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Public Service Commission of Wisconsin
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BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Joint Application of Wisconsin Electric Power Company and Wisconsin Gas LLC for Authority to Adjust Electric, Natural Gas, and Steam Rates

Docket No. 5-UR-110

DIRECT TESTIMONY OF JOSEPH ZGONC

Q. Please state your name, business address, and title.

A. My name is Joseph Zgonc. My business address is 231 West Michigan Street, Milwaukee, Wisconsin 53203. My title is Manager – Financial and Regulatory Planning in the Finance Department of WEC Business Services, a company within WEC Energy Group, Inc. (WEC) that serves all of the WEC utilities, including Wisconsin Electric Power Company (Wisconsin Electric) and Wisconsin Gas LLC (Wisconsin Gas).

Q. Please describe your educational and business experience.

A. I received a Bachelor of Business Administration Degree from the University of Cincinnati College of Business in 1994. I joined the finance staff at Wisconsin Electric in 2012 and have performed various roles within budgeting, accounting, and rate cases. Prior to Wisconsin Electric, I worked at Utilities International, Inc. for 15 years, rising to the position of Principal. Utilities International is the industry leader in planning, budgeting, regulatory, revenue, and accounting software solutions for the utilities sector. As a Principal at Utilities International, I was responsible for designing, selling, and managing consulting and software installation projects that focused on financial and regulatory planning, budgeting, and reporting at large investor-owned utilities.

Q. What are your responsibilities as Manager - Financial and Regulatory Planning?

A. I lead and support regulatory filings, compliance with regulatory accounting and reporting requirements, financial forecasts, project and business analysis, and internal and external financial reporting across WEC Energy Group's utility subsidiaries in Wisconsin, Illinois, Michigan, and Minnesota, and at the Federal Energy Regulatory Commission (FERC).

Q. Have you testified previously before the Public Service Commission of Wisconsin?

A. Yes, I testified on behalf of Wisconsin Electric and Wisconsin Gas in their test year 2020 rate case, Docket 05-UR-109, and on behalf of Wisconsin Public Service Corporation (WPSC) in its test year 2020 rate case, Docket 6690-UR-126. I am also providing testimony on behalf of WPSC in its concurrent test year 2023 rate case, Docket 6690-UR-127.

Q. What is the purpose of your testimony in this proceeding?

A. For the 2023 test year, I provide the budgeted income statement and balance sheet for the three operating utilities within Wisconsin Electric and for Wisconsin Gas (I will sometimes refer to Wisconsin Electric and Wisconsin Gas jointly as "Applicants"). For each utility, I derive the test year revenue required to recover the forecasted costs. Based on how that revenue requirement compares to revenues that would be collected under current rates, I identify the revenue shortfall for each operating utility based on the forecasted 2023 test year.

In addition, my testimony will briefly address financial aspects of the retirement of generating units at two coal-fired power plants: Oak Creek Power Plant (OCPP) Units 5 and 6, which are owned by Wisconsin Electric. I identify the net remaining

(unamortized) book value for each plant, and the accounting and ratemaking treatment Wisconsin Electric is requesting for this remaining balance.

Q. How is your testimony organized?

A. The remainder of my testimony is organized as follows:

Section I: Description of the operating utilities at issue in this rate proceeding

Section II: Derivation of the test year revenue shortfall for each utility operation

Section III: Financial impact of scheduled coal plant retirements

I. Description of operating utilities

Q. Please identify the operating utilities at issue in this rate proceeding.

A. Wisconsin Electric operates three utilities: an electric utility that I will refer to as WEPCO Electric, a natural gas utility that I will refer to as WEPCO Gas, and a steam utility that I will refer to as WEPCO Steam. Wisconsin Gas operates as a natural gas utility only.

