WATKINS**

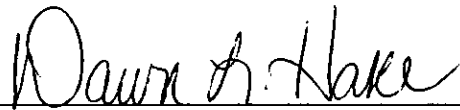
STATE OF MISSOURI )  
 ) ss  
COUNTY OF COLE )

James C. Watkins, of lawful age, on his oath states: that he has participated in the preparation of the following written Surrebuttal Testimony in question and answer form, consisting of 11 pages of testimony to be presented in the above case, that the answers in the attached written Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.

  
James C. Watkins

Subscribed and sworn to before me this 20<sup>th</sup> day of June 2002.

DAWN L. HAKE  
Notary Public - State of Missouri  
County of Cole

  
Notary Public

My commission expires

My Commission Expires Jan. 9, 2005

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1 Commission's order in Case No. EO-96-15, UE's most recent rate design case, and the  
2 results of the Staff's customer class cost-of-service study filed in that case?

3 A. Yes. First, these witnesses point out that the Stipulation And Agreement  
4 incorporated in the order in Case No. EO-96-15 is neither binding on the parties to that  
5 agreement nor on the Commission. Second, these witnesses allege that the data the Staff  
6 and the other parties used to develop their studies in Case No. EO-96-15 is now so old  
7 that the results of those studies are no longer reliable.

8 Q. When you prepared your direct testimony, did you believe that the terms  
9 of the Stipulation And Agreement in Case No. EO-96-15 in any way limited the position  
10 that the Staff, the Commission or any party in this case could take on any issue in this  
11 case?

12 A. No. I do not believe that the parties in this case or the Commission are  
13 bound by that agreement, nor did I make that claim in my direct testimony. I did, and  
14 still do, believe that the agreed-upon resolution of the various parties' proposals regarding  
15 each class's revenue responsibility, or cost of service, based on the studies prepared in  
16 that case, remains reasonable.

17 Q. Have circumstances changed so much since the customer class cost-of-  
18 service studies were prepared in Case No. EO-96-15 to cause those studies to be  
19 unreliable for the purposes of determining a reasonable allocation of UE's overall cost of  
20 service to the customer classes?

21 A. No. While there have undoubtedly been significant events that have  
22 occurred within the last few years, I am not aware of any event that has been significant  
23 in materially altering the percentage increases or decreases in each class's revenues that

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1 would be required to match revenues to the costs allocated to each class by a customer  
2 class cost-of-service study.

3 It has been my experience that the basic results of a customer class cost-of-service  
4 study are primarily influenced by the choice of allocation methodologies, particularly  
5 with respect to demand-related generation plant costs, and are not significantly affected  
6 by the choice of the study period, within reasonable limits, unless major generation plant  
7 additions have been made since the last study was performed or major shifts have been  
8 made in class revenues. These types of events have not occurred since the resolution of  
9 Case No. EO-96-15.

10 Q. Is your experience in this regard supported by testimony prefiled in this  
11 case?

12 A. Yes. Mr. Kovach, UE's witness, has filed updated class cost of service  
13 study results for UE, which he indicates are based on a twelve-month test year ended  
14 June 2001. (Kovach Rebuttal, p. 64, line 16 through p. 65, line 2). The results of that  
15 updated study are basically the same as the results of the study UE filed in Case No.  
16 EO-96-15.

17 Mr. Brubaker, MIEC's witness, has filed the results of MIEC's class cost-of-  
18 service study filed in Case No. EO-96-15 (Brubaker, Schedule 1) and adjusts that study  
19 (Brubaker, Schedule 2) to "recognize the reduction in revenues that was allocated to the  
20 non-residential, non-lighting customer classes in that proceeding" for use of that study in  
21 this case. (Brubaker Rebuttal, p. 6, lines 11 - 14). A comparison of line 19 in his  
22 Schedule 1, to line 23 in his Schedule 2 shows that both of his studies have the same  
23 basic result. In fact, the increase or decrease in revenues required to equal cost of service  
24 for each class differs by no more than about one percentage point for any class.

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1           Q.     Has any other party presented a reasonable proposal for allocating any  
2 overall revenue reduction to the customer classes?

3           A.     Yes. OPC's proposal to spread the overall revenue reduction to all rate  
4 classes as an equal percentage reduction based on current class revenue is not  
5 unreasonable. Furthermore, if the Commission were to adopt the Staff's basic rate design  
6 proposal, it would not be unreasonable for the Commission to apply a modification of the  
7 two-step approach recommended by OPC, once the remainder of the \$25,000,000 of the  
8 revenue reduction contemplated in the rate design case (i.e., the first \$9,834,790 of the  
9 overall revenue reduction) is distributed as recommended by the Staff. Thus, the  
10 remainder of the overall revenue reduction could be allocated between the residential  
11 class and the non-residential classes, as a group, based on an equal percentage of the  
12 adjusted revenues, then applied as an equal percentage reduction to the non-customer-  
13 charge rate components. This would result in a different percentage reduction applying to  
14 the non-customer-charge rate components of the residential class than to the non-  
15 customer-charge rate components of the non-residential classes; however, the percentage  
16 reduction applying to the non-residential classes would apply to each non-customer-  
17 charge rate component in all non-residential rate classes.

