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VIA EMAIL (tpuc.docketroom@tn.gov) & FEDEX
Dr. Kenneth C. Hill, Chairman
c/o Ectory Lawless, Dockets & Records Manager
Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243

Re: IN RE: PETITION OF KINGSPORT POWER COMPANY d/b/a AEP APPALACHIAN POWER FOR A GENERAL RATE CASE
DOCKET NO.: 21-00107

Dear Chairman Hill:

On behalf of Kingsport Power Company d/b/a AEP Appalachian Power, we transmit for filing Rebuttal Testimony for the following:

A. Wayne Allen
William K. Castle
Jessica M. Criss
Eleanor K. Keeton
Vanessa Y. Oren
Katharine Walsh
Michael H. Ward

The originals and four copies are being sent by overnight delivery.

Should you have any questions, please do not hesitate to contact the undersigned.

Very sincerely yours,

HUNTER, SMITH & DAVIS, LLP

William C. Bovender

Enclosure: As stated

cc:

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KgPCo Exhibit No. ____
Witness: MHW

REBUTTAL TESTIMONY OF
MICHAEL H. WARD
ON BEHALF OF KINGSPORT POWER COMPANY
D/B/A AEP APPALACHIAN POWER
BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
DOCKET NO. 21-00107

INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Michael H. Ward.

Q. ARE YOU THE SAME MICHAEL H. WARD WHO SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Consumer Advocate Unit (CA) witness Novak regarding his concerns about the class cost-of-service (CCOS) study and his proposal on recovering the revenue deficiency from the various customer classes.

Q. WITNESS NOVAK TESTIFIED THAT HE HAS NO KNOWLEDGE OF THE COMMISSION ADOPTING A CCOS STUDY FOR ANY UTILITY THAT IT REGULATES. PLEASE COMMENT.

A. I have looked back at the Company's rate case orders since 1981, and while it may be true that the Commission has not based rates solely upon a CCOS, it has indicated support for cost-based rates. In those orders, the Tennessee Public Utility Commission (TPUC), or its predecessors, indicated that it 1) approved generally of the cost-of-service approach (August 21, 1981 order in Docket No. U-7022); 2) will move toward the implementation of cost-based rates (November

15, 1984 order in Docket No. U-84-7308); and 3) would continue the gradual movement towards a positive rate of return for the residential class (May 29, 1987 order in Docket No. U-86-7472). Furthermore, CCOS studies were the foundation of the Company's consideration for both its proposals and settlement discussions in every subsequent case. Given this history, the Company's proposal to allocate its revenue requirement to the classes based upon its CCOS, along with the concept of gradualism, is more in keeping with the Commission's previous pronouncements on this subject than Mr. Novak's recommended allocation approach.

Q. PLEASE ELABORATE ON THE PURPOSE OF THE CCOS STUDY?

A. Cost-of-service studies are a basic and nearly universally accepted tool used in electric utility ratemaking based on the principle of cost causation. A cost-of-service study is a largely objective method to attribute costs to the categories of customers based on how customers cause those costs to be incurred. These studies assure rates are reasonably set and do not unduly discriminate between rate classes. The CCOS study fully allocates the test year revenues, expenses, and rate base to each customer class based on how those customers cause costs to be incurred. By conducting a CCOS study, cost-based rates are developed and each customer class is responsible for the costs it imposes on the system. Different classes of customers use electricity differently and that difference is the basis for the disparity in the cost to provide them service. A residential customer may use very little electricity at night in the autumn months but a significantly higher amount of electricity on a hot summer day or cold winter morning. Contrast that

with an industrial customer who may use electricity in a nearly uninterrupted manner both day and night, all year. On a per-unit basis, that residential customer is more expensive to serve because the Company must design its system to deliver electricity on the peak hour, but must collect the revenues over the year at times when consumption is often considerably less than the peak. This principle of cost causation is widely accepted throughout the industry and throughout the American Electric Power (AEP) system and should be used by the TPUC to set rates in this case.