Q. Please describe Wisconsin Electric's electric utility.

A. WEPCO Electric generates, distributes, and sells electric energy to more than 1.1 million customers in southeastern, east central, and northern Wisconsin, with energy sales to all classes of customers of approximately 23.6 million megawatt-hours (MWh) in 2021. It is the largest electric utility in the state of Wisconsin, with a service territory in eastern Wisconsin that includes the metropolitan Milwaukee area. The company supplements its own generation with power purchase agreements (PPAs), of which the nuclear power Point Beach PPA with NextEra Energy Resources is the most significant. During 2021, WEPCO Electric owned or controlled through PPAs approximately 5,100 MW of coal, natural gas, nuclear, wind, and hydro-powered electric generation. During the test year,

the electric utility will serve customers in two regulatory jurisdictions, and, similar to prior years, the test year reflects 99% of total sales in the Wisconsin jurisdiction, with the balance to wholesale customers in the FERC regulatory jurisdiction.

Q. Please describe Wisconsin Electric's gas utility.

A. WEPCO Gas served approximately 498,000 gas customers at the end of 2021 in northern and southeastern Wisconsin. It maintains over 12,000 miles of gas distribution mains.

Q. Please describe Wisconsin Electric's steam utility.

A. WEPCO Steam provides steam service to customers in downtown Milwaukee and the near south side of Milwaukee through approximately 13 miles of steam piping. Steam is supplied to this system from Wisconsin Electric's Valley Power Plant, which is a natural gas-fired cogeneration facility.

Q. Briefly describe Wisconsin Gas.

A. Wisconsin Gas served approximately 647,000 natural gas customers at the end of 2021. Its service territory includes areas throughout Wisconsin, but its heaviest concentration of customers is in and around the City of Milwaukee. It maintains nearly 14,000 miles of gas distribution mains.

II. Derivation of the test year revenue shortfall for each utility operation

Q. Please describe the derivation of the test year revenue requirements.

A. I will describe our approach by reference to a number of the exhibits I am sponsoring. Schedule 1 of Ex.-WEPCO/WG-Zgonc-1 contains, for each of Wisconsin Electric's three utility operations and for Wisconsin Gas, a summary of the revenue shortfall for each utility based on the forecasted test year. Schedule 2 provides the drivers for the change in each utility's revenue requirement compared to the last test year (2020). Schedule 3

contains the forecasted test year income statements for each utility. The derivation of the weighted cost of capital for Wisconsin Electric and Wisconsin Gas is presented in Schedule 4, and the required rate of return for each utility in Schedule 5. Schedule 6 contains the average net investment rate base and the budgeted 2023 test year revenue requirements for each utility.

Ex.-WEPCO/WG-Zgonc-2 provides fully forecasted monthly balance sheets for both Wisconsin Electric and Wisconsin Gas, and the balance sheet working capital detail comprising the ratio of net investment rate base to utility capital.

Ex.-WEPCO/WG-Zgonc-3 provides a summary of proposed 2023 and 2024 regulatory asset and liability amortizations for both Wisconsin Electric and Wisconsin Gas compared to recent annual amortizations, as well as a comprehensive detailed amortization schedule.

It may be convenient for the reader of this part of my testimony to have these exhibits close at hand for ease of reference.

Q. Please describe Schedule 1 of Ex.-WEPCO/WG-Zgonc-1.

A. The top of Schedule 1 of Ex.-WEPCO/WG-Zgonc-1 provides a summary of the forecasted revenue shortfall for each of Wisconsin Electric's three utilities and for Wisconsin Gas. Shown on this schedule is the impact of a 2023 bill credit, which lowers the revenue requirement for WEPCO Gas.

Q. Please identify the electric utility revenue shortfall shown on Schedule 1 of Ex.-WEPCO/WG-Zgonc-1.

A We forecast a revenue shortfall of $260.5 million for WEPCO Electric in 2023, representing a 2023 revenue requirement increase, including monitored fuel, of 8.4%. On

a Wisconsin jurisdictional level there is a $258.5 million revenue shortfall representing a revenue requirement increase of 8.5%.