18          Q.     Why should the same percentage reduction be applied to all non-  
19 residential rate components?

20          A.     There are two reasons. First, this assures that the present continuity  
21 between rates is maintained. Second, this assures that the Rider B Credits, for example,  
22 remain the same for customers on the Small Primary Service rate schedule as for  
23 customers on the Large Primary Service rate schedule.

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1           Q.     Has any other party presented a proposal for allocating any overall revenue  
2 reduction to the customer classes?

3           A.     Yes. Other than OPC, only UE and MIEC have made such proposals.  
4 I view both of those proposals to be unreasonable.

5           Q.     Why?

6           A.     Each of these proposals is premised on determining just and reasonable  
7 rates for each class solely on that class's cost of service as determined by that party's  
8 class cost of service study. The cost of service for a class is but one of a number of  
9 factors that the Commission should consider in establishing just and reasonable rates for  
10 each class of customers, and a class cost-of-service study, unlike a total company cost-of-  
11 service study, does not calculate the cost of service for each class. A class cost-of-service  
12 study merely attempts to provide a reasonable estimate of each class's proportionate share  
13 of responsibility for UE's total cost of jointly serving all of its customers.

14          Q.     Do UE's and MIEC's studies produce reasonable results?

15          A.     In my opinion, no. The results of those studies rest on an assumption that  
16 100% of production capacity costs are *caused* by the loads in a few peak hours, with none  
17 of the costs being related to utilization of the plant to serve loads in any other hours.  
18 While this may be a *traditional approach* in other jurisdictions with which Mr. Brubaker  
19 is familiar (Brubaker Rebuttal, p. 5, line 20), it is an approach that has never been adopted  
20 by the Missouri Public Service Commission at any time during the past twenty years that  
21 I have been with the Staff. On the contrary, on those few occasions when cost allocations  
22 have been litigated, the Commission has always favored the Staff's approach. The Staff's  
23 approach, which is also favored by OPC, allocates a portion of each generation plant's



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1 costs to every hour of the year during which that plant is being utilized to serve  
2 customers' loads.

3 Q. What factors should the Commission consider in addition to an estimate of  
4 cost of service when determining the amount of UE's revenue that should be paid in by  
5 each customer class?

6 A. The Commission should consider all relevant factors. These factors would  
7 certainly include fairness, affordability and the impact on customers as well as other  
8 public policy considerations.

9 Q. Do you have any other concerns of which the Commission should be made  
10 aware in regard to class cost of service and rate design?

11 A. Staff Witness Janice Pyatte is addressing the details of UE's rate design  
12 proposal in her surrebuttal testimony; however, I want to stress that UE has presented no  
13 evidence regarding the outcome of adopting its proposals for shifting class revenue  
14 responsibilities and radically altering the way revenues are collected within the current  
15 rate structure. Aside from the possibility that residential customers may face a significant  
16 rate increase while non-residential rate classes could see rate reductions in excess of 25%,  
17 there will be significant effects within classes and between non-residential classes. One  
18 example is that UE's proposed 56% increase to the residential customer charge will have  
19 vastly different impacts on individual customers, or groups of customers, with the  
20 greatest impact on customers with the lowest usage.

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1       The most glaring example of the problems created between classes by UE's  
2 proposal is between the Large General Service and the Small Primary Service rate  
3 classes. Mr. Kovach states:

4       The structures of these rates, which are applicable to UE's larger  
5 commercial and industrial customers, are virtually identical, as the service  
6 provided to such customers varies only by the delivery voltage and meter  
7 location. The SPS customers receive their service, and are normally  
8 metered, ahead of any [customer-owned] transformer voltage reduction,  
9 and the LGS customers receive their service and are metered after the [UE-  
10 owned] transformer voltage reduction. (Kovach Rebuttal, p. 91,  
11 lines 17-22).

12  
13       Thus, the cost difference between these two groups is only the cost of the  
14 transformers. The current differential between these two rate schedules is still too large,  
15 even after narrowing this differential somewhat in the last rate design case. The Staff's  
16 rate design proposal addresses this problem. Mr. Kovach acknowledges this problem;

17       I disagree with the first recommendation made by Mr. Watkins. However,  
18 in developing its proposed rates for the test year in this case, the Company  
19 will consider his second recommendation, regarding the proposed rate  
20 differentials between the LGS and SPS Rates as a rate design objective.  
21 (Kovach Rebuttal, p. 63, lines 4-7).