Q. MR. NOVAK STATES CONCERNS OVER THE NUMBER OF ALLOCATION FACTORS THE COMPANY USED IN ITS COST STUDIES AND HOW THOSE COSTS ARE CLASSIFIED. WHY ARE THESE ALLOCATORS NECESSARY?

A. To accurately determine cost causation, costs must be assigned to the source, or class, that causes them to be incurred. As described in my direct testimony, this is the purpose of the CCOS study. As is the industry standard, each line item in these studies is reviewed, and an appropriate assignment or allocation method is determined based on cost causation. Numerous forms of Company data are used to allocate costs to the various classes. Allocators used in this study are similar to those used and approved in rate cases across the AEP system as well as for practically all other electric utilities. For Mr. Novak to state that he could easily allocate plant accounts (which apply a demand allocator) using an alternative energy allocator (Novak Page 25, Lines 12-15) ignores the critical fact that utility infrastructure is largely built and sized based on peak usage, or the demand

requirements of the system, not annual consumption of electricity. Demand allocators are necessary to allocate demand-related costs among the various rate classes based on their respective contribution to that peak demand. The common application of this concept is identified in the National Association of Regulatory Utility Commissioners (NARUC), Electric Utility Cost Allocation Manual, Washington, D.C., 1992, page 13, as follows:

> "Since generating units and transmission lines are sized according to the peak demand consumed, the individual contribution to peak demand came to be considered the appropriate factor for the allocation of those facilities."

Additional examples of the use of specific allocators include: Company data on customer deposits to allocate the interest on customer deposits; pre-tax operating income to allocate taxes; retail sales to allocate the gross receipts tax; electric utility plant (gross utility plant) to allocate property taxes; detailed Company meter data to allocate investment in meters; detailed Company data on overhead and underground lines, as well as transformers and poles, between the primary and secondary distribution system to allocate investments associated with this distribution equipment. As these examples demonstrate, extensive efforts are made to fairly, and as objectively as possible, determine the costs of serving each customer class and the return earned from each class. Numerous allocation factors are necessary to properly determine and assign costs.

Finally, while it is unclear how Mr. Novak would allocate the items listed previously, he states "factors beyond just the cost of service need to also be considered in allocating costs. These other factors include value of service,

product marketability, encouragement of efficient use of facilities, broad availability of service functions, and a fair distribution of charges among users" (Novak page 25, lines 18-21). He provides no explanation as to how these subjective and unquantifiable factors would be determined or how they were considered in his margin-based approach. In contrast, the Company's proposal takes into account the principle of gradualism in the movement toward cost-based rates and recognizes factors other than cost-of-service.

Q. DOES THE COMPANY SUPPORT MR. NOVAK'S PROPOSAL TO RECOVER THE REVENUE DEFICIENCY FOR ALL CUSTOMER CLASSES BASED ON THE CURRENT MARGIN PROVIDED BY EACH CUSTOMER CLASS (NOVAK PAGE 26, LINES 12-15)?

A. No. In each of the other regulatory jurisdictions in which AEP operating companies provide service, the principle of cost causation is applied to rate development. The same principle should be applied by the TPUC in this case. Mr. Novak proposes a method that socializes the cost of electricity for Kingsport Power Company customers by perpetuating and, in some cases, exacerbating existing subsidies among the classes. With Mr. Novak's proposed allocation method, certain classes of customers will continue to over-pay and others under-pay for their service from Kingsport Power Company. The logic of assigning revenues proportionately to the tariff classes rests on the foundation that the underlying, existing revenues are apportioned correctly. If the underlying revenues, as is often the case, are not representative of the underlying costs, a

strict revenue apportionment based on current revenues will only exacerbate any inequities that exist in current revenues.

As discussed above, as well as in my and Company witness Castle's direct testimonies, the objective is to design rates that reflect the actual cost of serving customers while avoiding the potential for adverse economic shocks to individual customers. The Company's proposal strikes a balance that moves toward cost-based rates, while limiting the impact of the revenue increase on any one class. The Company recommends that TPUC approve this fair and objective method that will gradually reduce subsidies and continue the move towards cost-based rates, consistent with past Commission orders.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.