Q. Please identify the WEPCO Gas revenue shortfall shown at the top of Schedule 1 of Ex.-WEPCO/WG-Zgonc-1.

A. We forecast a revenue shortfall of $50.7 million for WEPCO Gas in 2023, representing a 2023 revenue requirement increase, including the cost of gas, of 10.7%.

Q. What is the steam utility revenue shortfall shown on Schedule 1 based on the test year forecast?

A. We forecast a revenue shortfall of $3.3 million for WEPCO Steam in 2023, representing a 2023 revenue requirement increase, including fuel, of 15.5%.

Q. Is the economic impact to the steam utility customers a 15.5% increase?

A. No. Steam customers are currently paying a fuel surcharge. This surcharge ends at the end of 2022, which effectively offsets the 2023 base rate increase.

Q. Please identify Wisconsin Gas's revenue shortfall shown at the top of Schedule 1 of Ex.-WEPCO/WG-Zgonc-1.

A. We forecast a $60.1 million revenue shortfall for Wisconsin Gas in 2023, representing a 2023 revenue requirement increase, including the cost of gas, of 8.3%.

Q. Describe Schedule 2 of Ex.-WEPCO/WG-Zgonc-1.

A. Schedule 2 of Ex.-WEPCO/WG-Zgonc-1 identifies the major utility revenue requirement drivers by utility for 2023. Except for fuel, which is adjusted every year, the 2020 test year is the baseline for discussing 2023 drivers because it was Wisconsin Electric's last comprehensive rate case and the last time the Commission adjusted base rates.

Q. What are the major drivers of the revenue shortfalls for WEPCO Electric?

While other witnesses address the principal drivers in more detail, WEPCO Electric's revenue deficiency is driven by capital investments and additional factors over which Wisconsin Electric has little control: recovery of previously approved regulatory assets, changes in transmission expenses, and changes in wholesale customer contract revenue.

First, WEPCO Electric is forecasting an almost $1.0 billion increase in rate base since its last rate case. The increase in rate base improves reliability by strengthening our distribution systems while transitioning our generation fleet by adding clean renewable generation and retiring older fossil-fired units. Offset slightly by a change in working capital, the revenue requirement impact of this investment represents $139.2 million of Wisconsin Electric's as-filed revenue deficiency for 2023.

Second, continuing to implement previously approved regulatory amortizations (escrows and deferrals) consistent with past practice, as discussed below, accounts for $68.1 million of WEPCO Electric's as-filed revenue deficiency.

Third, $34.8 million of WEPCO Electric's as-filed revenue deficiency is attributable to reduced wholesale contract revenues, reflecting current wholesale customers who have elected not to renew their wholesale contracts. Increased transmission expenses of $29.3 million, an increase of $23.7 million associated with changes in sales and monitored fuel, and an increase to tax expenses of $9.8 million account for most of the remaining revenue deficiency.

Q. Are there significant factors offsetting the revenue deficiency?

A. Yes, these cost increases are offset by savings that Wisconsin Electric expects to achieve through execution of its Generation Reshaping Plan (GRP) and continued focus on

operating efficiency. Day-to-day operations & maintenance (O&M) savings, largely resulting from the retirement of Oak Creek Units 5 and 6, reduce the revenue requirement by $18.1 million. Effective management of interest expense through the execution of debt refinancing strategies over the past several years during a period of historically low cost of debt – and prior to what appears to be a market with increasing interest rates – reduces the revenue requirement by $8.4 million. In addition, the GRP reduces non-monitored fuel costs by $17.9 million in the test year.

Q. What major assumptions underlie Applicants' revenue requirement targets?

A. Applicants' revenue requirement calculations depend on the Commission approving the regulatory amortizations shown in Ex.-WEPCO/WG-Zgonc-3. Because regulatory amortizations represent expenses, any change in regulatory amortizations would require a corresponding change in Applicants' revenue requirement calculations.