22  
23       Yet, UE proposes, on a revenue-neutral basis, to reduce SPS revenues by 15.92%  
24 while reducing LGS revenues by only 5.16%. (Kovach Rebuttal, Schedule 6). This can  
25 only result in some of the LGS customers purchasing transformers and switching to the  
26 SPS rate. UE has presented no information on the expected extent or impact of this rate  
27 switching. One obvious impact is that UE would needlessly incur costs to remove its  
28 transformers when its customers purchase their own. Alternatively, if the customer seeks  
29 to purchase its transformer from UE, UE will need to obtain Commission approval to sell  
30 the transformer. As a result, each time a customer wishes to purchase its transformer

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1 from UE, the Commission will need to process another application by UE to approve the  
2 transfer of the transformer, wasting everyone's time and resources. This is exactly what  
3 alerted the Staff that there was a problem with the rate differential in the first place.

4 Q. Has UE also presented testimony on another rate design proposal?

5 A. Yes. Mr. Kovach presents this proposal on page 110 of his prefiled  
6 rebuttal testimony. UE's proposal is to:

7 . . . implement this rate reduction [associated with its proposed alternative  
8 regulation plan] on an equal percentage basis within and among rate  
9 classes (excluding customer and miscellaneous charges) for all Missouri  
10 retail electric customers.

11 Q. Will this proposal maintain existing rate relationships both between and  
12 within each of UE's rate classes?

14 A. Mr. Kovach says, "Yes."

15 Q. Is this proposal more reasonable?

16 A. Yes. In my view, this proposal is very similar to the proposal made by  
17 OPC. It is a reasonable alternative to the Staff's proposal. It is certainly the antithesis of  
18 UE's alternative proposal.

19 Q. Has the Staff's recommendation regarding class revenue responsibility and  
20 rate design changed since the filing of your direct testimony?

21 A. No. The Staff's recommendation was offered as a reasonable balancing of  
22 the interests of all customer classes when all relevant factors are considered. My  
23 recommendation is that the Commission adopt the Staff's rate design proposal as  
24 presented in my direct testimony prefiled on March 1, 2002.

1    **Miscellaneous Tariff Issues**

2    Rider E (Supplementary And Backup Service)

3           Q.     What is the Staff's recommendation regarding UE's proposed changes to  
4   its Rider E?

5           A.     The Staff views UE's proposed changes as a significant improvement to  
6   its current Rider E. I understand from Mr. Kovach that UE has made several  
7   modifications to its original proposal as a result of discussions during and subsequent to  
8   the prehearing conference, and that Mr. Kovach will file those changes in his surrebuttal  
9   testimony. The Staff does not oppose UE's proposal, as modified, so long as (1) there are  
10   no unreasonable negative impacts on its existing Rider E customers, (2) the revenue  
11   effects of the changes are appropriately accounted for in the determination of UE's  
12   revenue requirement in this case and (3) the rate values are scaled to reflect the  
13   corresponding rate values approved by the Commission in this case for the Large Primary  
14   Rate Schedule.

15   Rider RDC (Reserve Distribution Capacity)

16           Q.     What is the Staff's recommendation regarding UE's proposed Rider RDC?

17           A.     The Staff views UE's proposed Rider RDC as a reasonable alternative to  
18   offer to its customers on an optional basis. The Staff does not oppose UE's proposal, so  
19   long as the revenue effects of implementing Rider RDC are appropriately accounted for  
20   in the determination of UE's revenue requirement in this case.

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Interest On Customer Deposits

Q. What is the Staff's recommendation regarding UE's proposed change in the interest rate it will pay on customer deposits?

A. The Staff supports the concept of linking the interest rate applicable to customer deposits to a published market rate of interest. The Staff recommends, however, that the rate of interest applicable in each year should be one percentage point above the prime rate published in the Wall Street Journal as being in effect on the last business day of December, 2001 of the prior year, except as otherwise required by Commission rule. This approach is consistent with the Commission's Rules regarding telephone utilities (4 CSR 240-33.050) and has been approved by the Commission for Laclede Gas Company and Citizens Electric Corporation.

Q. What interest rates would currently be in effect based on Staff's and UE's proposals?

A. Mr. Kovach did not report what the current rate would be; however, UE's proposal would result in a current rate of interest on customer deposits of only 2.00%, if calculated by rounding to the nearest one-half of one percent the 2.23% yield on U.S. Treasury securities with a constant one-year maturity as reported for the week of November 30, 2001 in the Federal Reserve Statistical Release. The Staff's proposal would currently result in a much more reasonable 5.75% rate of interest, which is one percentage point above the prime rate published in the Wall Street Journal as being in effect on the last business day of December, 2001.

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1 OPC's TOU Program

2 Q. What is the Staff's recommendation regarding the OPC's proposed Time-  
3 Of-Use Program?

4 A. The Staff is very interested in participating in a program to investigate the  
5 response of customers' demands to timely price signals. As the Staff understands OPC's  
6 proposal, OPC is requesting that the Commission establish an Executive Committee (or,  
7 more likely, a Task Force) to investigate the design and feasibility of a possible program  
8 to study demand response. With this understanding, the Staff supports OPC's proposal.  
9 The Staff would oppose a proposal that would limit such a project to investigating  
10 traditional time-of-day rates or mandate that the Task Force would seek only to  
11 implement a trial program similar to trial programs already implemented in other states.

12 Q. Does this conclude your testimony?

13 A. Yes, it does.