In addition, the revenue requirement calculations represent the results of Applicants' most recently completed depreciation study in Docket 5-DU-103 (PSC REF# 429718), which becomes effective January 1, 2023, and assume no material changes in current tax laws.

Q. What are the major drivers of the revenue shortfalls for WEPCO Gas and Wisconsin Gas?

A. As with WEPCO Electric, investment in rate base is the most significant driver of the 2023 revenue deficiencies for the gas utilities, with regulatory amortizations and O&M costs also contributing to the revenue deficiency for Wisconsin Gas. These drivers are offset in part by reduced regulatory amortizations for WEPCO Gas and interest expense management for both utilities.

Q. What is the major driver of the revenue shortfall for the steam utility?

A. The forecasted WEPCO Steam revenue shortfall results from investments to improve steam system reliability ($1.8 million), the impact of sales and fuel costs ($2.0 million), and recovery of over-refunded tax credits in 2018 and 2019 ($1.3 million). Those increases are offset by a $1.5 million decrease in O&M costs.

Q. Describe Schedule 3 of Ex.-WEPCO/WG-Zgonc-1.

A. Schedule 3 shows the 2023 test year income statement for each utility based on the test year forecast. WEPCO Electric's amounts are shown on a total company basis; the revenue and expenses shown are for both the Wisconsin and FERC jurisdictions the electric utility will serve in 2023. The gas and steam utilities serve only retail customers in Wisconsin. Amortizations of regulatory assets and liabilities are included in test year income statement lines consistent with the original cause of the deferrals for each utility. Schedule 1 of Ex.-WEPCO/WG-Zgonc-3 identifies all ratemaking regulatory amortizations and the FERC accounts to which they are expensed on the income statement in the test year.

Q. Are any incentive costs included in the 2023 projected O&M costs?

A. No. All O&M incentive compensation has been removed from this income statement and from the revenue requirement.

Q. Please describe Schedule 4 of Ex.-WEPCO/WG-Zgonc-1.

A. Schedule 4 shows the weighted cost of capital calculations for Wisconsin Electric and Wisconsin Gas for the 2023 test year. Ann Bulkley of The Brattle Group is submitting testimony supporting the utilities' estimated costs of equity and the companies' proposed regulatory capital structures. Wisconsin Electric and Wisconsin Gas are separate legal

entities and have separate capital structures, each with capitalization ratios and cost rates specific to their overall business operations. Wisconsin Electric has a weighted cost of capital that is common to each of its operating utilities. Wisconsin Gas, as a standalone gas utility only, has its own weighted cost of capital. Todd Shipman of Concentric Energy Advisors is submitting testimony explaining the current credit ratings environment and how rating agencies will assess regulatory risk in connection with the Commission's decisions on these points.

Q. Schedule 4 shows two different capital structures for both Wisconsin Electric and Wisconsin Gas. What does the first calculation represent?

A. The first capital structure calculation shown is the ratemaking or "regulatory" capital structure, which derives the weighted cost of capital that is ultimately used to determine each utility's required return on rate base. This calculation removes certain non-utility amounts from common stock equity as prescribed by prior Commission orders so that the utilities do not earn a return on equity on those amounts through rates. For Wisconsin Electric, the calculation uses the equity return of 10.00% and a target equity ratio of 54.57% in the regulatory capital structure, and debt rates based on current projections. For Wisconsin Gas, the calculation uses the equity return of 10.20% and a target equity ratio of approximately 52.71% in the regulatory capital structure, and, again, debt rates based on current projections. The regulatory capital structure results in a weighted cost of capital of 7.34% for Wisconsin Electric, which is used for each of its utility operations as an input into their respective required rate of return calculations. Wisconsin Gas's regulatory capital structure results in a weighted cost of capital of 7.06%, which is used in its required rate of return calculations.

Q. What is the second capital structure shown on Schedule 4 of Ex.-WEPCO/ WG-Zgonc-1?

A. The second capital structure is the "financial" capital structure, which shows how credit rating agencies such as Standard & Poor's and Moody's view the test year capitalization for each company. Based on the financial capital structures forecasted in the 2023 test year, Wisconsin Electric's and Wisconsin Gas's proposed financial equity ratio is 53.00%. These agencies treat certain financial obligations that are not carried on the balance sheet as "debt"—most commonly leases and PPAs that meet specific criteria—as "debt equivalents" when calculating a company's debt leverage and interest coverage ratios. In order to secure the benefits of the GRP, Wisconsin Electric will enter into long-term leases with landowners. The impact of these leases is included in the debt equivalents in the calculation of the financial equity ratio.

The financial capital structure shown on Schedule 4 derives a Wisconsin Electric common equity ratio based on total debt equivalents of $269.3 million. Wisconsin Gas does not have any debt equivalents, but its financial capital structure reflects removing merger-related goodwill and deferred tax asset amounts from its equity since the rating agencies are aware that those relatively large balances do not earn a return.

Q. How did you determine the cost rates of preferred stock, long-term debt, and short-term debt included in the weighted cost of capital?

A. Since there are no new issues or retirements of preferred stock forecasted, the test year cost rate of preferred stock merely reflects the embedded weighted cost of existing outstanding preferred stock. The cost rate of long-term debt reflects the embedded weighted cost of existing long-term debt as adjusted for forecasted new issues and

retirements of existing debt. Wisconsin Electric has forecasted long-term debt issuances in March of 2022 for $300 million at an assumed rate of 4.00%, June of 2022 for $450 million at an assumed rate of 4.10%, and June of 2023 for $400 million at an assumed rate of 4.70%.

Wisconsin Gas has forecasted long-term debt issuances in November of 2021 for $150 million at a rate of 2.07%, and November of 2022 for $150 million at an assumed rate of 4.60%.

For the 2023 test year, Forecasted Nonfinancial Commercial Paper - 1 Month rates were sourced from Moody's Analytics February 2022 forecast. A 50-basis-point spread was added for the historical difference between Tier 1 and Tier 2 commercial paper issuances and market volatility. These rates ranged from 1.54% in January 2023 to 2.41% in December 2023 and were applied to the forecasted monthly average balances of short-term debt to derive short-term interest expense before credit facility and rating agency fees were added. Including the credit facility and rating agency fees, the all-in cost of short-term debt in the 2023 test year is 2.48% for Wisconsin Electric and 2.92% for Wisconsin Gas.

Q. How do you propose addressing interest rate developments between now and the Commission's final decision in this proceeding?

A. Given the current climate of increasing interest rates and the important role interest rates play in the cost of debt as factored into the revenue requirement, we may find it necessary to update the underlying data and resulting revenue requirement through a delayed exhibit.

Q. What is shown on Schedule 5 of Ex.-WEPCO/WG-Zgonc-1?

A. Schedule 5 shows the derivation of the required rate of return on utility net investment rate base for each utility. It starts with the ratemaking weighted cost of capital for each as shown on Schedule 4. As discussed above, Wisconsin Electric's weighted cost of capital is 7.34% for each of its utilities. That value is adjusted by the average ratio of utility net investment rate base plus Construction Work in Progress (CWIP) to capital applicable primarily to utility operations shown on Schedule 3 of Ex.-WEPCO/WG-Zgonc-2 to provide a return on working capital. In addition, the cost of capital is adjusted to provide a current return on a portion of CWIP for each utility. For WEPCO Electric, certain regulatory items are pulled out of working capital and given alternative carry costs. Examples include the SSR regulatory balances (net of the mines margin), which are assigned a long-term debt carry cost, and the Power the Future-related regulatory balances, which are assigned a short-term debt carry cost.

The final required rate of return is 8.43% for WEPCO Electric, 8.32% for WEPCO Gas, and 8.34% for WEPCO Steam. In a similar fashion, the weighted cost of capital of 7.06% for Wisconsin Gas from Schedule 4 is adjusted by its ratio of utility net investment rate base to capital applicable primarily to utility operations shown on Ex.-WEPCO/WG-Zgonc-2, Schedule 4, to provide a return on working capital. The cost of capital is further adjusted to provide a current return on a portion of CWIP. The final required rate of return for Wisconsin Gas is 8.13%.

Q. Describe Schedule 6 of Ex.-WEPCO/WG-Zgonc-1.

A. Schedule 6 calculates the revenue deficiency for each utility based on the 2023 test year budget detail shown in Schedules 3 through 5 of Ex.-WEPCO/WG-Zgonc-1. Schedule 6

provides the 2023 average net investment rate base for each utility; shows the operating income under current rates as derived on Schedule 3; derives the expected earned return and contrasts that with the required rate of return from Schedule 5; and then calculates an earnings deficiency. The earnings deficiency for each utility is grossed up for income taxes to get to a revenue deficiency. The adjusted revenue deficiency or excess amounts based on the budget detail are shown at the bottom of Schedule 6.

Q What are the adjustments shown at the bottom of Schedule 6?

A. Three adjustments are shown. Those adjustments exclude from the revenue requirement items that are recovered or refunded via a discrete bill credit or surcharge and thus are not part of base rates.

In Docket 5-UR-109, WEPCO and WG were ordered to pass the impact of re-measuring unprotected deferred taxes back to customers via a bill credit or surcharge. The first adjustment on Schedule 6, "Remove TCJA Bill Credit / Surcharge," removes the bill credit or surcharge from the revenue requirement. The second adjustment, "Remove TCJA Unprotected EDIT Impact," removes the related tax impact. These two adjustments net to zero and do not affect the revenue requirement. The third adjustment applies to a credit balance related to the Bluewater gas storage escrow account for WEPCO Gas. This adjustment removes the impact of returning that balance to customers via a proposed bill credit in 2023, rather than over time in base rates.

Q. Please explain the proposed 2023 WEPCO Gas bill credit.

A. In Docket 5-UR-109, Wisconsin Electric was ordered to escrow gas storage costs related to the Bluewater gas storage facility. This escrow balance is projected to have a credit balance of $4.1 million. Wisconsin Electric proposes to return that balance to customers

in 2023 as a credit on customers' bills. Handling this as a bill credit enables customers to receive this benefit in 2023. If it were included in base rates, the credit would have to be amortized over a longer timeframe. Any amount over- or under-refunded would be applied to the escrow balances. The amortization of the Bluewater Cost of Gas Escrow account reflects the proposed credit in 2023, then changes in 2024.

Q. Describe Ex.-WEPCO/WG-Zgonc-2.

A. Schedules 1 and 2 of Ex.-WEPCO/WG-Zgonc-2 provide full balance sheet detail for Wisconsin Electric and Wisconsin Gas, respectively, from September of 2021 through 2022 and 2023 by month as required in a comprehensive rate filing. Given the required lead time to develop the balance sheet detail for the test year, the actual September 30, 2021 balance sheets were the starting points for preparing the forecasted amounts. Schedules 3 and 4 of Ex.-WEPCO/WG-Zgonc-2 develop the ratio of net investment rate base plus CWIP to utility capital for Wisconsin Electric and Wisconsin Gas, respectively. This ratio was used to adjust the weighted cost of capital for each company to provide a return on working capital requirements as discussed earlier. The balance sheet detail that comprises the working capital requirements implied by this ratio is provided in Schedules 3 and 4 for both Wisconsin Electric and Wisconsin Gas.

Q. Describe Ex.-WEPCO/WG-Zgonc-3.

A. Schedule 1 of Ex.-WEPCO/WG-Zgonc-3 provides detail of each ratemaking regulatory asset and liability, starting with the September 2021 actual balances and showing forecasted deferrals and amortizations through 2023. Amortizations through 2022 reflect existing authorized amortizations based on the 2020 test year order in Docket 5-UR-109 (PSC REF# 381305), and changes to those amounts from Docket 5-AF-107.

Ex.-WEPCO/WG-Zgonc-3 shows 2023 deferrals, escrows, and amortizations that Applicants are proposing and seeking authority for in this proceeding.

Q. How do Applicants propose to amortize regulatory items in this test year?

A. In general, we propose regulatory amortization consistent with past practice. Most amortization terms for 2022 ending balances are set at two years, with the following exceptions:

- Project acquisition costs, project pre-certification costs, and deferred costs related to gas pipeline construction contributions are amortized over the life of the related projects. For example, the requested escrow for Whitewater pre-certification costs is amortized over 15 years.
- The projected 2022 ending balances for Act 141 and other energy efficiency escrow accounts are amortized over six years.
- The projected 2022 ending balance for WEPCO Gas's Bluewater storage costs are amortized over one year (2023) and are not included in base rates, but are expected to flow back to customers via a bill credit, as I have discussed.
- Tax amortizations related to excess deferred income taxes (EDIT) are amortized as prescribed in Docket 5-UR-109.
- The Section 199 projected 2022 ending escrow balance is amortized over five years, which is the remainder of the eight-year amortization ordered in Docket 5-UR-109.
- Deferred manufactured gas plant (MGP) costs are amortized over five years as prescribed in PSCW general guidelines. No forecasted costs are included in the calculation of the MGP amortization.
- Deferred costs related to unrecovered retired generation assets and forecasted retired

generation assets are amortized over the original remaining life of the unrecovered asset.

- The forecasted 2022 ending balance for escrowed bad debt expenses is amortized over six years.
- The PIPP SSR projected 2022 ending balance is amortized over twelve years, which is the remainder of the fifteen-year amortization ordered in Docket 5-UR-109.

Other than MGP deferred expenses, forecasted deferred 2023 and 2024 amounts are averaged and amortized over two years.

Acquisition costs related to distribution-connected utility owned solar generation and battery energy storage system projects and dedicated renewable energy resource (DRER) projects beneath the CA threshold and not forecasted in this docket will be deferred, and Wisconsin Electric will seek to recover those costs in subsequent test years.

Q. How has O&M changed for WEPCO Electric and Gas from the last test year?

A. Excluding incentives, WEPCO Electric's and WEPCO Gas's non-fuel, non-amortization-related O&M has decreased modestly relative to the levels approved for 2020, reflecting Applicants' financial discipline in managing O&M below authorized rates, including through the retirement of coal generation.

Q. Please describe the methods and assumptions used to prepare the test year cost and revenue projections for Wisconsin Electric and Wisconsin Gas.

A. Revenues were estimated by applying the appropriate current tariff rates for each utility to forecasted unit sales by customer class. Electric fuel and purchased power cost estimates were derived using the PROMOD production cost model, as described by witness Kim Keller. Gas costs were based upon the test year sales forecast and the

associated cost to procure the necessary volumes of gas. Non-fuel O&M expenses were determined using our SAP accounting and budgeting system. SAP is an integrated system in which all estimates of expenditures originate at the business unit level. The SAP system is based on "natural" accounts, which identify and quantify revenues and expenses based on a source or process view of work activities that Applicants use for internal management purposes. The SAP system maps the natural accounts to the FERC system of accounts for regulatory reporting and ratemaking purposes.

Q. In general, how are payroll costs estimated?

A. Payroll forecasts were developed by the individual business units using actual staffing levels as of April 30, 2021, as the starting point and specifying, by month, which positions are forecast to be added or removed. The payroll model includes general data assumptions such as work hours, unplanned absence hours, holiday hours, and vacation hours by month based on historical data. Overtime hours were entered by month based on historical trends and specific business unit needs. Average base wage rates were used for each cost center/employee group/job class combination.

Q. How did you estimate depreciation cost?

A. Estimates of depreciation are based on estimated plant balances using depreciation rates consistent with the approved depreciation rates from the most recently completed depreciation proceeding, Docket 5-DU-103.

Q. How are taxes forecasted?

A. The Wisconsin gross receipts tax is calculated on the basis of estimated taxable revenues and applicable tax rates. Payroll taxes are calculated by applying estimated tax rates to the portions of payroll subject to such taxes. Federal and state income taxes are based on

the tax laws in effect at the time of this filing and are determined by detailed calculations that include estimates of income and allowable deductions. Again, Applicants assumed no material changes in tax laws during the test year.

Q. Does Applicants' test year filing conform to the modified FERC system of accounts adopted by the Commission?

A. Yes, it does.

Q. How are estimates of the major components of rate base determined?

A. Monthly test year balances of utility property were developed based on forecasted capital expenditures and estimates of assets to be retired. Depreciation amounts were derived based on the forecasted plant, and the balance of accumulated provision for depreciation for each month reflects those accruals as well as estimated retirements. Electric fuel inventories are based on forecast coal deliveries and power plant load dispatch levels consistent with the PROMOD modeling. Gas storage inventory levels were based on the forecasted use of gas storage facilities consistent with the corresponding sales and delivery forecasts. Deferred income tax balances were calculated by Applicants' tax department based on estimated plant, book depreciation, and applicable tax depreciation rates and regulations. Estimates for other rate base items such as materials and supplies, and customer advances were prepared by the departments involved in the relevant activities.

Q. What are the major overall economic assumptions that you used to develop the 2023 test year?

A. Major corporate assumptions in preparing the test year budget included a general inflation rate of 2.3% for the 2022 bridge year and 2.4% for the 2023 test year where

specific price changes were not available. These inflation rates are per the Moody's economy[.com] May 2021 forecast. Allowance for funds used during construction (AFUDC) was assumed on 100% of major electric, gas, and steam utility CWIP projects, including WEPCO Electric's utility-scale solar projects. All other projects for all utilities are assumed to receive a current return on 50% of all remaining CWIP.

III. Financial impact of scheduled coal plant retirements

Q. Which of Wisconsin Electric's coal-fired generating units will retire during the test year?

A. As part of the GRP, Wisconsin Electric and WPSC will retire approximately 1,600 MW of generation in 2023 and 2024, including older, less efficient coal generation. As relevant here, the coal-fired units to be retired during the test year are Wisconsin Electric's OCPP Units 5 and 6, scheduled for retirement in May 2023.

Q. What will the undepreciated book balance be for each plant on January 1, 2023?

A. As of January 1, 2023, the undepreciated book balance for Wisconsin Electric's OCPP 5 and 6 will be $85 million.

Q. What accounting treatment are Applicants requesting for this balance?

A. Applicants are requesting Commission approval to transfer the plants' unamortized rate base balance to Account 182.2 ("Unrecovered plant and regulatory study costs") of the Commission's Uniform System of Accounts ("USOA") and to amortize the amounts in Account 182.2 to Account 407 ("Amortization of property losses, unrecovered plant and regulatory study costs") over the plants' remaining book life, with carrying cost set at Wisconsin Electric's prevailing authorized weighted average cost of capital.

Q. How will this proposal affect customer rates?

A. From customers' perspective, there will be no increase: the unamortized balance will remain in base rates and collected over the same period as if the plants had remained in service. At the same time, Applicants project that relative to the 2020 test year, the retirement of Oak Creek Power Plant Units 5 and 6 in 2023 will further reduce O&M expenses by approximately $20 million in the test year, and customers will realize those savings in base rates.

Q. Over what amortization period are Applicants requesting to recover this unamortized balance?

A. The amortization period was not addressed in the recently approved depreciation study filed by Wisconsin Electric in Docket 5-DU-103. Applicants are proposing to simply continue the same rate of amortization that was in effect while the plants were in operation. As such, Applicants are proposing an amortization period of 13 years for OCPP 5 & 6. Again, this will not result in a bill increase from customers' perspective.

Q. Does this conclude your direct testimony?

A. Yes, it does.